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Can a state-owned bank be a catalyst for financial inclusion and economic development in South Africa? Lessons from China and India

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ABSTRACT

The role of state-owned banks in the banking sector as well as countries' economic development is an important topic for debate. It should not be left to the private sector to address market failures. Several studies have been conducted on the role of banking in economic development, however few have examined the role of state-owned banks in financial inclusion and economic development, or the conditions required for the successful establishment and operation of a state-owned bank.

The main objective of this study was to draw lessons from China and India as emerging economies that have been able to successfully establish and operate state-owned banks and use them as instruments to improve financial inclusion and economic development. To that end, the researcher produced a conceptual framework that can be used in South Africa to establish a state-owned bank.

The research was carried out using qualitative documentary analysis to obtain secondary data from academic papers, central bank reports and statistics. The results of the study reveal that a clear government policy and political support are important conditions for the successful establishment of a state-owned bank (SOB), as these allow for the creation of enabling laws and a supportive regulatory environment. The study also found that SOBs have the capacity to expand the accessibility of their financial services nationwide using both physical and digital infrastructure.

The success of SOBs in China and India – two BRICs countries – demonstrates that these banks will continue to play an important role in the world's banking industry and can positively contribute to the financial inclusion and economic development of these countries. The study therefore recommends that South Africa's policymakers consider the conceptual framework devised to establish an effective SOB that can help improve the level of financial inclusion and economic development in the country.

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I dedicate this minor dissertation to my late mother, Ms Lungiswa Doko; may she continue to rest in eternal peace.

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GLOSSARY OF TERMS

AfCFTA : The African Continental Free Trade Area Agreement

AsgiSA: Accelerated Shared Growth Initiative for South Africa

BCBS: Basel Committee on Banking Supervision

BRICS: Brazil, Russia, India, China and South Africa

DBSA: Development Bank of Southern Africa

DFIs: Development Finance Institutions

DTI: Department of Trade and Industry

IDC: Industrial Development Corporation

GDP: Gross Domestic Product

RDP: Reconstruction and Development Programme

SARB: South African Reserve Bank

SAPO: South African Post Office

SDGs: Sustainable Development Goals

SEFA: Small Enterprise Finance Agency

SMMES: Small Medium Micro Enterprises

SONA: State of the Nation Address

SOBs: State-Owned Banks

NEF: National Empowerment Fund

NFIPF: The National Financial Inclusion Policy Framework

NHFC: National Housing Finance Corporation

GEAR: Growth, Employment and Redistribution

NGP: New Growth Path

NDP: National Development Plan

WBG: World Bank Group

Chapter One: Introduction

1.1 Introduction and background of the study

The relationship between financial development and economic growth is an area of great interest in academia and economies across the world (Laurenceson & Chai, 2001). There are diverse views about the role of government in the financial sector, however, with some believing that banking should be left to private sector, while others believe that state intervention is required to make up for market failures (Marois, 2022). Some studies have been conducted on the successes and failures of government involvement in the financial sector, yet there is no consensus on the most effective way in which government should intervene (Acaravci, 2009; Levine, 2003).

In the South African context, President Cyril Ramaphosa recently signed into law a bill that allows the shareholding of Postbank to be transferred to the government, which can then set up a bank controlling company to establish a State-owned bank (SOB) (Government Gazette, 2024). The communication from the government after initiating this process indicated that it wants to convert Postbank into a full-service, state-owned bank. This development is relevant to this study, particularly regarding whether the government's final decision will be to create a State-owned bank.

South Africa is regarded as the most unequal society in the world (World Bank Report, 2022). The economy has one of the highest unemployment rates in the world at 32.9%, which means there are approximately 7.7 million unemployed people in the country (Stats SA, 2023). The economic growth rate has averaged only 0.8% since 2012 (National Treasury, 2019), and around 2.9 million people are excluded from the financial sector. Approximately 15% of Small Medium and Micro Enterprises (SMMEs) are also financially excluded, while about 28% are informally served. Other informal organisations like stokvels are also excluded from accessing credit by the established banking sector because of stringent bank requirements (OECD, 2022).[1] South African banks do not extend enough credit to SMMEs, as they consider them high-risk

[1] Stokvels in South Africa refer to a society that has members who regularly contribute funds and receive a lumpsum at the end of the agreed period.

clients that are unable to provide the required collateral, even if they have proven to be profitable and sustainable businesses (National Treasury, 2019).

Inadequate financing for industrial development and limited access to affordable credit are among the most significant constraints to industrialisation in Africa (AfDB, 2017). The global financial crisis of 2007/2008 re-ignited the local debate over ownership in the banking sector and the consequences of financial intermediation, especially as other developing countries, such as Brazil, China, and India, where State-owned banking is prevalent, were able to recover more quickly (World Bank, 2018). This raises the question as to whether an efficient State-owned bank can be a catalyst for financial inclusion and economic growth in South Africa, considering the country's socio-economic goals and its Sustainable Development Goals (SDGs). Economic growth has been a key focus for political leadership in South Africa, yet they have paid limited attention to some of the key instruments required to drive growth.

For any industrial policy to succeed, it requires a clear strategic financing model and partners to implement it. The African Continental Free Trade Area Agreement (AfCFTA) has created the largest free trade area in the world, however its member states, including South Africa, need to put measures in place to ensure that they fully utilise the platform and implement the agreement by expanding their own production bases and offering additional financing (AU, 2018).

The critics of state-owned banks refer to the failures of state-owned entities (SOEs) across the world, especially those caused by corruption and inefficiencies. In the 1990s and early 2000s, there was growing negativity about SOBs, the implementation of neo-liberal policies, and the privatisation of SOBs (Yeyati, Micco, & Panizza, 2004).

This critique of State-owned banks could be justified if one looks at the performance of South African SOEs in recent history, yet long-term policy decisions and studies should not be restricted to the current circumstances and calibre of leaders, but rather be guided by a long-term vision to develop and put in place the necessary checks and balances to minimise political risks. "The rapid industrialisation in many countries in the 19th century was achieved by state provision of long-term loans to risky projects via development banks" (Diamond, 1957).

The history of development and large-scale industrialisation has mostly been driven by the state. Many development finance institutions (DFIs) were established after 1945 when governments realised that after World War 2 there was a need to fast track economic growth and the creation of employment (Xu, Ren, & Wu, 2019). Despite this, proponents of liberalisation lean towards the free market system, with the idea that markets will fix historic injustices and allow everyone to freely participate in the economy.

Looking at the South African context and the history of institutions like the Development Bank of South Africa (DBSA) and the Industrial Development Corporation (IDC), which were established in 1983 and 1940, respectively, the intention at the time was only to develop Afrikaner businesses. The state thus became the cornerstone of developing the economy by establishing SOEs like Eskom and Transnet, which still exist today.

The theory of market failure is applicable in the financial industry in South Africa, where the majority of Black- and female-owned SMMEs and industrialists are not funded due to information asymmetry between the funding institutions and those with innovative ideas. DFIs, unfortunately, use the same measures as commercial banks to assess eligibility for credit according to the Black Industrial Policy (2015), and therefore sometimes fail to effectively address these failures. This financial exclusion has increased in the South African economy recently, with the banking sector extending less credit even to financially-included clients due to higher business risks and unfavourable economic environment. This leaves a gap for an efficient State-owned bank that would drive the developmental agenda of the country in all financial aspects.

This research sought to contribute to the body of literature in this area, with a special focus on how a state bank could contribute to financial inclusion and economic development, based on an examination of state-owned banks in China and India. The study also produced a conceptual framework that can be used as a guide to successfully implement an efficient state-owned bank in South Africa.

1.2 Research Problem

There is no consensus as to whether banking development leads to economic development (Nyasha & Odhiambo, 2018). An even more polarised debate exists when it comes to state-

owned banks, which are characterised as essentially bad or good by those who believe that government should play no role in the banking sector, and those who believe the state must intervene to negate market failures (Marois, 2022). These two opposing views are an orthodox political view, which is typically negative, that says that state-owned banks are inherently inefficient, corrupt, and likely to fail, and a heterodox development view, which is typically positive, that says that state-owned banks are developmental and will achieve their objective of driving a developmental agenda (Marois, 2022).

A contributor to underdevelopment in South Africa is a lack of financing, which affects not only on large-scale projects, but also SMMEs. In the South African context, SMMEs have great potential to stimulate economic growth, thus their financial exclusion is concerning (AfDB, 2017). Although the extant DFIs have covered some ground in terms of financing start-up projects, they have not had the desired effect on economic growth and the expansion of the industrial base in South Africa, as evidenced by the economy having only grown by 0.3% since 2019 (National Treasury, 2019).

Commercial banks adopt a very risk-averse approach when it comes to granting finance, and historically have not participated much in financing start-up projects without collateral. Instead, they choose to finance the tried and tested institutions that already have proven track records. Capitalists are risk averse and are always cautious in committing capital to new developmental projects, however venture capitalists at least do take some high risk projects. The state must thus lead the way and excite the confidence of capitalists by taking the initial risks, by creating an business friendly environment and investing in the larger industries (Hamilton, 1792).

Approximately 23.5% of the South African population is estimated to be unbanked, with around R12 billion believed to be held in cash outside the banking system (Oxford Business School, 2021). Private banks are unlikely to provide financing on developmental projects that are considered risky without the state going in first to provide guarantees and reducing the risk to a manageable level for the private sector to invest its funds (Dewatripot & Maskin, 1995; De'Aghion, 1999).

Studies on banking development and economic growth have reached no consensus on the direction and strength of the relationship (Okello, Kigaba & Kitambal, 2015; Abusharbeh, 2017; Qamruzzaman & Jianguo, 2018; Sibindi & Bimha, 2014). Given that few studies have

examined which determinants are necessary for a state-owned bank to succeed, this study thus intended to fill the gap by looking at how an efficient state-owned bank should operate to maximise its impact on financial inclusion and economic development.

Previous studies mostly focused on DFIs' contribution to economic growth (Zikhali, 2021; Mopeli, 2018), whereas this study drew lessons from China and India as developing countries that have successfully established and operated State-owned banks. The analysis also considered how these countries were able to impact financial inclusion and economic growth through their SOBs. Little empirical work has been done to link SOBs to economic development, with Li (1994) and Liu (1999) being among the first to study this relationship.

1.3 Research objectives

The objectives of this study were to:

(a) confirm the determinants for the establishment of a State-owned bank in South Africa; and
(b) develop and propose a conceptual framework that can be adopted to justify the role of a state-owned bank in financial inclusion and economic development in South Africa.

1.4 Research questions

Given the problems identified and the objectives specified above, this study sought to answer the following research questions:

(a) What conditions are required to ensure the successful establishment of a state-owned bank in South Africa?
(b) What conceptual framework can be adopted to explain the role of a state-owned bank in financial inclusion and economic development in South Africa?

1.5 Justification for the study

The existing body of knowledge on this topic largely focuses on DFIs in South Africa (Zikhali, 2021; Mopeli, 2018), although similar studies have been conducted to assess the relationship between the development of banking and economic development internationally (Levine, 1997). The limited studies on SOBs in South Africa may be due to the fact that there is no

established national SOB from which to obtain data. This study aimed to contribute to the empirical literature from the perspective of State-owned banks that cover unbanked individuals and SMMEs, as well as to confirm the determinants for the successful establishment of SOBs using lessons from China and India.

Discussions about the establishment of a State-owned Bank (SOB) are often used as a political tool, especially in the South African context. For this reason, it was important to conduct a study that examined their practical implementation by taking lessons from other emerging economies that have effective SOBs, including how they were able to influence financial inclusion and economic development in their countries. The findings and recommendations can help policymakers by providing a conceptual framework to guide policy decisions that they can adopt in South Africa. The study can also be linked to the SDGs, eight and ten that seeks to promote decent work and economic growth and reduce inequalities.

1.6 Organisation of the study

This study is comprised of six chapters, with the first chapter providing a brief background to the research topic, including a problem statement, the research objectives and questions, and a justification for the study. Chapter two is a literature review, which examines the existing body of knowledge around the topic of state-owned banks, financial inclusion, and economic growth, including theories, frameworks, key findings, and gaps in knowledge. Chapter three assesses the status quo of state-owned banks in China and India, while chapter four describes the methodology adopted and how data were gathered and analysed. The study's findings and conclusions are presented in chapters five and six, respectively.

Chapter Two: Literature Review

2.1 Introduction

This chapter outlines the theoretical and empirical underpinnings of the relevant literature that guided this study. After defining the key terms applicable to this study, an overview of the financial system in South Africa is provided. This theoretical framework underpins the main theories that guided this study, which are complemented by a critical analysis of the existing scholarly literature.

2.2 Definition of key concepts

State-owned Banks: State-owned banks (SOBs) are those banks with at least 50% of equity being owned by national or subnational governments of a particular country (IMF, 2020). SOBs are made up of two broad categories, namely: commercial banks, which provide competitive banking services; and development banks, which provide credit for development-related projects, usually at subsidised rates, with funding coming from a government's budget or with government guarantees (IMF, 2020). In practice, SOBs have been used to drive national development agendas and set the strategic programmes of governments, including financing infrastructure development, supporting SMMEs, promoting regional development, and closing market failure gaps in key sectors of the economy (Lyubich, Bortnikov, & Drobyazko, 2021).

Economic development: "Economic development is a process whereby the real per capita income of a country increases over a long period of time, and the number of poor people and economic inequality in the society do not increase" (Rao, 2003). This involves improving the living conditions and well-being of the citizens in general. The last part of this definition is especially important in the South African context because of the country's high levels of inequality.

Financial inclusion: This means that a country's citizens who are adults have access to, and can use, financial services, including access to credit from financial institutions that can be accessed responsibly within a regulated environment (World Bank, 2017). The mobilisation of finance is the movement of funds from savers to users, which in the context of government is the collection of taxes from citizens to finance government expenditure (Bhatt, Meerman,

2002). The National Financial Inclusion Policy Framework (NFIPF) sets out the South African government's approach to financial inclusion for all (NFIPF, 2023). The policy assesses current levels of financial inclusion and proposes principles that will ensure financial inclusion. It also provides a basis for monitoring and evaluating financial inclusion (National Treasury, 2023).

Development Finance: Development finance is "an approach to funding developmental outcomes which covers strategies, principles/processes and instruments employed by multiple development stakeholders to mobilize and align finance for sustainability" (Alhassan, 2023). This type of finance is normally associated with development finance institutions, as they are expected to play a significant role in closing the market gap and providing development finance to boost economic activity along value chains, from raw materials to finished products (AfDB, 2017). DFIs do not only exist to fix market failures, but are strategic institutions that can be used to direct resources to key sectors of the economy that have the potential to positively impact the country's economic growth.

2.3 Overview of the Financial system and DFIs in South Africa

2.3.1 **The South African Financial system**

The South African financial system is multi-faceted. It includes a robust stock market, active bond market, and a banking sector. The local banking sector is one the most professionally run sectors in the South African economy and the largest in the African continent, reaching US$34.4 billion capital in 2021 (Saifaddin, 2023). There were 31 privately-owned registered banks in South Africa as of September 2022, with the six largest commercial banks dominating the banking industry being: FNB, Capitec, Standard Bank, Absa, Investec, and Nedbank. These banks hold the bulk of the banking assets in South Africa (Saifaddin, 2023).

In 2020, SMME loans accounted for only 25% of business loans, which were valued at R631 billion in total. Banks' attitudes to extending loans in South Africa have long been conservative, as they hold on to large sums of assets rather than supplying them to the economy (SARB, 2020).

