The Past and Present of Investment Banks: Investment Banks Leading the Development of China's Financial Market

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Abstract. The evolution of Chinese investment banks reflects their adaptability within a rapidly transforming global financial landscape. Unlike their counterparts in developed economies, Chinese investment banks emerged from a distinct capital development process shaped by state policy and market regulation. While their functions encompass traditional investment banking activities, they also play a critical role in advancing national strategies, including the Belt and Road Initiative, supporting high-tech industries, and fostering regional economic development. However, state-owned dominance has hindered smaller institutions' market competitiveness, and policy-driven operations often reduce information efficiency and increase costs. As domestic financial reforms align with global standards, Chinese investment banks face intensified competition from international counterparts, regulatory cost pressures, and risks linked to industry concentration. To thrive, these institutions must enhance professional capabilities, leverage AI and big data, and adopt ESG standards to optimize operations and reduce costs. With increased investor attention and structural reforms led by the China Securities Regulatory Commission, investment banks are becoming pivotal in building an advanced financial market that serves the real economy and protects investors' rights. Positioned as global leaders, "Chinese-style investment banks" aim to redefine the global financial order, elevating China as a financial powerhouse.

Keywords: Chinese Investment Banks; Financial Market Reform; Global Financial Competition.

1. Introduction

After more than 30 years of development, China's capital market has gradually become an important market with global influence that matches the size of the national economy. The large number of individual investors is an important feature of China's capital market. According to the Statistical Yearbook of China Securities Depository and Clearing Corporation, by the end of 2022, the number of investors in China's capital market reached 212 million, of which natural persons accounted for 99.76%, and investors with a shareholding value of less than 500,000 yuan accounted for nearly 80%. "Protecting the legitimate rights and interests of investors, especially small and medium-sized investors, is the most important central task of the China Securities Regulatory Commission. This is also a direct reflection of the political and people-oriented nature of capital market supervision." Wu Qing, chairman of the China Securities Regulatory Commission, said in response to reporters' questions at the press conference of the 2024 National People's Congress that this interview undoubtedly showed the determination of the iron-fisted chairman to rectify the financial market and promote the legality and compliance of the capital market [1]. As an important role in capital market supervision, investment banks are also undergoing unprecedented changes.

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At present, the market trend of big data, big finance, new asset management, and the new era, with the new innovative model of Internet intelligence + finance, has pushed us into a new historical window of financial development. Faced with a securities market with one billion accounts and over 100 million long-term active accounts, various factions are competing fiercely in the A-share stock market represented by the Shanghai Stock Exchange. In order to seize market advantages and establish strong comprehensive operational capabilities, developing large investment banking business has become the primary strategic choice. Since the establishment of CICC in 1995, the development and evolution process and development pattern of investment banks can be divided into four categories: securities investment banks, commercial bank investment banks, asset management investment banks and boutique investment banks [3]. The difference is that securities investment banks refer to securities companies, commercial investment banks refer to the investment banking business of commercial banks, including departments such as investment banking, asset management, and financial markets; asset management banks include trust companies, subsidiaries of fund companies, insurance companies, family offices and other asset management institutions; boutique investment banks mainly refer to investment institutions that do not hold financial shares, but are also various institutions engaged in investment banking business, including private investment banks, PE, etc.

