



Analysis on the Motivations for the Internationalization Operation of China's Commercial Bank

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Abstract

As the contemporary trend of world's economic and financial integration has become more and more visible to see, and as the global market opens up day by day, the economy & finance of individual country penetrates into each other. And the interdependence and fusion between them has reached such a degree that each nation has been integrated into the huge world economy category and become an organic part of it. Under such situation, internationalization has developed as the main feature of current world economy, among which the internationalization development of the commercial bank constitutes a very important part. In 2006, the overall-open-up in China's bank field was realized, while the internationalization operation of domestic commercial bank has also become an inexorable trend. Therefore, the thesis makes an analysis on the internal and external factors for the internationalization operation of China's commercial bank based on the introduction of internationalization operation theory.

Keywords: Commercial Bank, Internationalization, Theory, Motivation

1. The Theoretical Basis for Commercial Bank's Internationalization Operation

Concerning the theory of the overseas expansion of transnational banks, there are two branches, internalization theory and eclectic theory. Based on the hypothetical premise of enterprise's maximum profit and incomplete market, the internalization theory thinks that with the adoption of market internalization, the bank aims at eliminating the defect of the market, thus to gain the profit brought by the internalization itself. On the other hand, the eclectic theory takes the view that the advantage of ownership constitutes the condition for the competition between transnational bank and local banks. And the transnational bank can create the short term advantage through the obvious products distinction, and the long term advantage through the predictable products distinction. Location advantage is the necessary but not the sufficient condition of internationalization. Therefore, in this section, we will mainly probe into the subject from the aspect of the two theories.

1.1 Internalization Theory

Internalization theory originates from Kos's Enterprise Theory and Location Theory and it takes two hypotheses, enterprise's maximum profit and incomplete market as its premise. In the theory, knowledge advantage becomes one kind of product, which can be exported to other countries. And as a result of the information asymmetry, it's difficult to set prices on these intermediate products, and thus the incomplete external market occurs. Under such circumstances, it's hard for enterprise to defend its rights and interests while transferring intermediate products. And the enterprise cannot allocate its resources through market to ensure its maximum profit, either. While through forming the internal market for intermediate products, enterprise can reserve the controlling power over them and avoid their spread in order to catch the advantage.

The research of internalization theory reveals that the line features of the transnational bank dominate its motivations of overseas expansion, that is, by making use of its internalization advantage, transnational bank can reduce the transaction cost. However, the internalization advantage can only explain bank's motivation for expansion, while it cannot give an explanation on why the bank chooses to expand its business abroad, as it can also set up the branch organization at home without going abroad to internalize its advantage. In addition, internalization theory does not research on the choosing standards of external market.

1.2 Eclectic Theory

When doing research on transnational enterprise theory, John Harry Dunning (1977) refers to the industrial organization theory, location theory, and internalization theory, and he then proposed the eclectic theory. The framework of this theory puts forward the conclusion that there are three factors, i.e. ownership advantage, location advantage, and

internalization advantage, that will dominate transnational enterprise's overseas direct investment.

By applying Dunning's eclectic theory, Gray (1981) first explains the development of transnational enterprise. He lists out the location advantage and internalization advantage of transnational bank and makes an explanation on this economics phenomenon. However, he also thinks that the eclectic theory is too complicated and too general. And Dunning (1981) realizes that the location factor cannot account for why foreign-funded bank can rival local banks in the competition. Yannopoulos (1983) extends the application of the theory in the field of transnational bank trade. He holds the view that transnational bank can gain the short term advantage through the remarkable products distinction, and the long term advantage through perceptible products distinction. However, none of them made attempt to confirm the theory by substantial evidence. In addition, there are no sufficient examples to show the efficiency of this theory, either.

Cho (1983), whose research makes further analysis on the above three advantages, points out their connection and interdependence, which, according to Cho, will change along with the time. Merrett (1990) finds that the competitive human resources market can hardly reserve the skilled workers and the perceptible advantage has some relationship with bank's scope, its credit status and many other factors. All these factors cannot be traded nor imitated in the market. Therefore, these advantages have brought the long term advantage for transnational bank. Taeho Kim (1993) makes an analysis on three comparative advantages of bank's transnational operation, i.e. host country advantage, mother country advantage and enterprise's special advantage. The special advantage of the host country originates from the favorable environment created by the boundary, mainly refers to the difference in regulation and control. And such environment often possesses the following features: with little control, low cost and underdeveloped bank system or with highly centralized bank system, monopolized market and the sharp gap between deposit interest and withdrawal interest. The mother country advantage is mainly reflected by the fact that the currency of mother country becomes the international currency.