Below is the current market share in terms of total assets value held by South African banks.

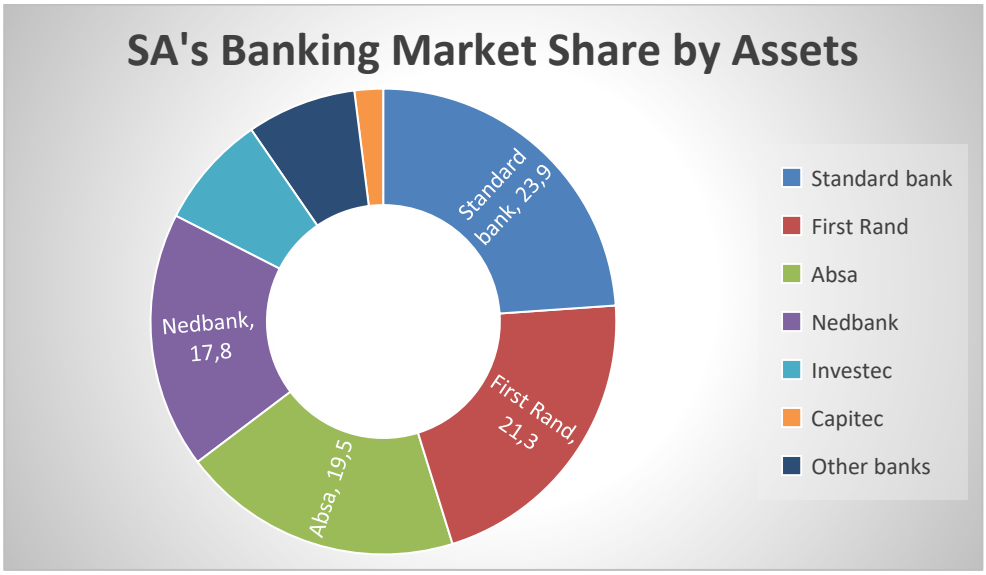

Figure 1: SA Banking Share

Source:(Kean, 2020)

2.3.2 **Overview of DFIs in South Africa**

The South African Government, through the Department of Economic Development, Trade and Industry (DTI), uses DFIs as vehicles to drive economic development in South Africa by providing capital to SMMEs and industrialists (Mopeli, 2018). The DFIs historically played a key role in South Africa during the apartheid era, when the government led industrialisation and the establishment of State-owned entities (SOEs) (Pere, 2020). During this period, the government established the DFIs to counter the international isolation and sanctions imposed against South Africa.

As part of re-purposing the mandate of DFIs after democracy in 1994, in addition to DBSA, IDC and the Land Bank, the South African Government established smaller DFIs like the National Empowerment Fund, Small Enterprise Finance Agency, National Housing Finance Corporation (NHFC), and Khula Enterprise Finance Limited to provide funding to sectors and enterprises that were not sufficiently covered by the larger DFIs. The results of these DFIs have varied in terms of how they have been able to effectively impact the economy, yet the market failure gap remains an unresolved challenge in the South African economy. The table below summarises the financial position of the top three DFIs in terms of asset value and loan books over a five-year period:

Table 1: DFI Total assets and Loan book (2017/18 to 2021/22)

Development Finance Institution	2017/18 R Billion	2018/19 R Billion	2019/20 R Billion	2020/21 R Billion	2021/22 R Billion
Industrial Development Corporation (IDC)					
- Loan book	30.7	27.1	29.1	25.5	24.3
- Total assets	137.0	144.6	109.6	143.7	174.1
Development Bank of Southern Africa (DBSA)					
- Loan book	75.0	77.1	86.2	82.7	84.2
- Total assets	89.2	89.5	100.5	100.0	100.0
Land Bank					
- Loan book	43.1	43.2	41.6	30.9	20.9
- Total assets	49.2	51.1	46.2	40.2	34.7

Source: National Treasury (2023)

As at the end of fiscal year 2022, the IDC and DBSA had maintained strong liquidity positions, with the total net asset value of DFIs growing by 8% to R161.5 billion in 2021/22 because of the two institutions. This highlights the sound financial management and sustainability of these two DFIs, however the Land Bank has remained in default since failing to meet its debt obligations in 2020 (National Treasury, 2023).

2.4 Government Policy and Regulatory Framework

2.4.1 **Government Policy**

The policy brief provided by the Development Bank of Southern Africa (DBSA) highlighted that in all the countries that were able to successfully transform their economies, the Government offered leadership, a long-term vision, and political will (Gumede, Govender & Motshidi, 2011). The South African government's economic policy has been subject to frequent changes over the years, having started with the Reconstruction and Development Programme (RDP) after the first democratic elections in 1994, followed by Growth, Employment and Redistribution (GEAR), Accelerated Shared Growth Initiative for South

Africa (AsgiSA), and New Growth Path (NGP). Even though the economic policy has frequently changed, however, the central goal of the policy has been to increase economic growth and create jobs (National Treasury, 2021). The National Development Plan (NDP), on the other hand, sets out the long-term vision and the roadmap to achieving an inclusive economy and equality by 2030 (NDP, 2012).

The current President of South Africa, Mr Cyril Ramaphosa, introduced an Economic Reconstruction and Recovery Plan after the global crisis of the Covid-19 pandemic as an intervention to stimulate the economy and accelerate the recovery process (SONA, 2021). The plan was to "reconstruct" and "transform", which entailed building a sustainable, resilient, and inclusive economy.

2.4.2 Regulatory Framework

The National Treasury is responsible for the policy formulation of the country's economy and derives its legislative mandate from section 216(1) of the Constitution of the Republic of South Africa of 1996. The aim is to ensure transparency, accountability, and sound financial controls in the management of the country's public finances.

The South African Reserve Bank (SARB) has the prudential authority to oversee all banks in South Africa and is responsible for issuing banking licences in compliance with Banks Act No 94 of 1990 and Companies Act 71 of 2008. Banks must follow a stringent process to be granted a banking licence, which is applicable for both private commercial banks and SOBs. One of the key requirements for applying for a banking licence includes having initial capital of R250 million (SARB, 2024).

2.4.3 Role of State-Owned banks (SOBs)

The role of a state-owned bank in the banking sector is to offer financing that is in the interest of the country's strategic objectives, i.e., their focus is not on making a profit, but on driving the developmental needs of the country. This role becomes increasingly important in times of crisis, but SOBs also play a critical role in driving sustainable development under normal circumstances (Lyubich, Bortnikov & Drobyazko, 2021).

The South African government currently owns the Postbank, which is a deposit-taking state-owned banking institution (SA Government, 2023) that sits under the South African Post Office (SAPO). Postbank is in the process of applying to the SARB to get a full commercial banking licence so that it can expand its services. The Postbank's mandate comes from the Postbank Amendment Act of 2013, which is about making financial services more accessible and affordable to the financially excluded population.

The Financial Matters Amendment Bill of 2019 made it possible for the SARB to approve this banking licence for Postbank (SA Government, 2023). If approved, the bank will have access to a national footprint of offices that are accessible to the most rural areas in South Africa, as the post office has a presence nationally which is a major advantage in terms of access and inclusion of the unbanked population.

2.5 Theoretical Framework

2.5.1 A Dynamic Theory of Public Banks

Public banks have been set up in many countries around the world, with over 900 SOBs worldwide that have a combined asset value of almost US$49 trillion. They are often seen as static financial institutions, based on economic theories that begin from fixed notions of what it is to be a publicly owned bank. This has given rise to polarised debates wherein public banks are identified as being either good or bad.

According to Marois (2022), there needs to be a rethink of public banks as dynamic and contested institutions within the public spheres of states. Their study proposed that instead of looking at orthodox political or heterodox developmental views, a new alternative conceptual approach is necessary that will position the institutional functions ahead of ownership, making it a time- and place-bound context. "To rethink state banks dynamically is to move reflexively from and between the institution, the public sphere, the state, and global financialized capitalism as interconnected scales of reproductive existence, power, and privilege" (Marois, 2022, p. 366). The advocacy for private banks reduced after the 2008 global financial crisis and the more recent Covid-19 pandemic, with public banks coming in to smooth their effects (Griffith-Jones, 2018; Mazzucato & Semieniuk, 2018).

However, if state-owned banks cannot be controlled democratically to act in the public interest, they may not achieve the developmental objectives set out for them. They thus require active

citizens and civil society to hold them accountable (Marois, 2022). A dynamic conceptual view does not write-off the catalytic and public interest potential of a State-owned bank based on assumption that they are corrupt and inefficient, but accepts that it can be used positively or negatively by politicians, and as a final analysis it depends on the environment it operates in.

Below is a presentation of the two views on State-owned banks, referred to as public banks in the figure:

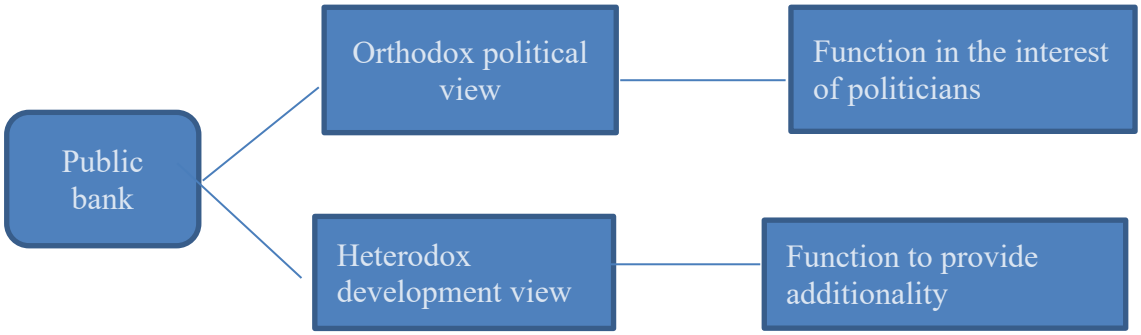

Figure 2: Perspectives on Public Banks

Source: Author's own conceptualisation, adapted from Marois (2022)

This study adopted a view based on the foundational principles of state-owned banks, i.e., they are developmental, meant for the greater good of humanity, and contribute to the collective prosperity of a nation. This research drew on lessons from countries that have successfully established SOBs, including examining the conditions under which they were able to successfully implement them and overcome the political risk associated with them.

2.5.2 Finance-Economic Growth Theory

"The finance-economic growth theory is based on evidence from over 80 countries from between 1960 and 1989 that shows that a financial system can promote economic growth. The theory argues that higher levels of financial development can be linked with faster GDP growth and improvements in the efficiency of an economy. Financial development is a good predictor of long-term growth" (Schumpeter, 1911). Therefore, using this theory, one can infer that if a country can holistically improve its financial development in terms of efficiency and size, it will be able to experience faster growth. The issue of access to finance for SMMEs and industrialists in South Africa is a big challenge, as they are key markets that can unlock economic growth if properly developed and provided access to funding.

2.5.3 Market failure theory

Market failure is the inability of private commercial banks to attain economically or socially desirable efficiency objectives such as welfare maximisation (Rao, 2003). Financial market distortions in the form of information asymmetry restrict the supply of financial services (credit rationing), and DFIs have been found to be the best solution to address market credit rationing (Lewis, 1955; Gerschenkron,1962).

It is not a given that a market failure should result in government intervention, and that a government's involvement will automatically solve the problem. However, in the context of the South African economy, the credit profiling and lack of funding for Black industrialists, women and other excluded groups does make for a compelling case for the government to intervene and ensure that these financially excluded groups are funded because of the country's history of exclusion specifically to these groups.

An important perspective on SOBs is presented by Mazzucato who argues that SOBs should not only be viewed as fixers for market failures but be recognised for the key role they play in creating the market (Mazzucato & Penna, 2016). The study argues that state investment banks (SIBs) go beyond the role of closing market failure gaps and play an integral part in creating the market. The study identified limitations in the market failure theory, in that it fails to recognise instances where SIBs have played a critical role in leading industrialisation and development in developed countries and proposes a broader conceptualisation of SOBs, which suggests that their function should be seen beyond failures of the market.

2.5.4 Access to Financial Services

Financial services access can be viewed in two dimensions – supply and demand – which means that there must be financial products available to meet the needs of citizens (Stijin, 2005). Access to finance is a key issue in development finance, and it is accepted that there is always a limitation on the supply side in terms of available finance or willingness to offer the finance required by borrower (Parrott, 2020).

Other issues that have a direct impact on access to finance are information asymmetry, moral hazard, and the inability of smaller businesses to gather the required collateral to guarantee their

loans. Imperfect information exists between the suppliers of finance and those who have a need to be funded, which makes it difficult to find the right match for financing (Greenwald & Stiglitz, 1986). State-owned banks have largely been established to bridge the gap from the supply side, by making finance available to SMMEs and other groups that would not normally have access to finance.

2.6 Review of Empirical Literature

Several studies have been conducted on the relationship between state-owned banks and their effects on the economic growth of a country (Panizza, 2023; Andrews, 2005; Galindo and Micco, 2004). This section examines the existing empirical evidence from emerging markets to assess how they provide a foundation for this study and how the identified limitations can be addressed to answer questions specific to the South African context. The empirical studies below are structured thematically according to the key concepts considered for this study, and include some of the key findings related to this study's research questions.

2.6.1 State-owned banks' contribution to economic growth.

Several studies have found that financial development is an engine of long-term economic growth (Goldsmith, 1969; Rajan & Zingales, 1998). In the context of the United States, studies found a positive relationship between financial development and the economic growth that followed in cities (Bodenhorn & Cuberes, 2010). Similarly, significant development finance invested in China through State-owned banks led to accelerated urbanisation (Yao, 2005). This shows that SOBs and DFIs have historically been able to positively affect economic development as intended in their formation, despite the challenges they face.

The long-term investments into developmental projects in Britain and Europe that led to the first industrialisation in the 19th century were made by government DFIs (Da Rin & Hellamann, 2002). Commercial banks, which were in the majority, were only interested in short-term projects and were not willing to participate in strategic development through long-term funding. During the 1998 global financial recession, the state-owned banks again came to the rescue by cushioning the effects of the financial crisis, which was attributed to financial institutions engaging in high-risk transactions (World Bank, 2018). Countries with SOBs like China and Russia were able to recover quicker than other countries, which is consistent with the strategic objectives of DFIs and State-owned banks.

However, not all studies have arrived at a positive conclusion about the impact of SOBs, with some arguing that state ownership in the banking sector can negatively affect financial sector development (La Porta, Lopez-de-Silanes, & Shleifer, 2002). These contrasting results may be affected by factors such as country- and region-specific dynamics, as well as the political environment in which they operate. However, basic determinants for success can be learnt from the experiences of other countries and be adopted to successfully establish an efficient SOB.

A study conducted by Panizza (2023) contributed to the discussion on SOBs by building a new dataset to re-assess the relationship between State banks, financial stability, and economic growth. The distinction of this study is that it focused on state-owned commercial banks and not development banks. The study found a positive correlation between state ownership and subsequent growth, yet noted that it was not conclusive as the results were weak. The researcher thus suggested that further work be done to determine the extent of this relationship. It has also been noted that other studies that link financial sector development and economic growth have been inconclusive (Gourinchas & Jeanne, 2006), hence the need for this study.

Another principle highlighted by the study conducted on Swedish industrialisation was block development, i.e., the Swedish bank identified that it could not grow one sector in isolation, but identified key industries to allocate funding to, in order to grow those and therefore the economy (Potter, 1963). While the model proved to be very successful in executing the developmental agenda of the Swedish bank, it is important to see more recent results from modern economic times.