2. The Past and Present of Investment Banks

The development of investment banks can be traced back to the early stages of capitalist development, and is closely related to the rise of financial markets, the rapid advancement of industrialization and urbanization, and the more frequent and closer globalization of trade. The earliest investment bank in the literature can be traced back to the 18th century. The concept of investment banks began in Europe, especially in the United Kingdom and the Netherlands. Merchant banks represented by the Rothschild family mainly engaged in trade financing and government bond issuance. Then, with the further development of the capitalist market, the American investment banking industry emerged in the early 19th century. Bankers such as Jay Cooke helped the government issue a series of bonds during the American Civil War and provided capital support for the US government financing and its infrastructure such as railways, laying the foundation for the prototype of American investment banks. Subsequently, with the promotion of the Industrial Revolution, the capital market became more and more perfect and the capital demand of the market continued to expand, and the financial industry ushered in the spring of development. The commercial banks and investment banks that constitute the main body of the financial industry also had an early primitive separation stage and gradually moved towards a mixed stage. At first, investment banking was a vague concept, referring to institutions with investment and securities issuance businesses. The Banking Act of 1933 (also known as the Glass-Steagall Act) promulgated by the United States first defined the name of investment banks and made it clear that investment banks were prohibited from absorbing public deposits and other businesses [4]. Therefore, for the first time, investment banks were legally allowed to become financial institutions specializing in securities business. Since Europe has always adopted the traditional universal banking model and does not emphasize the difference between commercial banks and investment banks, the concepts of investment banks and separation of industries mostly come from the United States. It was also during the same period that Goldman Sachs, Morgan Stanley, Merrill Lynch, etc. emerged. With the outbreak of the economic crisis and the two world wars, the global economy ushered in a rapid recovery and development in the 20th century, and the globalization process of investment banks has also been accelerating. With the emergence of financial instruments such as derivatives and high-yield bonds and the gradual liberalization of the global capital market, the development strategy of diversified globalization has become the main theme of modern banks. According to the official website of China Statistical Yearbook, as of 2018, in terms of total assets, Industrial and Commercial Bank of China is the largest commercial bank in China, and CITIC Securities is the largest securities company in China. After decades of development, China's financial market has also made great progress. With the rapid development of China's industrialization and urbanization, the proportion of direct financing in the capital market has increased, and investment banking has become an increasingly important financial business. Before the reform and opening up, China implemented a highly centralized planned economic system, with the People's Bank of China as the core of the financial system, which uniformly managed the country's financial business. The business was mainly concentrated on policy and planned loans, and there was no independent investment bank. After the reform and opening up, the Chinese government began to gradually reform the financial system. Since 1980, a number of policy banks and specialized banks have been established, some of which have investment banking functions. In 1984, Industrial and Commercial Bank of China was separated from the People's Bank of China, China Construction Bank began to support infrastructure and real estate development, and Agricultural Bank of China began to focus on rural agricultural finance. The segmentation of commercial banks has gradually expanded, and China's financial market system has gradually improved. In 1987, China International Trust and Investment Corporation (now CITIC Group) was established. As China's first institution mainly engaged in trust and investment business, it marked the emergence of the prototype of China's modern investment bank. Since the 1990s, the reform of China's securities industry has accelerated. The establishment of the Shanghai Stock Exchange and the Shenzhen Stock Exchange has promoted the rise of the stock market and accelerated the transition of China's financial industry from the original mixed stage to the separate stage [5]. In the late 1990s, the reform of state-owned enterprises promoted a large increase in the demand for bond and equity financing in the capital market, and the investment banking business emerged. Chinese investment banks such as Haitong Securities and CITIC Securities also grew rapidly at this time. With the success of the WTO negotiations, China's accession process has accelerated, and investment banks have gradually integrated with the world.

3. The Significance of Investment Banking

The development of investment banks is accompanied by mixed and separate operations with commercial banks. As their respective functions and attributes are gradually clarified, investment banks focusing on capital market business and traditional deposit and loan business and payment and settlement services make the capital market more efficient, open and transparent. At the same time, the independence of investment banks helps to reduce systemic risks and avoid credit collapse caused by credit risks, which affects the capital market. The direct financing method of investment banks helps them to bear capital market risks alone and avoid the linkage relationship between commercial banks and investment banks that leads to insufficient overall risk resistance in the market; at the same time, different specializations help government organizations and the public to facilitate supervision and review of industry conditions, and more efficiently avoid industry insider information and improper operations that lead to unfair market competition. As a financial intermediary in the capital market, the professional development of investment banks can promote their in-depth development in specific fields and specific businesses (securities underwriting, mergers and acquisitions, restructuring and investment consulting), and make highly professional service systems to adapt to the market [6]. At the same time, the independence of investment banks has promoted the expansion and deepening of the global capital market. The refined and distinctive financial services meet the diversified investment and financing needs of different people in different countries and regions. It is an important driving force for innovation in financial market product models, promoting the development of stock, bond and derivative markets, and providing diverse solutions for structured financing tools and new capital markets. The separation of investment banks from broad banks is an important milestone in the specialization of the modern financial system [7]. It has improved the efficiency and professionalism of financial services and laid the foundation for the development of the global economy and the prosperity of the capital market. Although the paths in different regions are different, the independence of investment banks has played a key role in the maturity and innovation of the global financial market as a whole.