In 2000, the Chinese government initiated an ambitious programme that targeted 12 provinces in Western China to accelerate their industrialisation (Jia, Ma, & Qin, 2020). The state-led programme focused on infrastructure investment in the targeted regions, which came from increased budget allocations. This Great Western Development Programme (GWD) succeeded in accelerating industrialisation and improving regional GDP growth. The rise in capital in the targeted regions was explained by the government's preferential treatment of Chinese SOEs, which were given easier access to bank loans than private firms through the government's control of the banking system (Guariglia & Song, 2011).

The study concluded that it could not determine the broader effects on the whole country and the impact on employment, however, even though there was clear growth in the targeted regions. The role of State-owned banks was also not explained in detail, except their assistance to the SOEs, thus the authors concluded that these areas are interesting avenues for further study considering that the GWD programme is still ongoing.

2.6.2 Efficiency of State-owned banks

A study conducted by Yao, Jiang, Feng and Willenbockel (2007) to assess the efficiency of Chinese banks, including SOBs, used panel data from 22 banks over the period 1995 to 2001. The Stochastic Frontier Production model was used, which is an intermediation approach that measures bank inputs and outputs as main determinants of efficiency. The outputs are represented by profit before tax and the book value of loans. The study determined that ownership and hard budget constraints are key factors in achieving efficiency; the empirical results showed that the average technical efficiency of Chinese state-owned banks is 59.61% and that of joint-stock banks is 77.48%.

The average score for banks' efficiency is ~80% for US banks, while Chinese banks have an average of 63%. The lower efficiency of Chinese banks is attributed to government involvement (Berger & Humphrey, 1997). The efficiency studies in this case seem to have been restricted to profitability and the book value of loans, yet State-owned banks are able to contribute to the economy and the developmental agenda of a country without being profitable, as they are not really established for profit making, therefore looking at profitability alone as a measure of efficiency may be misplaced. Other measures that can be used include assessing the diversification of a bank's portfolio, a bank's investment decisions, a bank's market share, and the kind of industries financed. Limiting the assessment of an SOB's efficiency to accounting ratios is inadequate, i.e., the assessment should include multiple indicators (Xu, Gan, & Hu, 2013).

Another study conducted on Chinese banks found that using the same criteria as that for commercial banks was inappropriate for assessing the performance of China's State-owned banks. Even though there were reforms made to the Chinese banking sector, the SOBs have retained most of the characteristics of being developmental (Laurenceson & Chai, 2001). State banks attach more importance to the impact that their lending has on development than the

returns generated from their lending (Diamong & Raghavan, 1982; Kane, 1983), i.e., testing the direct impact of a State-owned bank's lending on economic growth is a more appropriate measurement of its performance. This is a particularly important distinction to make between commercial banks and state-owned banks, as that speaks to the mandate of the SOBs. Another important consideration is how an SOB contributes to the UN's social development goals for the reduction of poverty , inequality and the improvement of human lives.

2.6.3 Access to Financial Services

Countries across the world have renewed their focus on improving financial inclusion in their respective economies. This is supported by world organisations like the Global Partnership for Financial Inclusion (GPFI), which allows countries to share best models to broaden the scope of access to financial services (WBG & PBOC, 2018). Access to financial services is defined as the ability of citizens to conveniently access and use financial services. This accessibility includes easy access to physical branches, ATMs, and remote banking services to select the financial products they need. Research has shown that easy access to financial products also improves the level of uptake. For SMMEs, the emphasis is also on the suitability of financial products, which include easy online payment platforms for customers and readily available credit facilities (WBG & PBOC), 2018).

2.7 Challenges and Criticisms of SOBs

SOBs are often criticised for being unprofitable, having poor asset values, and owning non-performing loans. However, as argued by Laurenceson & Chai (2001), the mandate of SOBs is bigger than only looking at their profitability; if their contribution can make the country increase its productivity through the financing of strategic sectors of the economy, the SOB would have achieved its objectives. This argument should not, however, take away from the responsibility of SOBs to be self-sustainable and maintain the minimum capital requirements as required by the Basel Committee on Banking Supervision (BCBS).

There is also criticism that government ownership of SOBs hinders their ability to be competitive, according to a study on the State Bank of India (SBI) that established how public ownership affected its competitiveness (Chakrabarti, 2012). It is worth mentioning, however, that the same study also found that the SBI has remained a market leader in India's banking

sector, as it has a national footprint and presence which is a major advantage over its private competitors, especially as it has also moved into digital banking.

The biggest critique for SOBs is that they are susceptible to political interference and poor corporate governance. (Marois, 2022). In practice, there have been several reported cases of corruption. However, the example of the Communist Party of China's political influence on the People's Bank of China and other sectoral strategic banks is one of the greatest success stories of government-led development (Turner, Tan, & Sadeghian, 2012). Government should however ensure that banks are operated by qualified professionals and overseen by independent boards to ensure that they are efficient; political leadership should only provide the strategic direction of an SOB, without interference in the daily operations and allocations of loans.

Therefore, in conducting this study, it was important to consider all the lessons learnt from other countries and to understand what led to the failures and successes of the SOBs in those countries. This served as a basis for the study's framework, which will ensure that there are sufficient risk management controls in place to ensure that any new South African SOB can achieve its original mandate with minimum interference from politicians.

2.8 Summary

This literature review was aimed at critically examining the subject matter based on the existing body of knowledge. The chapter also identified existing gaps and areas where more research is required. While financial inclusion and economic development are key issues in South Africa, limited empirical research has been done on the supply side, which is a key determinant of whether governments will successfully grow their economies (Balkaran, 2014).

Some studies in support of the supply-leading hypothesis have concluded that financial development results in economic growth (Korkmaz, 2015; Nyasha & Odhiambo, 2015; Okello, 2015), while other studies have found that state involvement in banking does not result in economic growth as it stifles competition and efficiency in the banking sector. This study sought to explore these especially looking at government's role in banking.

Criticism has been levelled at those studies that did not assess State banking based on its pure functions and the founding principles for which these institutions were established. The studies that oppose State banking also did not consider that governments and citizens are not helpless

in cases of political inference and corruption, i.e., there are legal and democratic remedies, checks and balances for the protection of state institutions in many countries however these require active citizenry and community activism to ensure that they are not abused by politicians (Marois, 2022).

This study contributes to the body of knowledge by looking at the government policies and initiatives adopted by other emerging countries to increase financial inclusion and economic growth. The political and economic environments in which they were able to successfully establish and operate their SOBs were also considered as a determinant.

The next chapter presents an assessment of state-owned banks in China and India.

Chapter Three: State-owned banks in China and India

3.1 Introduction

This chapter discusses state-owned banks in China and India, including how and why the SOBs were established and the conditions that allowed for their successful establishment and operations.

3.1.1 Overview of SOBs in China

(a) Historical Context and Political Ideology

The People's Republic of China was founded in 1948 under a government led by the Communist Party of China (CPC). The CPC adopted a socialist economic approach, which is a centrally planned economy where the government controls all strategic sectors of the economy. The financial sector was identified as one of the key industries that the state wanted to control to be able to achieve its developmental agenda. The People's Bank of China (PBOC), which is now the central bank, was established as part of the economic reforms introduced by the CPC (People's Bank of China, 2024).

Between 1979 and 1984, China established several state-owned banks, which were designed to finance the policy projects of the government. These included the Industrial and Commercial Bank of China (ICBC), the Agriculture Bank of China, and the People's Construction Bank of China (PCBC) (Baliño, 1991). Centralised control through the State Council played a significant role in the establishment of a banking sector that is dominated by SOBs, as it reduced bureaucratic obstacles. It is important to have a policy position and a clear chain of command so that governments can make policy decisions that can be implemented without bureaucratic delays. In the case of a democratic state, majority support is needed.

(b) Economic Reforms, Development, and Industrialisation

The Chinese economic development strategy was based on developing the state's capacity to implement large-scale industrialisation and infrastructural development projects. In the early years of their economic development, the government identified that the economy needed a

massive investment in infrastructure to build roads, airports and rail networks that would enable industrialisation and urbanisation (Shahbaz, Bhattacharya & Mahalik, 2018).

The SOBs were thus formed as strategic partners to finance infrastructure projects and drive economic development (ICBC, 2014). Post-independence economic reforms led to a high demand for financial services, and as a response, the government established various SOBs, with the main objective being to cater for the specific needs of each industry that was identified as a key sector for the development of China.

Resource-led massive industrialisation and effective government policies led to the transformation of many Chinese cities into production cities (Shahbaz et al., 2018). A study conducted on China and India's development and high economic growth found that the role played by their governments contributed to the growth experienced by these two countries (Shahbaz et al., 2018). The Belt and Road Initiative (BRI) is one of the latest key initiatives funded by Chinese SOBs as part of the government's strategy to expand into international markets and create a road network of over 150 countries that have signed a corporation agreement with China in support of the BRI (Wang, 2023).

(c) **Financing State-Owned Entities (SOEs) and SMMEs**

One of the objectives for the establishment of China's SOBs was to prioritise the financing of state-owned entities, which are strategic government organisations that drive infrastructure development and the economy (Zhang, 2023). The SOEs play a strategic role on behalf of the State as agents responsible for the implementation of industrial policies and regional development. Based on this mandate, the SOEs get a bigger percentage of the SOBs' lending than private companies, which enables them to implement their infrastructural development mandate. Between 1980 and 1995, 90% of lending by the Industrial and Commercial Bank of China went to SOEs (Lardy, 1998). These SOEs were previously funded through direct government allocations, however the state council decided that SOBs should be established to distribute credit more efficiently (Cull & Xu, 1999). The Chinese government has also supported the establishment of new private banks, which has increased the competition for SOBs and allowed for more competitive rates for SMEs and individuals to access credit (Lu, 2016).

(d) **Financial inclusion policies and mechanisms in China**

One of the objectives of the establishment of SOBs was to promote financial inclusion and rural development in the remote regions of China. According to their study, these efforts to increase financial inclusion had support from the government in the form of regulations and policies. The financial institutions, including privately-owned banks, ensured that by end of 2019, China had 4,607 banking institutions with a total asset value of US$41.5 trillion (Chen & Yuan, 2021).

The need to drive rural economic development in China also created a demand for establishment SOBs, which were used to bridge the financing gap in rural areas. SOBs like the Agriculture Bank of China were established to ensure that they could focus on financing the agricultural sector, which is mostly done in the rural regions (Jia, Ma, & Qin, 2020). The pursuit of development in the rural areas also indirectly promoted financial inclusion, as the state had to create branches that could be accessed across the country (Chen & Yuan, 2021).

The interventions introduced by the government have yielded positive outcomes in terms of improving financial inclusion in China. The People's Bank of China and the China Banking and Insurance Regulatory Commission reported that at the end of June 2020, loans advanced to MSMEs and agricultural regions were RMB40.7 trillion and RMB 37.8 trillion, respectively, contributing to an estimated 24% of the total loans issued by the financial sector (Chen & Yuan, 2021).

(e) **Global Economic Conditions**

The establishment of many Chinese SOBs between 1949 and 1984 coincided with favourable global conditions, as there was a move towards industrialisation and modernisation in different countries. SOBs played a significant role in economic development in that period, before the financial globalisation wave that led to private ownership of the banking sector in the 1990s (Cull, Peria & Verrier, 2018).

In terms of global trends, foreign and private banks now play a more dominant role in many countries' economies across the world, with government-owned banks being key role players in fewer countries, especially in the BRICS countries of Brazil, Russia, India, China and South Africa (Cull, Peria & Verrier, 2018). The conditions are thus still favourable for BRICS member

states to pursue SOBs, as part of the BRICS alliance's agenda to change political and economic relations in the world.

3.1.2 Current Status of SOBs in China

The Chinese banking system has gone through major financial industry changes over the years to modernise it to meet global banking standards. Despite these changes, the government has retained majority control of the state-owned banks, which contribute over half of the total banking assets and deposits in the country. China has now over 100 commercial banks that have regional and foreign branches, in addition to the large SOBs (Statista, 2024). The SOBs now also have minority private shareholders through their listing on the Hong Kong Stock Exchange (Turner, Tan & Sadeghian, 2012).

The significant asset value of Chinese SOBs indicates that they are important both in their countries and to the global financial system. As of December 2023, China had four of the largest banks in the top 10 banks in the world in terms of total bank assets and market capitalisation (Statista, 2024). The top four banks that are state owned are: Industrial and Commercial Bank of Bank of China (ICBC), China Construction Bank (CCB), Bank of China (BOC), and Agricultural Bank of China (ABC) (Statista, 2024).

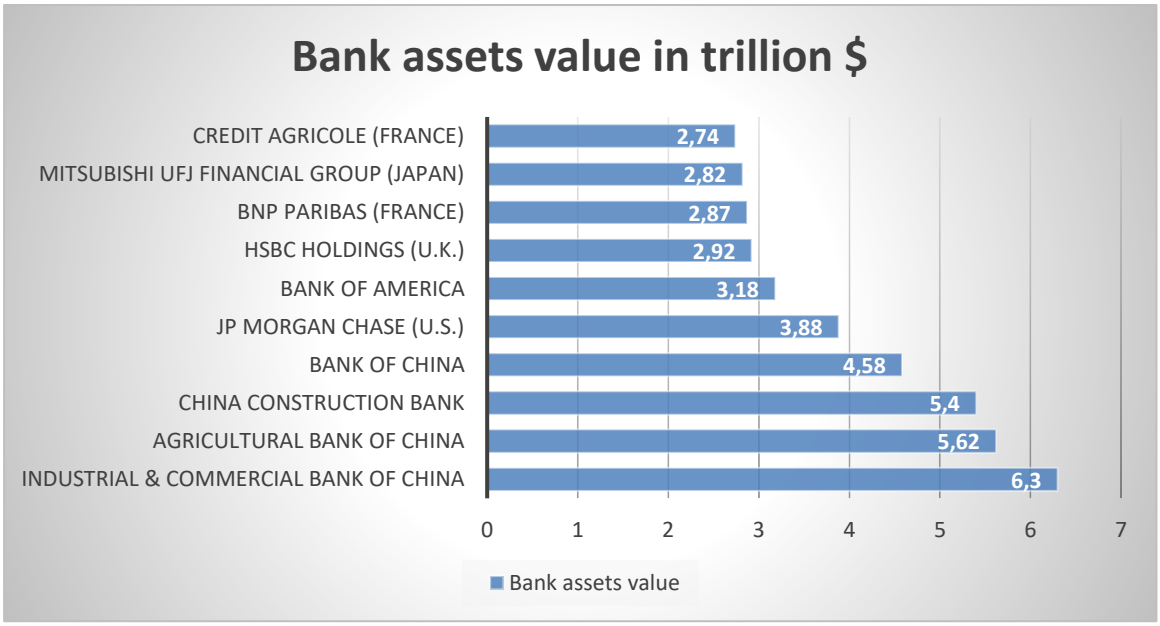

Figure 3:Largest banks worldwide as of December 2023, by assets

Source: Statista (2024)

3.1.3 Adequate Capitalisation

The availability of adequate initial capital is important for the successful establishment and operation of a State-owned bank to ensure that it meets the regulatory capital requirements and is able to meet its obligations to customers (IMF, 2022). In addition to the initial capital required, SOBs are required to maintain the same capital requirements as private banks to give confidence to investors, protect depositors, and ensure that they can absorb any unexpected financial losses as set out in the Basel framework that governs banks' capital requirements (IMF, 2022).

In the early years, the Chinese SOBs depended on government appropriations for funding their operations (Turner, Tan & Sadeghian, 2012), therefore the state needed to have fiscal discipline to be able to allocate savings and surplus to the SOBs. However, as the banking industry developed, the SOBs became more dependent on traditional financial intermediation between savers and borrowers. As a result, most of their income now comes from deposits by corporations, households, and SOEs, although it has been noted that these SOBs are undercapitalised (Turner et al., 2012). In the 1990s, the state-owned Chinese banks went through a process of recapitalisation, with government injecting a total of US$33 billion, which was financed by the sale of bonds to the same banks (Allen, Qian, Zhang & Zhao, 2012).

The recapitalisation process was followed by the clearing of non-performing loans by selling them to separate asset management companies established for this purpose in the 1990s (Turner et al., 2012). In this way, the SOBs have been able to maintain the required capital requirements.

3.1.4 China’s Financial Regulatory Framework

A strong regulatory environment plays an important role in ensuring that SOBs are operated in an efficient and corruption-free manner that is in line with the banking regulations applicable to private banks. The establishment of State-owned banks in China required the State council to make reforms in the banking sector by enacting enabling laws that would allow for the formation of the SOBs. A meeting of the 11th Central Committee of the CPC, which was held in December 1978, adopted new reforms and an ‘opening-up’ policy, which included changing the PBOC’s mandate to be restricted to playing the role of the central bank and allowing for the establishment of SOBs to meet the diversified financial needs of each strategic sector (ICBC, 2014).

The Law of the People's Republic of China on banking Regulation and Supervision, which was later adopted during the Tenth National People's Congress on December 27, 2003, is the current law for regulation and supervision of banking institutions in China. The Chinese financial regulatory system, which has recently been revised had four major bodies: the Financial Stability and Development Commission, the People's Bank of China (PBOC), China Banking and Insurance Regulatory Commission and the China Securities Regulatory Commission (Chen, 2023). The changes only came into effect in 2024, and therefore, for the purpose of this study, the emphasis will still be on the old regulatory regime.

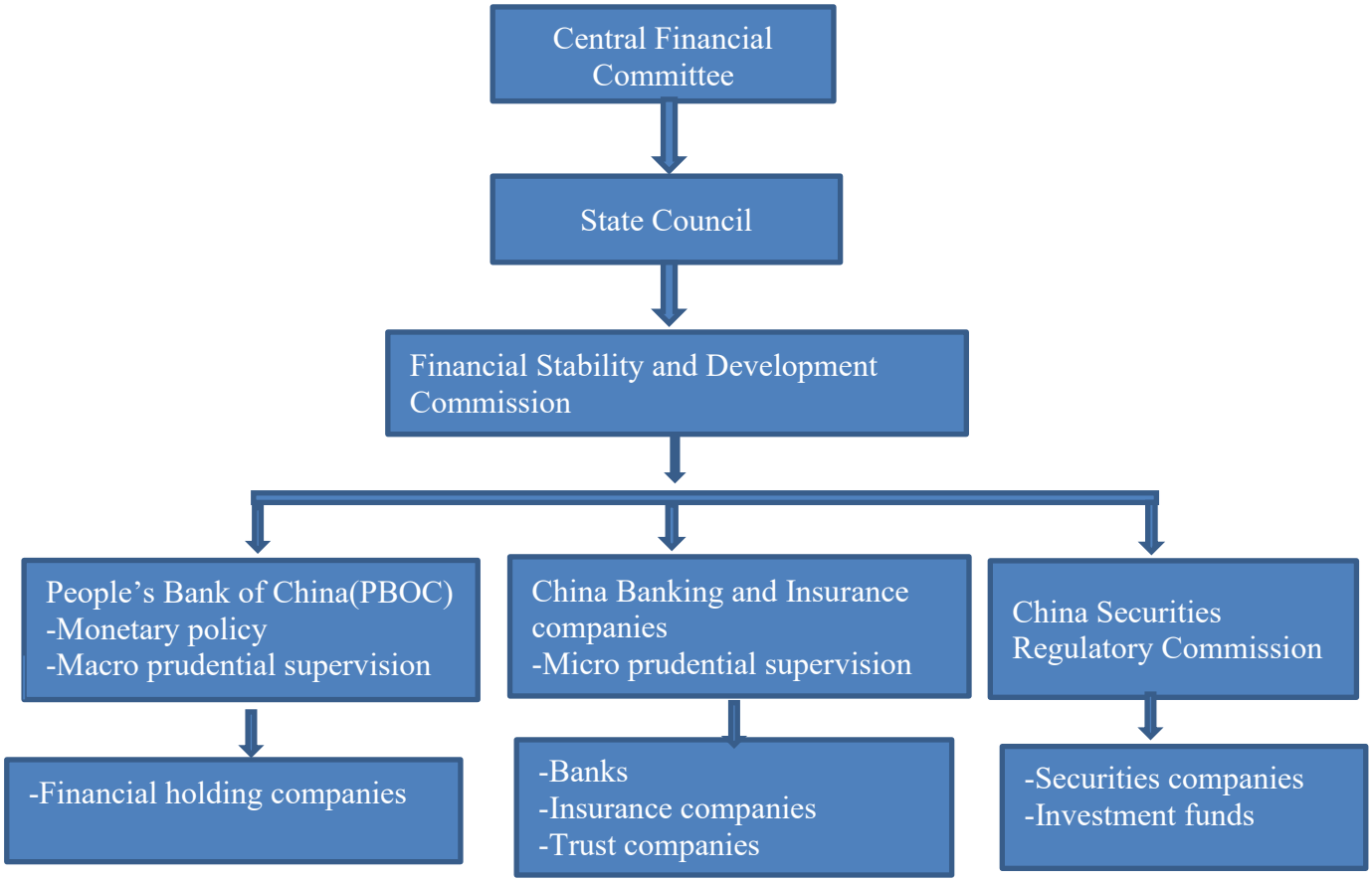

Figure 4:China's financial regulatory regime before the recent changes

Source: (Deloitte, 2023) (reproduced by author)

The reform introduced a new regulator, the National Financial Regulatory Administration (NFRA) to replace China Banking and Insurance Regulatory Commission (CBIRC) and will oversee financial industries in China while PBOC will focus on monetary policy and prudential supervision. The NFRA will operate alongside PBOC and China Securities Regulatory Commission (CSRC) (Zhang, 2024).

The change gives power to the NFRA to become a super regulator that will oversee all the financial industries including those previously under PBOC (Chen, 2023).

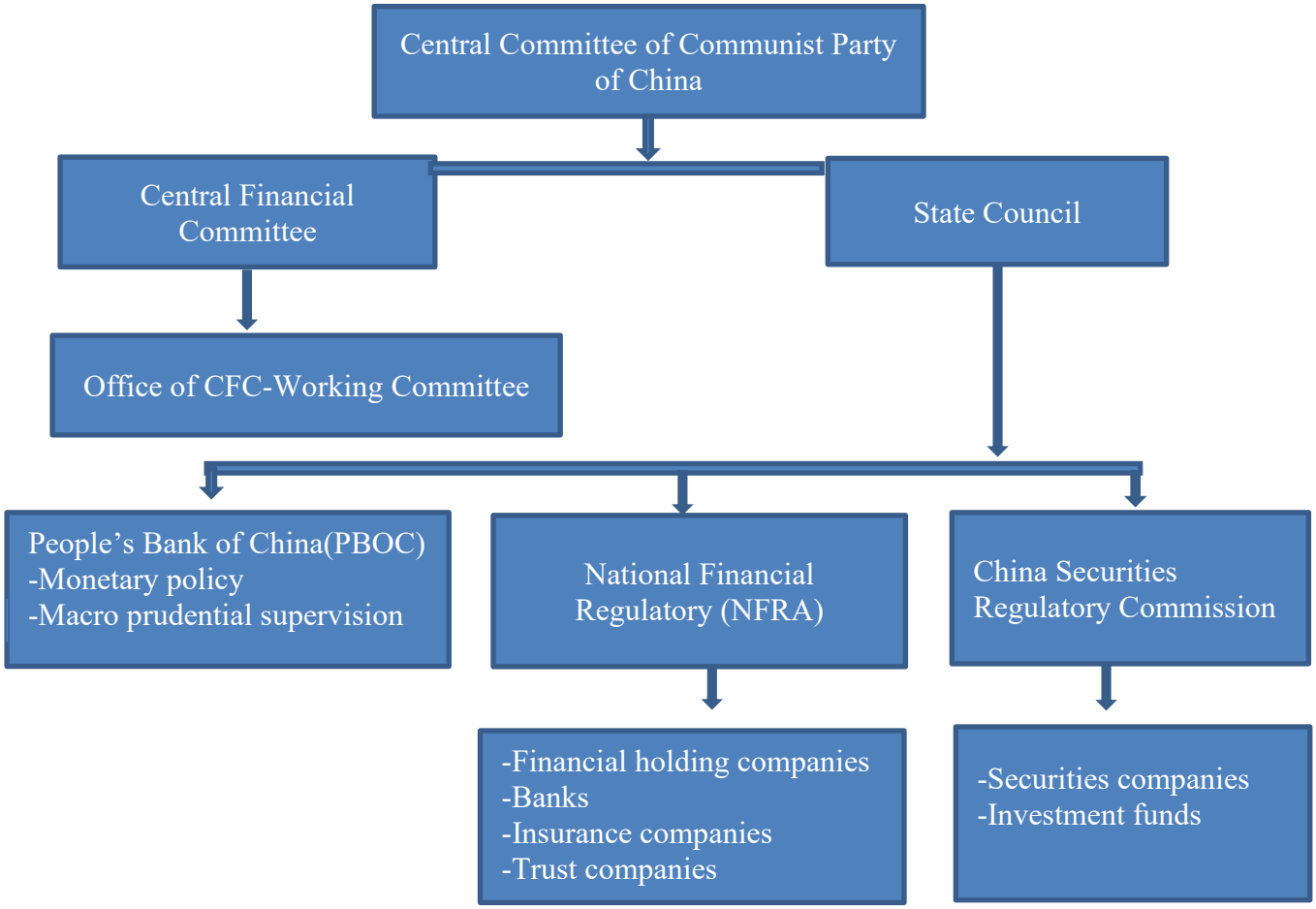

Figure 5: China's new financial regulatory regime

Source: (Deloitte, 2023) (reproduced by author)

The objective of the reforms of the Chinese regulatory system is to strengthen the powers of financial regulators in performing their supervisory functions (Chen, 2023). The move will also see PBOC focussing on directing monetary policy and macro-prudential supervision without the need to also conduct oversight to financial holding companies.

(a) Corporate Governance and Management

A strong corporate governance framework and structure for SOBs is an important control measure needed to ensure that the SOBs are run efficiently with the required risk management and corruption prevention measures (IMF, 2022). The Law of the People's Republic of China

on Commercial Banks sets up rules and regulations that guide the appointments and operations of the independent boards of the SOBs (ICBC, 2024).

Ownership

The state is the majority shareholder in the big SOBs, even after the SOBs were listed in the Stock exchange. The PBOC, which now plays the role of the banking regulator is also under the control of government and this has raised concerns over corporate governance and fears that it may not be independent as there may be conflict of interests (Liu, 2005). The rules for governance of SOBs makes provision for establishment of strong board that includes independent board members to ensure implementation of risk management strategies to protect the SOBs from wrong political influence (ICBC, 2024).

Board of Directors

The Chinese banking system has a unique dual board system, where a board of directors supervises management and a board of supervisors provides advice to the board (Wai & Chung, 2009). These boards have significantly improved in the last 10 years in terms of having more independent and non-executive directors; previously there was an over representation of government-linked male politicians as board members, who were not independent and did not represent minority interests (ICBC, 2024).

Table 2 highlights the board compositions of four Chinese state-owned banks (2023-2024).

Table 2: Board of Directors: China's Big Four Banks

Bank	**Year**	**Directors**	**Men**	**Women**	**Non-Executive Directors**	**Independent Directors**
Agriculture Bank of China (ABC)	2024	13	11	2	5	5
Bank of China (BOC)	2023	11	9	2	3	7
China Construction Bank (CCB)	2024	14	11	3	6	5
Industrial and Commercial Bank of China (ICBC)	2024	13	11	2	5	5
Average		**12.75**	**10.5**	**2.25**	4.75	5.5

Source: ABC (2024), BOC (2024), CCB (2024) and ICBC (2024). Table compiled by author.

As much as the Chinese banking system has undergone significant reforms in recent years, there is still improvement needed if it is to reach the global corporate governance standards and demonstrate values of transparency, fair competition, effective risk management and transformation, especially in relation to the inclusion of women on their Boards.

3.1.5 Technological Innovations and Infrastructure in China's Banking

Technological innovation plays a key role in the banking sector today, thus as the largest banks in the selected countries, SOBs should play a leading role in introducing technological efficiency to improve financial inclusion. China is one of the world leaders in technology, thus it is no surprise that the number of digital transactions in that country is high. A survey conducted in 2017 indicated that over 50% of Chinese adults used mobile phones to access their banking services. The introduction of digital services provides an opportunity to fast track financial inclusion, even to areas that do not have physical storefronts to bring financial services closer to the people. Financial technology (fintech) companies have also entered the market to provide financial services like traditional banks, which has helped to improve financial inclusion (Chen & Yuan, 2021).

The Chinese economy has moved to a mostly cashless economy, as the government is encouraging the use of e-payment platforms like WeChat Pay and Alipay on mobile phones. This has challenged the banking sector to move to digital platforms to maintain their competitiveness and to keep up with the direction the economy has taken (KPMG, 2020).

3.2 SOBs' status quo in India

3.2.1 Overview of SOBs in India

(a) **Historical Context and Political Ideology**

Formal banking in India was started around 1786 with the establishment of the General Bank of India (Chakrabarti, 2012). In 1806, the Bank of Calcutta was formed, and was later changed to Bank of Bengal in 1809. In 1921, the Bank of Bengal, Bank of Bombay and Bank of Madras were combined to form the Imperial bank of India. After India attained independence in 1947, the new government wanted to achieve rapid economic growth and tasked parliament to enact the State Bank of India Act, 1955. This Act was used to establish the SBI, with specific instructions that the Reserve Bank should hold at least 55% shareholding (Chakrabarti, 2012). The nationalised Imperial Bank was established by integrating it with other state-owned smaller

banks, with the purpose of being socially relevant and reaching out to rural areas of India (SBI, 2024).

In contrast to China's one-party state, India is a more democratic country with regular elections and a diverse number of political parties contesting those. The Indian government chose a mixed socialist economy approach led by state development as a way of coming out from its colonial past (Singh & Mukamba, 2015). Most Indian banks were nationalised until the 1990s, when market liberalisation started influencing the world economies towards privatisation. Despite this, strategic banks like the SBI remain under majority ownership by the state (Statista, 2023).

(b) **Economic Reforms, Development, and Industrialisation**

One of the key priorities of the new government was rural development. When they assessed the existing banks, they felt that they did not cater for the needs of economic regeneration, especially in the rural areas, and that need for economic change was one of the major reasons for the establishment of an SOB in India (SBI, 2024). The SBI was therefore set up with the mandate to lead the Indian banking towards the National development project.

India's economic growth in recent years has moved it from being one of the top recipients of aid to being one the largest emerging markets and suppliers of development aid to other countries (Singh & Mukamba, 2015). The SBI is the largest bank in the country and plays a strategic role in the economy as it contributes to economic development. The bank finances strategic infrastructural projects, industrialisation, and agricultural activities (Kumar, 2018).