4. Financial Functions of Investment Banks

In the 1990s, Robert and Zvi Bodie, professors at Harvard University in the United States, proposed the concept of financial function, which is the core theory to explain the resource allocation function of modern investment banks and one of the basic theories of investment banking. The system theory explains the financial intermediary nature of investment banks and explains why investment banks can become a strong driving force for financial innovation. Among them, the classic theory is that financial functions are more stable than financial institutions. No matter how the organizational form of financial intermediaries' changes, they can always find the best way to achieve the highest efficiency of economic resources across time and space, thereby optimizing the allocation efficiency of social resources [8]. Therefore, under this concept, investment banks are regarded as an open system composed of various financial elements. Therefore, three levels are layered on this open system, namely basic functions, extended functions and core functions. In terms of the relationship between the three, the core function of investment banks is the basic function and the extended function derived from the basic function. In terms of basic functions, financial products and services are provided to the real economy by providing financing intermediaries and information intermediaries. The extended function is to provide specific products and services to the virtual economy through wealth intermediaries, including asset management, proprietary trading, derivative design and trading. It is through this intermediary business that investment banks carry out their own financial functions such as liquidity management, risk management, and information processing, thereby forming a driving force to promote the transfer of social resources. Information is the key to prompting investors to make asset allocation decisions. Only when high-quality information can be transmitted from the investee to the investor can effective investment occur. In financial business, information asymmetry is the biggest obstacle. Therefore, it is generally believed in academia that investment banks can be summarized into three points in information processing (according to the "Investment Banking Theory and Practice" compiled by the China Interbank Market Dealers Association): as an information producer, collecting, processing and selling information and making profits from it, acting as a medium between producers and users of the information market, and reducing information asymmetry with their own reputation [9]. Therefore, the financial function of investment banks as financial intermediaries is essentially the transmission and collection of information. Old and large investment banks such as Morgan Stanley often have a wider network, and a large-scale network can make transaction pricing more accurate, thereby reducing the cost of obtaining unit information. Therefore, good investment companies can often form huge credit scale economies in the process of information generation.

5. The Function and Future of Chinese Investment Banks

The history of investment banks demonstrates their ability to evolve and adapt with economic development. Although they have experienced many crises and changes, their core position in the global financial system has remained unchanged. Due to China's special capital development process, the birth of policy banks and investment banks is different from that of developed countries. While ensuring the security of the financial market, more policy-oriented policies inevitably reduce the efficiency of market information circulation and increase the unit information acquisition cost. The giant investment banks with state-owned backgrounds also make it difficult for small investment banks to break through in the market competition. The functions of Chinese investment banks include:

traditional investment banking business; serving national strategies, supporting national key strategies (photovoltaic industry network, new energy, high-tech, etc.), following the national "Belt and Road" strategy to make overseas investments and financing, and helping regional economic development; policy-guided financial innovation and industrial integration development, cooperating with policy financial institutions, balancing policy goals and commercial effects, and using national backgrounds to promote capital flows to key national regions, while supporting the development of new capital market sectors such as the Science and Technology Innovation Board and the Growth Enterprise Market [10]. With the integration of financial industry reforms with the world financial market, international capital and domestic capital compete in the domestic market, international competition intensifies, and domestic investment banks still need to improve their professional capabilities to compete with top international investment banks. With the major reform of the domestic financial regulatory system this year, the requirements of the domestic capital market have increased, which may bring cost pressure to the company's operations, increase market uncertainty risks, and problems such as excessive industry concentration. In the face of the globalized and diversified global capital market, expand its corporate influence and reputation, provide more competitive services, interact deeply with capital from various countries, empower with big data and AI, reduce information collection and production costs, optimize its own corporate management, and reform the company in accordance with international ESG standards [11]. The government should use the new government organization Financial Supervision Bureau to carry out in-depth reforms of the existing capital market, optimize the market system, and improve the registration system access principle. With the establishment of new financial prosecutorial agencies, China's financial system is steadily moving towards a modern mixed-industry stage. Chinese investment banks are transforming from traditional investment and financing service providers to core capital market institutions that are guided by national strategies and give equal weight to marketization and internationalization. The development of Chinese investment banks not only needs to adapt to the trend of domestic capital market reform and opening up, but also needs to show stronger competitiveness on the global stage to achieve a capital market share that matches the Chinese market.

China's investment banks have undoubtedly entered a new era of development. A large amount of funds has escaped from the real estate market and poured into the financial market. The transformation of economic growth momentum, the construction of more efficient and fair industry norms and laws and regulations, and a more civilized and advanced financial system are the top priorities for attracting domestic and even global investors to enter the market. Investment banks under the new situation are not only the most innovative new force in the current financial field, but also the main pioneers in breaking the existing financial landscape and forging a more efficient, civilized and advanced financial system. The increasing attention paid to the stock market and the influx of a large number of new generation active users into the financial investment field continue to show that investment banks with Chinese characteristics have come to the center of the stage. With the macro-decision-making of national economic policies and the industry rectification and reform led by the China Securities Regulatory Commission, investment banks will surely become the backbone of building a financial market with Chinese characteristics, serving a strong real industry, and protecting the rights and interests of hundreds of millions of small and medium-sized investors. At the same time, the growth of "Chinese-style investment banks" will surely lead Chinese capital to the world, enter the world financial market, break the existing pattern, and establish China's position as a financial power.

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