India recorded impressive growth from the early 2000s, growing to US$ 3.57 trillion in 2023 (O'Neil, 2024). The SBI played a key role in this growth by financing major developmental projects to small scale industries and artisans to ensure that it drives a positive output (Kumar, 2018). Despite the good growth achieved in the last 23 years, however, India still has high levels of poverty and unemployment, and its government is always faced with a tough balancing act of pursuing its cooperative foreign policy of assisting other low-income countries and serving its own population (Singh & Mukamba, 2015).

(c) **Financing State-Owned Entities (SOEs) and SMMEs**

India's state-led economic growth policy between the 1950s and the 1980s was based on building SOEs to lead the country's industrial and infrastructure development, as per the Industrial Policy Resolutions (IPRs) (IMF, 2022). As part of the expansion strategy into international markets, the SBI has branches in other countries, whose purpose is to cater for the financial needs of Indian corporates that have expanded into those regions (SBI, 2024).

Even though the contribution of SOEs to the economy has declined, India's SOEs are still profitable on aggregate, contributing about 0.7% of GDP. They also still make a significant contribution to India's GDP, accounting for 22% of GDP in total assets at the 2019/20 financial year end. The SOBs are mandated to provide financial services to these SOEs by investing in infrastructure, housing, and the growth of Indian exports (IMF, 2022).

The Stand-Up India Scheme is an SOB intervention to support businesses in manufacturing and trade as way of making finance available to industries that can impact the country's economy positively. These are targeted at financially excluded groups like women and are collateral-free for deserving recipients (SBI, 2023).

(d) **Financial inclusion policies and mechanisms in India**

One of the strategic interventions of India's public banking sector was the introduction of the banking outreach programme, which is aimed at reaching the unbanked population of India through a national scheme called Pradhan Mantri Jan-Dhan Yojana (PMJDY). The programme allows individuals to open bank accounts without having to have a minimum deposit (Ministry of Finance India, 2024). An estimated 66.5% of the beneficiaries of this programme come from rural/semi-urban areas in India, with 78% of the recipients being serviced by the public sector banks (Degenhard, 2023). The programme also allows individuals who do not have all the required documents to self-certify and open accounts, and it provides financial literacy lessons for women and rural residents, which are two of the largest financially excluded groups in India. Access to banking services has significantly improved in India, as it now boasts at least one banking outlet or branch for each village amounting to 99.97% coverage across the country (Ministry of Finance India, 2024).

Access to finance in the rural regions is specifically covered by regional rural banks. The financial intermediation process has also improved since nationalisation in 1969, with public sector banks increasing the number of branches available to rural citizens (SABHA, 2013). Another product made available through the SBI is the Pradhan Mantri Mudra Yojana scheme (PMMY), which offers loans of up to ₹50,000 that do not require collateral. This allows businesses access to finance that would ordinarily be excluded by commercial banks (Degenhard, 2023).

Table 3: Pradhan Mantri Mudra Yojana scheme (PMMY)

Bank Name / Type	**Number of Beneficiaries at rural/semiurban centre bank branches**	**Number of Beneficiaries at urban metro centre bank branches**	**No of Rural-Urban Female Beneficiaries**	**Number of Total Beneficiaries**	**Deposits in Accounts(In Crore)**	**Number of RuPay Debit Cards issued to beneficiaries**
Public Sector Banks	25.90	15.41	22.76	41.30	176671.09	31.14
Regional Rural Banks	8.45	1.41	5.74	9.86	44824.00	3.49
Private Sector Banks	0.74	0.89	0.88	1.63	6866.83	1.34
Rural Cooperative Banks	0.19	0.00	0.10	0.19	0.01	0.00
Grand Total	**35.27**	**17.72**	**29.48**	**52.99**	**228361.93**	**35.9**

Source: PMMY (2024)

3.2.2 Current Status of SOBs in India

India has a total of 12 state-owned banks that are active (Reserve Bank of India (RBI), 2024). There are also 22 privately-owned banks in India, which are worth approximately US$800 billion in terms of asset value (Statista, 2023). The SBI is the largest financial and banking services organisation in India, with an asset value of over 61 trillion Indian rupees. It has a national presence of over 22,500 branches and 63,580 ATMS. The SBI has a global presence, operating in 241 offices in 29 countries (SBI, 2024).

Included in the top 10 banks in India are seven State-owned banks, which compete with private banks in terms of total bank assets, market capitalisation, and other performance indicators (Jaswal, 2023).

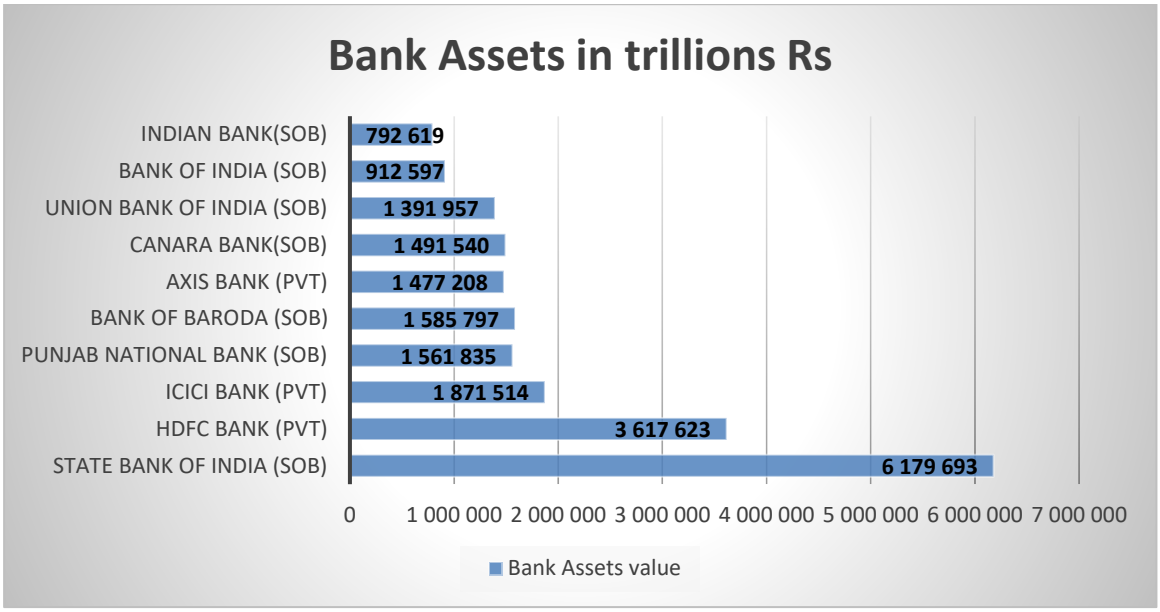

Figure 6: Top ten banks in India by asset value (2024)

(Source: Money control, 2024)

3.2.3 Adequate Capitalisation

The initial capital required to establish a state-owned bank plays an important role, as the government needs to have enough capital for an initial investment and to keep the SOB well capitalised to meet the minimum capital requirements (IMF, 2022). The SBI is the most capitalised public bank in India, with a capitalisation value of 5.4 trillion rupees as of December 2023. The level of capitalisation of Indian SOBs gives people confidence about their financial stability and being able to meet their client obligations in the long term.

3.2.4 India's Financial Regulatory Framework

A strong regulatory environment is an important requirement for ensuring that SOBs are run efficiently and in line with the banking regulations applicable to privately-owned banks. The Reserve Bank of India (RBI) is the primary banking regulator in the country, having been established in terms of the RBI Act of 1934, before being nationalised by the government after independence. All state-owned banks are established in terms of the State Bank of India Act, 1955 and Banking Companies Act, 1970, therefore this Act was a key enabler for the establishment of SOBs (RBI, 2024).

The RBI maintains a tight supervisory regime with higher-than-normal capital requirements and onsite inspections. These capital requirements are in line with Basel Accords requirements to promote a resilient banking system. However, there is inherent conflict of interests when it

comes to monitoring SOBs, as they are nationalised and may be exposed to political influence (World Bank, 2013).

The banks in India are grouped into two: schedule banks and non-schedule banks. The difference between these banks is legislated in the RBI Act of 1934 (Patel, 2016). Schedule banks are those that have met the condition for paid-up capital and reserves of Rs. 5 lakhs as required by the central bank. The schedule banks are further separated into commercial and co-operative banks. The main difference between these two is that corporative banks use corporative principles and are registered under the Corporatives Societies Act (Patel, 2016).

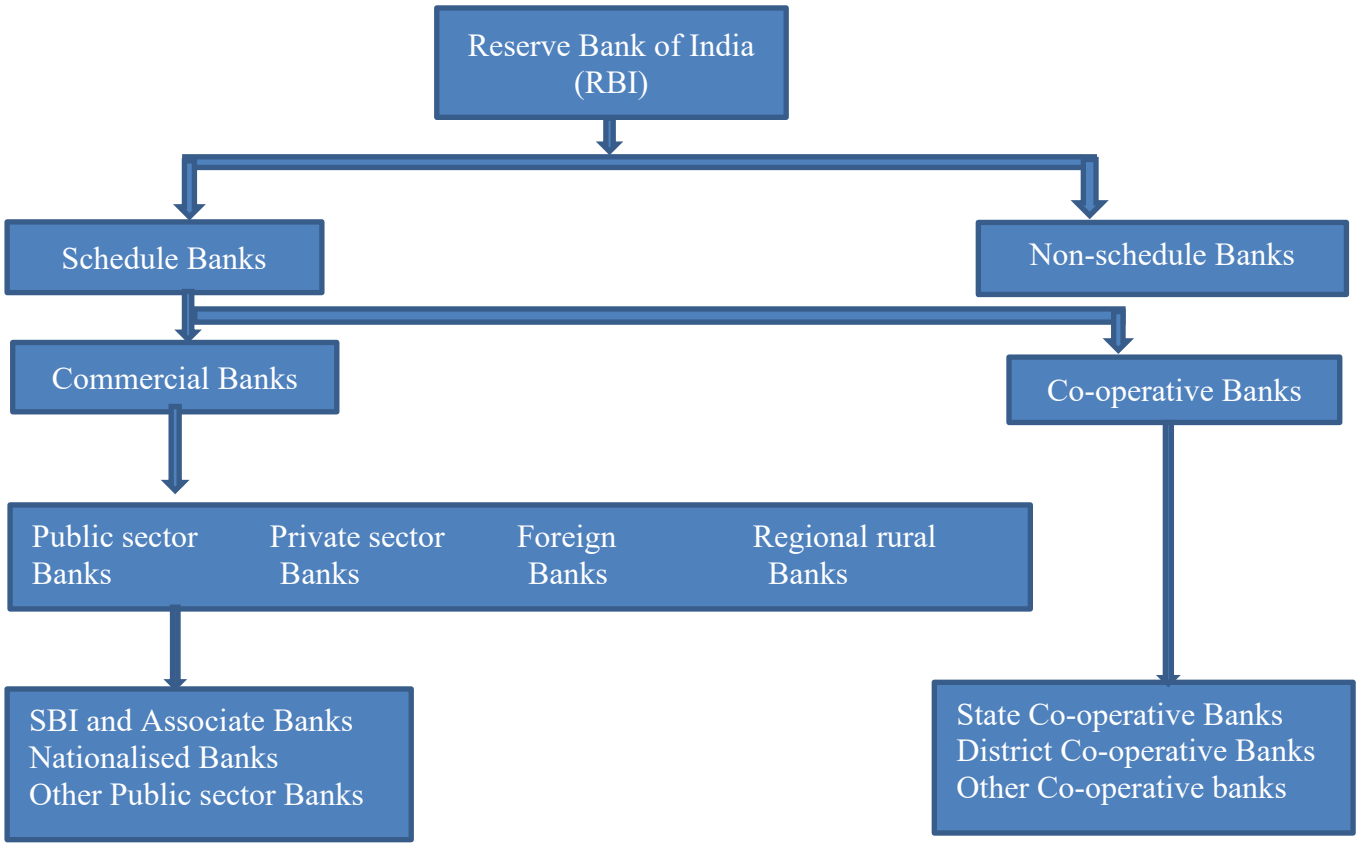

Figure 7: India's Banking system

Source: Patel (2016)

(a) **Corporate Governance and Management**

The Indian banking sector has undergone some changes, one of the more significant being a reduction in the requirement for government shareholding in public sector banks from 51% to 26% as a measure to dilute the government's shareholding (Gulati, 2022).

Currently there is mixed ownership between the government and the private sector, as most of the SOBs in India are listed on the stock exchange. This is good for corporate governance as the private shareholders can enforce good risk management controls. The RBI has the responsibility of balancing the objectives of government, ensuring that it plays an effective oversight role, and that banks comply with the RBI's corporate governance requirements (Gopinath, 2008).

3.2.5 Technological Innovations and Infrastructure in India's Banking

The government Digital India campaign has been a key policy to ensure the financial inclusion of the unbanked population. The initiatives were aimed at bridging the access gap for rural areas that could not be reached by the available branches and banking services. The programme culminated with the opening of 75 Digital Banking Units (DBUs), with the participation of 11 public sector banks and 12 private lenders. The DBUs are brick and mortar structures with digital infrastructure, which enable citizens to come in and access online banking facilities (Ahmad, Bulmer, Dadani, Rickaby & Rodríguez, 2021).

In 2016, the National Payments Corporation of India (NPCI), together with the RBI, launched a Unified Payment Interface (UPI) to encourage the country to move to a cashless economy. The UPI gives customers an option to make transfers from different banks without having to capture details and the funds appearing in the other bank instantly (SBI, 2016).

These technological developments presented the SBI with new competition from rival private banks, as they presented customers with more convenient banking options and affordable switching costs from one bank to another. This forced the SBI to introduce new IT solutions to create an integrated banking experience for their customers (Shukla & Singh, 2011).

The first online banking platform for the SBI was launched in 2001 and it was the first public sector bank to launch an online platform in India. (Shah, 2024)

3.2.6 Conclusion

Based on the observations of how the SOBs were established in China and India, it is evident that the government and political support played an important role in state bank ownership. In the case of China, the Communist Party wanted to control national strategic sectors, including banking, to drive the state-led industrial policy. India adopted nationalisation policies when it

gained independence as a measure to regenerate the economy. As a result of clear leadership and policy positions, they were able to enact enabling laws that would allow for the establishment of the SOBs without any bureaucratic delays.

Another factor that came out of the analysis is that both these countries wanted to effect economic reforms, and identified SOBs as strategic role players in financing these and state-led infrastructure and industrialisation projects. Financial inclusion and reaching out to rural regions were also important priorities in establishing the SOBs.

There is a need for a strong governance framework to establish independent boards and ensure transparency in line with international banking requirements. Adequate capitalisation is also an important requirement to ensure that SOBs are able to meet their financial obligations and absorb any losses.

Even though some of the major world economies have moved towards the privatisation of financial services following the liberalisation wave of the 1990s, it is evident that at least in the BRICS countries, SOBs still play an important role in the financial services sector and have managed to modernise their operations while keeping their principles of being socially responsible. This presents a positive condition for other BRICS countries as they will enjoy the support of their fellow BRICS members if they follow this route.

The SBI and ICBC remain the largest banks in India and China respectively in terms of asset value, and four Chinese banks are among the ten largest banks in the world. This highlights that even in times of privatisation, SOBs remain strategically important in the global financial services sector (Statista, 2024).

The following chapter outlines the study's methodology.

Chapter Four: Research Methodology

4.1 Introduction

This chapter describes the methodology used to conduct the research, including which data selection instruments and techniques were used. It also details the research strategy, data collection and analysis approaches.

4.2 Research Approach

The researcher used a qualitative approach to answer the research questions by carrying out documentary analysis, which is a systematic procedure to analyse and interpret both printed and electronic data. This allowed for the examination of the determinants for the successful establishment of a State-owned bank and the impact that it would exert on financial inclusion and economic growth in South Africa, drawing practical lessons from China and India. The researcher aimed to get develop an understanding of, and gain empirical knowledge from, the themes that were observed (Corbin & Strauss, 2008). The financial trends from these countries were also observed in order to supplement and corroborate the information obtained from the documents.

This qualitative approach was suitable for the study as it provided an in-depth understanding of the establishment of SOBs and the conditions under which they succeeded. From the previous studies and reports, the researcher was able to identify patterns, make sense of them, and formulate a conceptual framework (Leung, 2015). Although documentary analysis is mostly used to complement other research methods, it has also been used as a single method to conduct studies (Wild, McMahon, Darlington, Liu, & Culley, 2009).

4.3 Research Design

This section outlines the plan for the population, data selection and data analysis used in the study, as well as the measures taken to ensure the validity and credibility of the research.

4.3.1 Population and Sampling

Documentary analysis was done on SOBs in China and India. The sample was restricted to these countries because of their similar characteristics, including their high levels of poverty and the common developmental objectives they share as BRICS member states (Singh & Mukamba, 2015). South Africa also experiences high levels of poverty and unemployment, however careful consideration was applied for the specific factors, contexts, and global conditions in which these countries operate when developing the conceptual framework for South Africa.

The total population of SOBs in these two countries was 18 SOBs – 12 in India and 6 in China (Statista, 2024). The researcher used selected documents that covered the subject of the study, based on availability (Leedy & Ormrod, 2013). A combined total of 10 documents and reports were analysed, which is in accordance with sampling guidance that four to five cases per study for case study research can be selected (Creswell, 2013).

It is better to have access to a variety of documents to cross check information, especially when a study is dependent on documents (Bowen, 2009). The emphasis, however, is not on the size of the sample, but rather on the quality of the information in the documents and its ability to help fulfil the objectives of the study. In this case, it was to develop a sound understanding of, and empirical knowledge on, the establishment of a state-owned bank in South Africa and its impact on financial inclusion and economic growth.

4.3.2 Data selection instruments

In relation to data selection, Yin (2003) noted that a researcher can focus on case studies that are related to the topic under research, however there should be enough diversity and richness of data to enable the construction of a theory.

The selection of data was done via the internet, which is an effective and cost-saving tool. The data for this study were obtained from credible sources of academic data and official websites of the relevant organisations, such as Google Scholar, SpringerLink, the World Bank, Central banks, and government websites. The selected documents were assessed by the researcher for completeness to ensure that they covered the topic comprehensively before they were selected,

as the objective was to obtain rich, quality data that covers various aspects of the subject of research to arrive at a well-informed conceptual framework.

4.3.3 Analytical framework

This section addresses how the documentary analysis was conducted for the qualitative research process.

4.3.3.1 Qualitative Data analysis

A qualitative document analysis involves skimming, thorough examination, coding, and the interpretation of data to identify themes that will help formulate the conceptual framework (Bowen, 2009). The data from the reviewed documents are analysed to gain an understanding that can help develop empirical knowledge (Corbin & Strauss, 2008). The exploration of data involves reading and analysing, as well as the identification of terms from journal articles and research reports.

Thematic analysis

Thematic analysis was used to conduct the qualitative data analysis. This process involved the identification of patterns that emerged and categorising them in line with the research questions. The selected documents were reviewed, then data were extracted and coded into themes (Bowen, 2003). The themes coming through from the datasets of both countries were grouped together and matched with the research questions and the conceptual framework.

The thematic analysis process is made up of six phases (Braun & Clarke, 2006):

(i) Familiarise yourself with data
The first phase included spending time understanding the documents, making notes, and highlighting key terms (Braun & Clarke, 2006; 2012).

(ii) Generate initial codes
Once the key terms were extracted, the process of allocating initial codes followed. Using an inductive coding approach was suitable for this phase as the emerging codes were grouped together based on the data (Braun & Clarke, 2012).

(iii) Search for themes

During this phase, the researcher used codes that were grouped together to search for patterned responses that addressed the research questions. These were identified and recorded as emerging themes. The process involved the active construction of themes and linking them with the research questions (Braun & Clarke, 2006).

(iv) Review potential themes

This phase ensured that the data, themes, and research questions were all aligned, therefore the previously constructed themes were re-checked and merged where there was a need. Some of the questions considered in relation to the themes were: Is the theme emerging across the data from both countries under consideration in the study? Do these themes help to answer the research questions? In this way, the central themes were identified and carried forward (Braun & Clarke, 2012).

(v) Define and name themes

The critical step at this stage was ensuring that there was no repetition of themes and they were clearly defined (Braun & Clarke, 2012).

(vi) Produce the report

The last phase of thematic analysis brought everything together and ensured that the report tells a compelling story (Braun & Clarke, 2012). In terms of the study at hand, the outcome is the creation of a conceptual framework for the establishment of a State-owned bank.

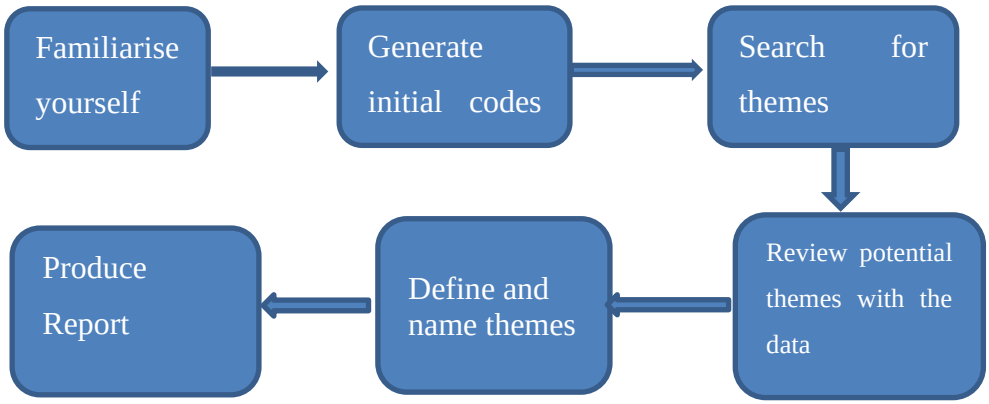

Figure 8: Thematic analysis process

Source: Adapted from Braun and Clarke (2012)

4.4 Ethical considerations

The study was conducted in line with UCT's Code for Research and Commerce Faculty Ethics in Research Policy. The study did not compromise any confidential information of any company or organisation, as it was conducted using publicly available information that was published by the organisations concerned. The researcher had no conflict of interests to declare, the research was conducted impartially, and the findings were reported consistently with the work done. The researcher obtained ethical clearance from the University Ethics committee in line with the UCT Ethics in Research Policy, prior to any data collection and analysis.

4.5 Research validity and credibility

Validity and credibility refer to the level of confidence in the data used, the interpretation thereof, and the methods used to ensure the trustworthiness of the study (Connelly, 2016). With regards to secondary data, the validity of the information presented was ensured by using correct citations and original documents and reports (Saunders, 2009). It was the responsibility of the researcher to ensure that all data used were referenced and there is audit trail of all documentation used for future verification of its validity.

The researcher sought to corroborate information from various sources, including analysis of reports and studies conducted in China and India, to help eliminate potential bias from a single study (Yin,1994). The financial trends from these countries were also observed to supplement the information obtained from the documents. Where there was contradictory information between the various sources, the researcher conducted a further investigation to ensure that the correct conclusions were reached and that there is greater confidence in the findings of the study (Angrosino & de Pérez, 2000).

4.6 Conclusion

The chapter discussed the research methodology chosen to conduct this study. The research process, including research design, population, sample size and data collection, were also explored in detail. All the important steps in conducting the research process and the reasoning behind choosing the qualitative research methodology to answer the research questions was explained. The last part of the section dealt with ethical considerations and how the researcher ensured the validity and reliability of the work done to produce credible research findings.
The next chapter presents the study findings and discussion thereof.

Chapter Five: Findings and Discussion

5.1 Introduction

This chapter presents the findings from the documentary analysis described in chapter four, which are presented in two main subsections. The first subsection discusses the results from the literature regarding the SOBs of China and India, including how they have contributed to financial inclusion and economic development in the respective countries. It also discusses the factors that were observed from the literature as being necessary for the successful establishment and operation of SOBs. These factors are grouped into the three dominant themes of the analysis, i.e., establishment and institutional design, operational efficiency, and external enabling conditions. The second subsection presents the conceptual framework, which draws from the literature and the SOB analysis set out in Chapter 3, and includes a brief discussion.

5.2 Description of Documents Analysed

The documents selected for analysis were academic papers, government policy documents and industry reports from both China and India, which addressed the role of State-owned banks in financial inclusion and economic development in the two countries.

Table 4: Documents selected

Key Topics	China	India
Role of SOB in Financial inclusion	World Bank Group & PBOC (2018) Towards Universal Financial Inclusion in China Models, Challenges, and global lessons Chen & Yuan (2021) Financial inclusion in China: an overview Frontiers of Business Research in China	Khera (2023) Digital Financial Services and Inclusion
Role of SOB in Economic development	Laurenceson & Chai (2001) State Banks and Economic Development in China Statista (2023) Financial Institutions of China and India	Kumar (2018) Role of State Bank of India in Economic Development Paramasivan & Ravichandiran (2022) An Overview of Branches and ATMs Of Commercial Banks in India
Factors that determine establishment and operation of SOBs	People's Bank of China Website Industrial and Commercial Bank of China (ICBC) website	Chakrabarti (2012) State Bank of India: The Opportunities and Challenges of Being a State-Owned Bank in India Reserve Bank of India Website

5.3 Data on SOBs' Role in Financial Inclusion

5.3.1 The analysis of the data showed that through government financial inclusion policies and intervention strategies by the SOBs, both China and India have been able to significantly increase the access to, and usage of, banking services in their respective countries, including agriculture and rural regions. The progress made by China in financial inclusion in the last 20 years provides important lessons for policymakers across the globe (Chen & Yuan, 2021). In terms of the basic metric of financial inclusion, which is account ownership, China has improved significantly and is now on par with the G-20 countries (World Bank Group, 2018).

The analysis also showed that financial inclusion has been a high priority for the Indian government. The SBI has played a key role in the implementation of government interventions, such as Pradhan Mantri Jan-Dhan Yojana (PMJDY) (Chakrabarty, 2011). This financial inclusion policy provided bank accounts to Indian households using a debit card named RuPay and mobile banking. Within a year after its launch in 2014, over 180 million Indians had accounts and were accessing government grants through this account.

Below is a discussion on some of the data that were observed during the analysis regarding the achievements of the two nations in their quest to improve financial inclusion, as well as the contributions made by their SOBs to economic development.

5.3.2 Accessibility of Financial services

The analysis showed that accessibility of financial services is a key driver to financial inclusion. The SOBs played a key role in this aspect, as they have an extensive reach in terms of branches and ATMs – even in the rural areas. This extensive reach was demonstrated in both China and India, for example the Agriculture Bank of China and the State Bank of India demonstrated the ability and desire to reach out to the most rural regions of their respective countries. Access to financial products has not only increased through physical outlets, but also remote access through mobile phones has been increased.

The number of digital (mobile and online) payments in China went up from 160 to 309 billion between 2017 and 2018. Further, a survey conducted in 2017 indicated that over 50% of Chinese adults were using mobile phones to access their banking services (Chen & Yuan, 2021).

(i) Indian banking financial institutions' physical reach

The number of branches of Indian state-owned banks increased from 61,211 in 2011 to 87,892 in 2020, while the number of SOB ATMs grew from 39,487 to 134,863 in the same period. This expanded physical reach happened across the country, from rural regions to urban regions and metropolitan areas (Paramasivan & Ravichandiran, 2022).

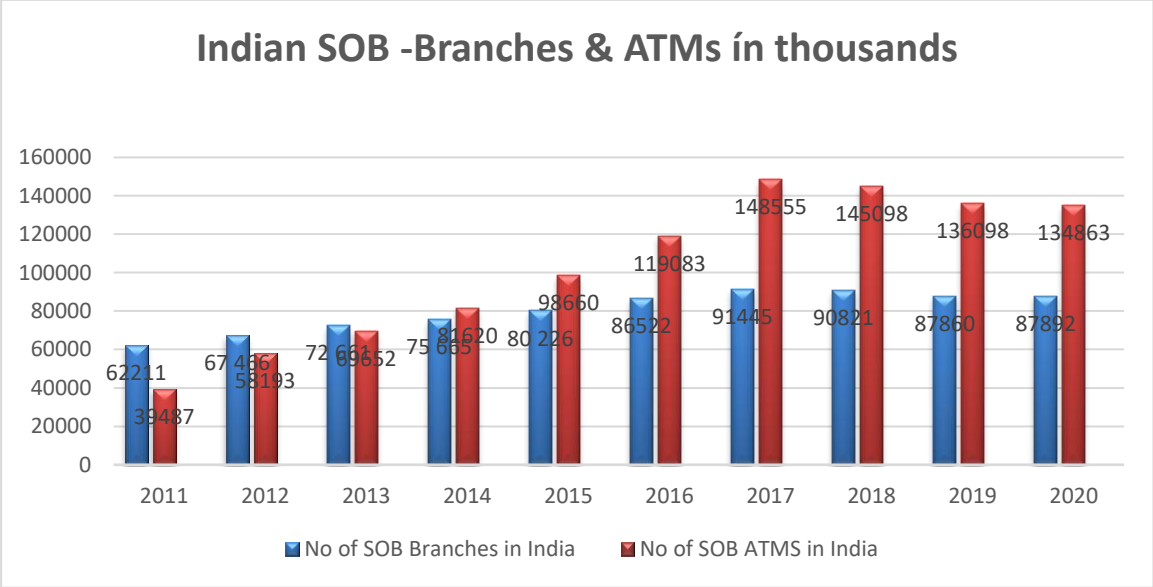

Figure 9: Indian SOB Branches and ATMS

Source: Paramasivan and Ravichandiran (2022)

Figure 9 above demonstrates how the India was able to increase access to ATMs and branches over the 10-year period through its SOBs.

(ii) Chinese banking financial institutions' physical reach

The Plan for Advancing the Development of Financial Inclusion in China saw banking financial institutions significantly expanding their reach from 2012 through branches and ATMs that could be accessed across the country. In 2019 the use of ATMs declined because of the increase in online payments and the Covid-19 pandemic, which introduced more online trading across the globe (World Bank Group (WBG) and People's Bank of China (PBOC), 2018).

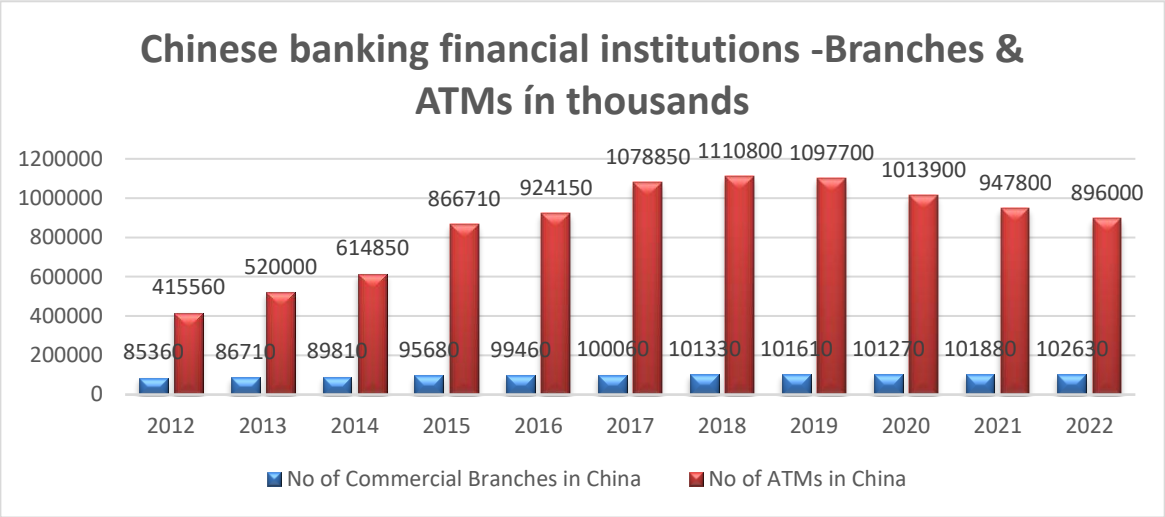

Figure 10: Chinese banking financial institutions branches and ATMs

Source: Statista (2024)

5.4 Data on SOBs' role in Economic development in China and India

The analysis also showed that Chinese and Indian SOBs are systematically important banks in their respective countries in terms of the value of their assets. In the case of Chinese SOBs, these are also significant banks in the world. The study observed an increase in lending by public banks and the contribution of total bank assets as a percentage of GDP over the eight-year period.

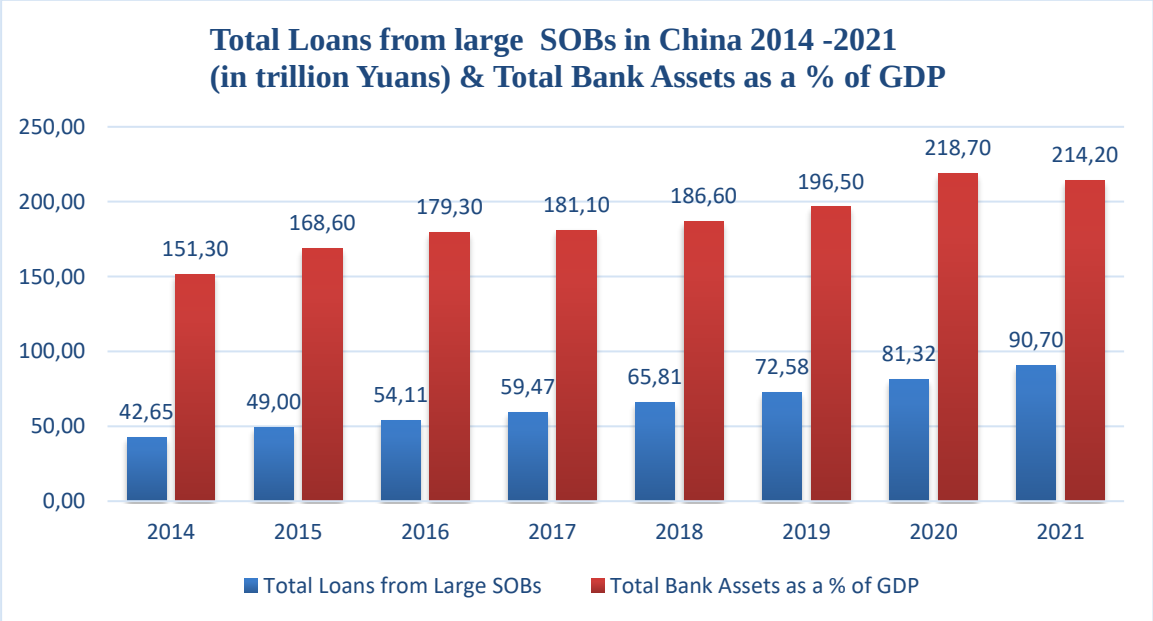

Figure 11: Total loans from SOBs and Total Banks Assets as a % of GDP in China (2014-21)

Source: Statista (2024) and (The global economy, 2024)

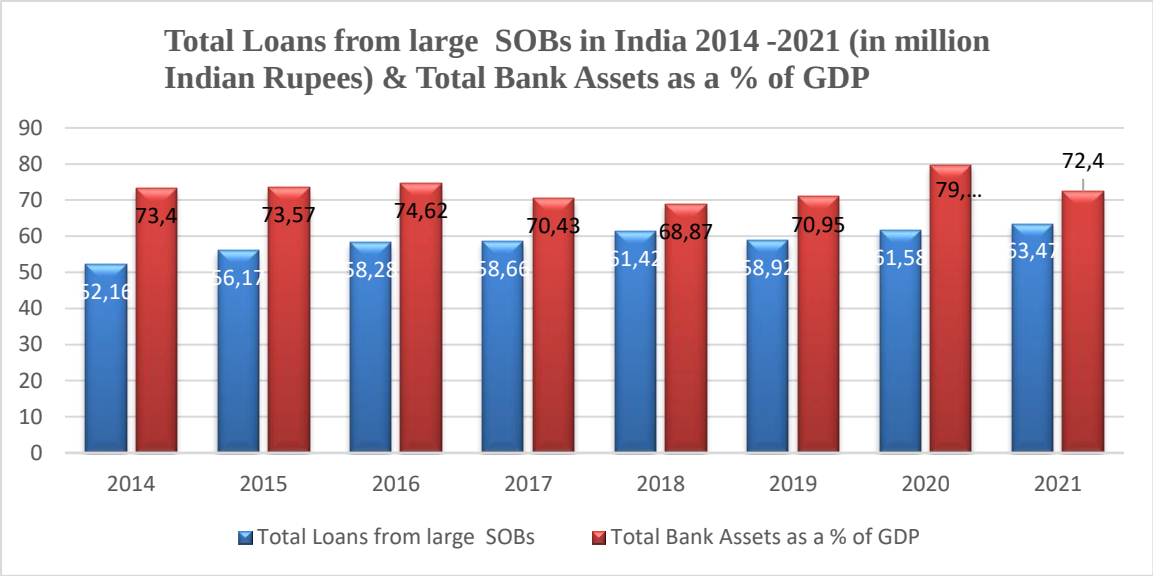

Figure 12: Total Loans from SOBs and Total Bank Assets as a % of GDP in India (2014-21)

Source: CEIC (2024) and RBI (2019-2021) and The global economy (2024)

The State Bank of India is the largest bank in the country and plays a strategic role in the economy as it contributes to economic development. The bank finances strategic infrastructural projects, industrialisation, and agricultural activities (Kumar, 2018).

As shown in Figure 12 above, the total loans from large SOBs contributed significantly to the economy, with the total SOB assets as a percentage of GDP representing 72.4% of GDP in 2021. The SOBs have a lion's share of the Indian banking market, as they accounted for 59% of total loan advances in 2021 (Reserve Bank of India, 2022).

5.5 Factors that determine the establishment and operation of SOBs

In this section, the study discusses the factors that should be considered in the South African market to successfully establish and operate an SOB, based on the lessons observed from the analysis of China and India's state-owned banks. The factors are grouped into three themes based on the most dominant themes that came through in the literature review and document analysis, i.e., establishment and institutional design, operational efficiency and sustainability, and external economic factors.

5.5.1 Establishment and Institutional design

The analysis revealed that the establishment and organisational design of an SOB is a fundamental step in the process, as it sets out a clear mandate and the objectives that a government seeks to achieve through the SOB as a policy instrument. The conditions below directly contribute to the successful establishment of an SOB and how it is structured.

(i) Government and Political Support

The literature has shown that political will plays a key role in the formation of SOBs, in most cases driven by the need to achieve national development, through state involvement in the financial industry of a country. Historically, SOBs have been associated with socialist ideological views, but over time they have been adopted for developmental objectives. The World Bank found that over 60% of SOBs were established after 1990, which is regarded as the liberalisation period (Lyubich, Bortnikov & Drobyazko, 2021). Irrespective of a country's ideology, an SOB requires full government support to set clear objectives and provide the required support to succeed.

"The CPC adopted a socialist economic approach, which is a centrally planned economy where government controls all strategic sectors of the economy. The financial sector was identified as one of the key industries that the state wanted to control to be able to achieve its developmental agenda" (People's Bank of China, 2024).

"In contrast to China's one-party state, India is a more democratic country with regular elections held and a diverse number of political parties contesting elections, however the Indian government chose a mixed socialist economy approach led by state development as a way of coming out from its colonial past" (Singh & Mukamba, 2015).

Even though the two countries have different political systems, a common theme that emerged was that the political leadership of both countries wanted to achieve national development by having the state play an important role in the banking sector. China has significantly more state control than India, but the intentions of the governing parties played an important role in the establishment of their SOBs. The South African political environment can also be likened to India as it has a mix of socialist and liberal policies. The decision to establish a state-owned

bank is highly contested between different interest groups, and it would require the majority support of the coalition partners under the current administration.

(ii) Enabling legislation

A strong legal and regulatory environment is a key enabler for the establishment of an SOB; even though an SOB is an initiative of a government, it is required to comply with the banking laws of the country and be granted the required banking licences by the country's Central bank, like private banks. The analysis showed that having a clear enabling legislation is fundamental to forming a strong and sustainable SOB.

"The plenary session of the 11th Central Committee of the CPC was held in December 1978, which adopted the reform and opening-up policy which included changing the PBOC's mandate to be restricted to playing the role of the central bank and allowing for the establishment of SOBs to meet the diversified financial needs of each strategic sector" (ICBC, 2014).

"All Indian state-owned banks are established in terms of the State Bank of India Act, 1955 and the Banking Companies Act, 1970, therefore, the Act was a key enabler for the establishment of SOBs" (RBI, 2024).

The passing of a law that allows for SOB establishment is one of the foundational steps of the process that needs to be in place to ensure that a bank is legally established. In democratic countries it may be subjected to bureaucratic delays if it does not enjoy public support. In the case of South Africa, one of the enabling bills – the South African Postbank Amendment Act – was signed into law in 2024 through a parliamentary process. This Act allows for the establishment of a bank controlling company that can apply for a full banking licence with the SARB.

(iii) Alignment with government economic policies

SOBs are used as policy implementation instruments, therefore it is important that the economic and industrial policies of a country are aligned with the mandate of an SOB. SOBs have traditionally been used to drive a country's national development agenda, especially for financing infrastructure projects and incorporating financially excluded sectors like agriculture

and SMMEs in rural regions. Therefore, it is important for economic policies to identify these industries and for an SOB to be mandated to design tailored financial products that will cater for the needs of the identified strategic industries and prioritise them for financing.

"One of the key priorities of the new government was rural development and when they assessed the existing banks, they felt that they did not cater for the needs of economic regeneration especially in the rural areas and that need for economic change was one of the major reasons for the establishment of the SOB in India" (SBI, 2024).

It is important for an SOB to be established with clear objectives and a mandate, thus its business model should consider all these factors and ensure that the risk tolerance level is adjusted accordingly.

(iv) Initial capitalisation

The banking sector is one of the most highly capitalised industries. In the South African context, the initial start-up capital required for licencing is R250 million for a fully-fledged banking licence (SARB, 2024). The bank should also comply with the minimum capital adequacy requirements as set out by the central bank to ensure that the deposits of customers are sufficiently covered in case of financial losses, and it can sustain its operations in the long-term.

"Applicants proposing to operate as banks or subsidiaries/branches of foreign banks (hereinafter collectively referred to as banks) must have a minimum capital of R250 million. Applicants proposing to operate as mutual banks must have a minimum capital of R10 million"(SARB, 2024).

"In the formation years the Chinese SOBs depended on government appropriations for funding their operations, therefore, the state needed to have fiscal discipline to be able to allocate savings and surplus to the SOBs" (Turner, Tan & Sadeghian, 2012).

Raising starting capital is an important requirement for an SOB, especially in a constrained fiscal environment. This will ensure that it can carry out its mandate and offer affordable credit for SMMEs, which will in turn help address fiscal challenges by contributing to the country's revenues.

5.5.2 Operational efficiency and sustainability

The setting up of operational systems, human resources, and infrastructure to ensure that an SOB is run in an efficient and sustainable manner is key. The factors below contribute to successful running of an SOB.

(i) Regulatory supervision and corporate governance

The central bank plays a key role as the prudential authority to ensure that SOBs comply with the banking regulations of the country and the Basel Core principles as set out by the Basel Committee. The central bank also plays an important role in monitoring SOBs to ensure that they are financially stable and able to meet their obligations to clients in the long term. Good corporate governance and skilled management are other important requirements that SOBs must comply with, especially to demonstrate their independence from undue political influence in their operations.

"The PBOC as a Central bank plays a key role in China's macroeconomic management and part of its functions is enforcing rules and regulations." (PBOC, 2003)

"A strong corporate governance framework and structure for SOBs is an important control measure needed to ensure that the SOBs are run efficiently with the required risk management and corruption prevention measures" (IMF, 2022).

SOBs should be monitored for compliance with regulatory requirements to ensure that they applies prudent risk management strategies and do not expose depositors to unsecured financial losses. The establishment of strong boards that have both independent and non-executive directors is key.

(ii) Systems and Digital Infrastructure

SOBs are required to have advanced technological systems to keep up with the digital finance advancements that are happening globally. In addition to the traditional brick and mortar buildings and physical ATMs that are required as part of their infrastructure, SOBs must invest in digital infrastructure that allows for the introduction of digital banking platforms that can reach across all regions.

"In 2010, Indian government introduced a biometric digital ID system called Adhaar, this has been a game changer in terms of providing digital banking access with over 90% of the population taking up the new system which allowed the holders to open banks accounts that are linked to their ID's" (Khera, 2023).

The development of modern systems plays an important role in ensuring that SOBs are able to have a national footprint and can efficiently provide financial services, even to areas in rural regions of emerging economies.

The number of ATMs in China reduced after 2019, which was due to more people using online platforms for payments and the Covid-19 pandemic. Considering this development, it is necessary to invest more in digital infrastructure so that a bank can run its operations online, while also fast-tracking financial inclusion through remote banking access as the world moves towards cashless economies.

Fintech is a major contributor to modern banking as it integrates modern technology into financial services. Fintech has been a major disruptor in the financial sector in the 21st century with the introduction of elements like crypto currencies, peer-to-peer app lending, and robotic assistants (Kagan, 2024). It has also played an important role in terms of financial inclusion, and it will be a worthwhile investment for a South African SOB to invest in fintech.

Fintech presents challenges in terms of security risks, however, as it has the potential to expose customers to data privacy risks. An SOB working together with the central bank must thus be equipped to ensure that customer protection is achieved through a robust and efficient digital finance platform.

(iii) Risk Management

The study found that SOBs are regarded as high-risk institutions because of their exposure to political influence, therefore effective risk management is a key requirement for their successful operation. The implementation of risk strategies must be monitored by independent boards and the central bank.

Non-performing loans (NPLs) are another inherent risk related to SOBs, therefore they should actively manage their loan book to ensure that the bank is sustainable. In this regard, it is

important for management to keep a reasonable balance between ensuring the sustainability of the SOBs and lending enough money to the economy in line with their mandate of lending to SMMEs without collateral. This will avoid the issue identified in this study that South African DFIs use similar assessment criteria to commercial banks, i.e., they end up being too risk averse for institutions that are mandated to develop new businesses and SMMEs.

"The Chinese SOBs had significant balances of NPLs before they were listed on the stock markets, and they established asset management companies with the responsibility of buying these NPLs and making them viable assets to clean-up the loan book of SOBs before listing" (Whatley, 2013).

The balancing act to ensure the sustainability of an SOB must also involve extensive financial literacy programmes and active management of NPLs to ensure the SOB does not require government bailouts to survive.

(iv) Financial stability and quality of bank assets

The analysis revealed that one of the key requirements for an SOB is to ensure that it is financially stable. One way of achieving this is to adequately capitalise them. The central banks play a key role in monitoring that the SOBs maintain the required minimum capital adequacy ratio to ensure that they always have adequate capital and can meet their obligations to their depositors.

The quality of bank assets was also a significant feature in the analysis, as the data demonstrated that both Chinese and Indian SOBs have the biggest asset portfolios in their respective countries, and four Chinese SOBs are in the top 10 banks in the world in terms of asset value. The data thus show that these SOBs are systematically important banks in global banking, and are able to compete in terms of asset value and capitalisation with their privately-owned counterparts in the global banking industry.

"China has four of the largest banks in the top ten banks in the world in terms of total bank assets and market capitalisation as of December 2023" (Statista, 2024).

"The SBI is the most capitalised public bank in India with a capitalisation value of 5.4 trillion rupees as of December 2023 and the other Indian SOBs are well capitalised as there are about

six SOBs in the top 10 banks in terms of capitalisation and asset value by end of 2023"(Statista, 2023).

(v) Diverse and appropriate products

The study highlighted the need for SOBs to design appropriate financial products that are specifically tailored for the unbanked population and SMMEs. To ensure that financial products are not only available but also taken up by customers, they must be appropriate financial products that meet the specific needs of customers. The Chinese SOBs were established with this concept in mind from the early 1980s, when they created what they called a bank for each industry, e.g., the Agriculture Bank of China and the China Construction Bank.

Even though these SOBs focused on the bigger corporations in the early years, the recent focus has been on creating products that are suitable for smaller businesses.
These can be approved with quicker turnaround times, and even use online platforms to cater for the speed of the competitive nature of business today.

"The appropriateness of financial products drives the uptake and usage of those products and increase the participation of the previously unserved citizens in the formal financial sector(WBG) and PBOC, 2018).

"The introduction of the PMJDY scheme in India that did not require the account owners to have a minimum balance resulted in a high up take and government used these accounts for people to get social benefits from government" (Chakrabarty, 2011).

(vi) Financial inclusion policies

A key mandate for the establishment of an SOB is to develop or implement government financial inclusion policies to ensure that the unbanked population has access to open accounts and financial services, including credit.

"Additional to the formation of SOBs, the efforts to increase financial inclusion had support from government through regulation and the policies"(Chen & Yuan, 2021).

"In 2013, the Third Plenary Session of the 18th Central Committee of the Communist

Party of China (CPC) explicitly announced the initiative to develop financial inclusion. On December 31, 2015, the State Council of China issued Plan for Advancing the Development of Financial Inclusion" (Chen & Yuan, 2021).

(vii) Financial Literacy programmes

The operations of SOBs are not limited to normal banking services; they also have the social responsibility to impact the financial literacy levels of the unbanked population. This will ensure that they can effectively participate in financial services and help reduce the information asymmetries that exists between banking institutions and ordinary citizens.

"The PMJDY programme also allows individuals who do not have all the required documents to self-certify and be allowed to open accounts and provides financial literacy lessons for women and rural residents which are some of the financially excluded groups in India" (Ministry of Finance, 2024).

Financial literacy programmes play an important role in society; over and above financial inclusion, they also empower citizens to better understand topics like savings and investments, which play an important role in a country's savings culture and economic development.

5.5.3 External Economic factors

(i) Macro-economic environment

The overall economic stability of a country and sound fiscal and monetary policies are an important foundation to run efficient SOBs, however as demonstrated in the analysis, there does not need to be a perfect economy, but there does need to be a clear direction and stability when the implementation takes place. The macro-economic environment of a country is an important factor as SOBs require adequate capital to start up; preferably the government should be able raise the required capital within the domestic market.

"In the 1990s the state-owned Chinese banks went through a process of recapitalisation, with government injecting a total of US$33 billion of capital into them, financed by the sale of bonds to the same banks" (Allen, Qian, Zhang & Zhao, 2012).

(ii) Global economic conditions

Contrary to the popular narrative, the World Bank indicates that over 60% of SOBs were established after 1990 (Lyubich, Bortnikov & Drobyazko, 2021). Therefore, as much as it is said that state-owned banks are disappearing in favour of privatisation, most SOBs were established after this liberalisation period and are still key players in the world today, especially in the BRICS bloc.

"The significant value of assets of these SOBs indicate that they are important banks both in their countries and to the global financial system. Currently China has four of the largest banks in the top 10 banks in the world in terms of total bank assets and market capitalisation as of December 2023" (Statista, 2024).

The South African government may face great opposition and competition from the local private banks, especially under the current coalition government which has no majority party. This study found that the country's banking sector is currently concentrated in six top banks, which dominate over 90% of the market share and would oppose the SOB initiative. That is why strong political will and government support are highlighted as key factors for the establishment of SOBs, as observed in China and India. The support from other BRICS member states is also a crucial factor when looking at global conditions, as their support may be used to obtain skills and some of the best banking systems to ensure that the South African SOB is globally competitive.

5.6 Conclusion

This chapter presented the findings from the study, supported by literature regarding the two countries selected. These findings were supported by data that were analysed in the study, which was necessary to verify the accuracy and integrity of the conclusions reached. The factors that influence the creation of an SOB were also presented, using the three main themes that were observed from document analysis.

The last chapter concludes this study and proposes recommendations.

Chapter Six: Conclusion and Recommendations

6.1 Introduction

This chapter summarises the key findings and their implications, draws conclusions from the analysis, presents the conceptual framework created, and proposes recommendations for policy makers who may be responsible for establishing and operating the state-owned bank in South Africa. Lastly, areas of future research are suggested based on the limitations of this study.

6.2 Summary of the study

The data analysis showed that SOBs play an influential role in improving financial inclusion and economic development if they have strong government support and a clearly defined mandate that is aligned to the country's economic policies. The study further found that a strong legal and regulatory framework is a key enabler for SOBs to operate effectively, as the Central bank can leverage its supervisory powers to encourage financial inclusion and preferential policies that will favour SMMEs through the SOBs.

Overall, the analysis showed that investments by SOBs in physical, rural infrastructure branches and on digital finance platforms play an important role in expanding the reach of SOBs across rural and urban regions. As much as the analysis showed increased investment in branches and ATM facilities, after the Covid-19 pandemic the number of ATMs decreased due to an increase in online shopping and the use of online payment platforms. This indicates that any future SOBs must invest in technology and digital finance products to cater for the growing needs of online banking.

6.3 Major findings and implications

The study showed that SOBs play a critical role as policy instruments of governments in driving economic reforms, which have a direct effect on economic development. One of the key findings is that an SOB requires clear government policies and political support to be successfully established and operate optimally. This support allows for the enactment of enabling laws and a supportive regulatory environment.

The study also highlighted the importance of SOBs in providing targeted financing for strategic sectors like agriculture and infrastructure development. This approach impacts both financial inclusion and economic development, as SOBs provide finance to sectors that are ordinarily excluded and require specialised finance products. Even though there has been renewed emphasis on the concept of suitability of financial products, it can be traced back to the 1980s when China established tailored policy banks for its key strategic sectors as part of its economic development strategy. These tailored financial products are even more important for individual accounts and SMMEs, which often require flexible credit solutions that are available timeously to enable them to take up business opportunities that require additional working capital.

The study shows that there has been an increase in digital banking and fintech. This means that there is a need for an investment in modern systems and digital platforms that would allow the South African SOB to be globally competitive and reach out to the citizens more effectively, while being cognisant of the fact that the rural areas of South Africa are behind in terms of technological development and access. This means that the SOB should balance its investment between physical banking facilities, financial literacy programmes, and digital platforms to ensure that all parts of the country are included in the banking programmes implemented by the SOB.

6.4 Conceptual Framework on the Role of the State-Owned bank

One of the main objectives of this study was to formulate a conceptual framework that can be adopted to justify the role of a state-owned bank in financial inclusion and economic development in South Africa. The framework below is based on the key themes and processes identified during the analysis and review of the literature as being fundamental to establishing an efficient SOB.

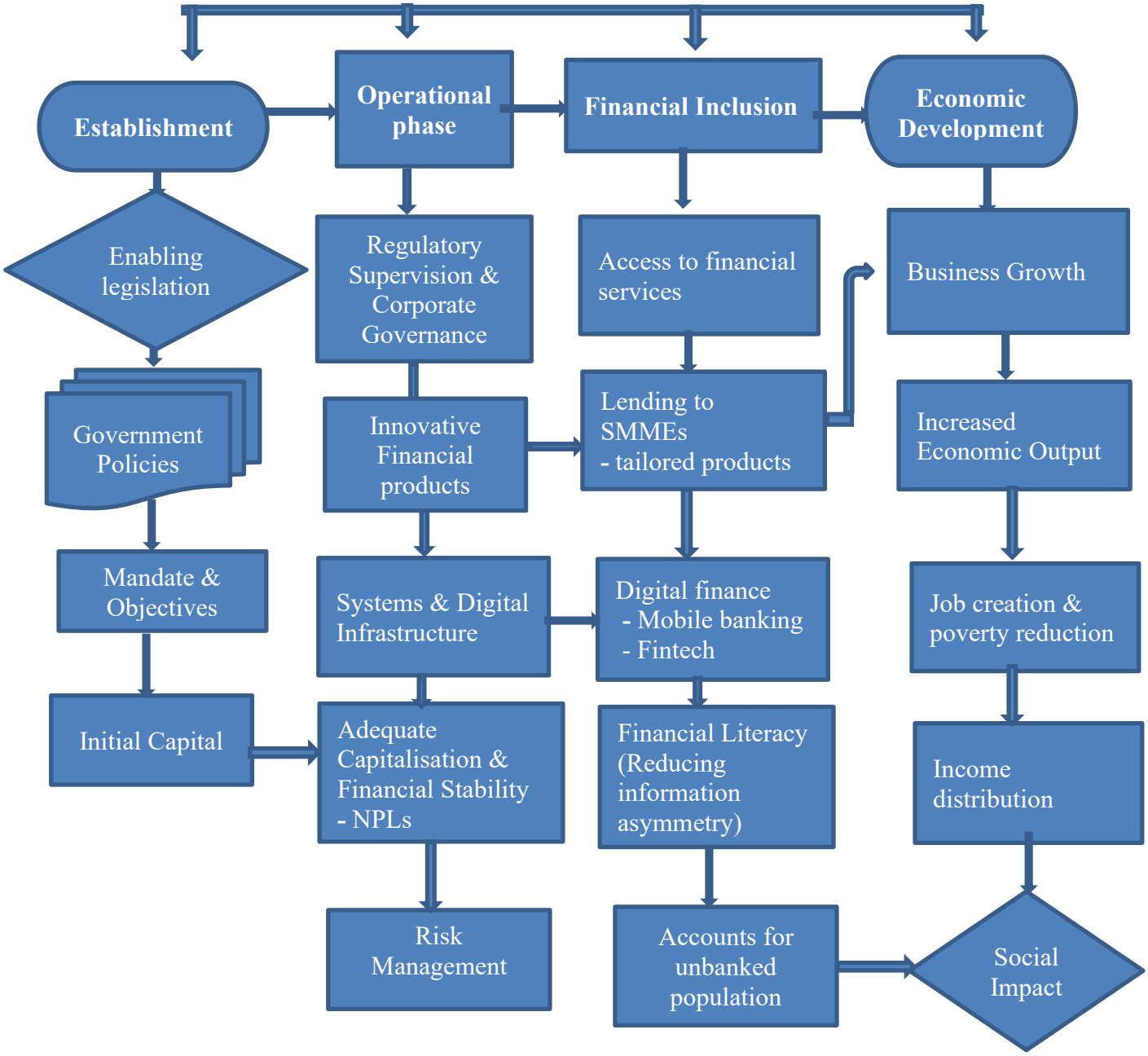

Figure 13: Conceptual framework

Source : Author

South African policymakers can follow the framework above to establish an efficient state-owned bank that can help to improve financial inclusion and positively impact economic development. The framework highlights important themes about the establishment of an SOB, as well as the operating phase, the financial inclusion aspects, and its impact on economic development. The government and political support set the tone and the vision for an SOB, which is then followed by enabling legislation and a strong regulatory environment.

Government policies inform the mandate of an SOB and government must monitor its activities to ensure that the bank is operated efficiently, and all risks are managed. The SOB must also have robust technological systems that can compete with the global standards to provide efficient services to citizens and introduce digital banking as one of the measures to expand the reach of the SOB to unbanked communities. The framework also shows the link from the SOB's lending activities to how it can impact economic development in South Africa.

6.5 Policy recommendations

The mandate of the South African SOB should be to intentionally bridge the market failure identified in the study, which remains a problem partly because the existing DFIs use assessment metrics like those of private commercial banks. As much as the business model should ensure that the bank is self-sustainable, there must be a differentiated and preferential approach by the bank to take calculated business risks on financing SMMEs that do not have collateral but show potential for growth. The small businesses that can be scaled up to expand their business operations, production, and revenue capacity should be favoured by the SOB for funding.

The literature reviewed in this study emphasised that the mandate of an SOB is more developmental than generating profits, therefore even if the SOB breaks even or makes a marginal profit, its mandate would still be achieved as long as it is able to efficiently run its operations and continue lending responsibly to deserving individuals and SMMEs.

The SOBs' lending policies should be linked to government procurement to ensure that businesses with the potential to create jobs are financed to expand production, while getting business directly from government until they can stand on their own and repay their SOB loans in full. This approach would provide a more sustainable contribution to economic development than the current tender system, which does not expand the production capacity of SMMEs as

they remain the intermediary between government and established corporations from which they procure goods to supply to government.

The financial inclusion policy in South Africa, as implemented by the SOB, should be designed to address the current inequality and access realities of the country. This should be done by developing a comprehensive approach that caters for both the younger and urban populations that have easier access to technology, and the older, poorer and rural communities that do not. This process should include reviving the old post offices that have an existing national footprint for the old, poor, and rural communities, which require traditional banking facilities and literacy programmes to deepen financial inclusion.

The literacy programmes should include installing digital services in the post office branches to provide internet banking access and to teach the rural communities how to use internet banking. For the younger and urban populations, the focus should be more on digital finance platforms and the use of mobile devices to access banking services to ensure that no one is left behind.

6.6 Recommendations for future research

This study touched on the impact of digital finance and fintech on financial inclusion, however the topic is quite broad and there are interesting developments happening globally in that space. It would be interesting to see studies on how these new developments can be incorporated into modernising SOBs, as they have potential to improve financial inclusion in South Africa and help find solutions to bridge the gap for the rural parts of the country.

Looking at what China and India's SOBs have been able to achieve with robust digital platforms and fintech, South Africa should invest in further studies and digital infrastructure to close the access gap in internet finance, digital finance and fintech, as they are the future of banking. Such studies could be based on the collection of primary data to gain the views of key stakeholders involved in the banking sector, where SOBs would become players too.

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