Internalization theory and eclectic theory is the mainstream of bank's overseas expansion theory. The former one is based on meticulous hypotheses and can be applied extensively, while the latter one, when applied to explain the transnational bank, seems more systematic and direct, and also easy to use. In a word, both the internalization theory and eclectic theory explain some aspects of the impetus mechanism for bank's transnational operation from different angles, which serve as the guidance for the research on the internationalization operation of domestic banks.

2. The External Motivations for China's Commercial Bank

2.1 The domestic bank opens up to the outside world, which propels commercial bank to speed up the step of internationalization operation

According to R.J.Mckinnon and E.S.Shaw's theory, the dominate task for developing country to deepen the finance lies in two aspects: to lessen or eliminate the improper financial control; to exercise financial open-up to the outside. In late 2006, China's bank field exercised the overall-open-up, allowing foreign banks to set up branches all over China and enjoy the equal rights and treatment as domestic banks. The majority of the foreign banks that have entered domestic market have the following features: with abundant funds, elite staff, advanced technology, sufficient management experience, backed up by the extensive fund-raising network and large scale transnational enterprise all over the world, and the active participation into the international financial market. Under this situation, domestic commercial bank will confront series of problems and challenge, for example, part of the market share, various high-quality resources, such as high-quality loans, human resources, customers, will flow to the foreign banks. Therefore, in order to strengthen the ability to meet the challenge of competition with foreign banks and to improve the management level, domestic commercial banks should "walk to the outside": to speed up the allocation of the network of branches, to improve their reputation and impressing power in the world, to enlarge the scope of products and to improve the ability of serving the high-end customers and transnational companies.

2.2 Making full use of the international financial resources, to speed up the process pf domestic banks' internationalization

Over the past 10 years, the scale of the international capital enlarges rapidly, with a growing speed much more rapid than that of GDP and international trade. And the main forms of capital circulation include direct investment, bank credit and securities investment, all of which relate closely to the management of commercial bank. Among the three forms, bank credit is bank's traditional business, while overseas direct investment can only realize the transference through bank clearance, and at the same time, it brings about a great deal of international clearance, credit, guarantee, consultation and other concerning business. Securities investment is also an important business field which has attracted the attention of commercial bank. In a word, nowadays, every bank in the world has been absorbed into the international capital circulation system. And of course, the circulation of the enormous international capital also brings about a great deal of business and profit for bank.

In the near future, when Renminbi can be converted freely, the inflow and outflow of the international capital in Chinese market will become more and more frequent and active, which demands that the state—owned commercial

banks should open up to the outside world and participate the capital circulating all over the world. As the financial resources can circulate and transfer at high speed without the limitation of boundary, in the process of economic and financial globalization, the development and application of world's financial resources will result in the day-by-day fierce competition over the master control right. Considering the long term development of China's economy, lack of funds will still be the prominent problem confronting economic development. Therefore, China's commercial bank should speed up the process of internationalization, to build up the international fame, and to strengthen the funds—making ability in international financial market and thus to make full use of the international financial resources to serve the increase of domestic economy.

2.3 The internationalization operation of domestic enterprise demands that state-owned commercial banks should pursue internationalization.

The internationalization operation of enterprise and that of bank is interdependent and develops along with each other: enterprise's internationalization development need the support from the sufficient development of that of bank; and bank's internationalization degree and scale, to some extent, dominate the level of enterprise's overseas expansion; while transnational enterprise is the major customer of the internationalized bank. As to transnational bank, compared with those customers with scrapes of business, transnational enterprise has not only the advantage of quantity, but also brings comparatively less risk. In this way, on one hand, it brings about remarkable economic benefits for transnational bank, and on the other hand will also bring along the development of other bank service.

According to the general law of socialized production and the international experience, enterprises' internationalization process will generally undergo three phases: independent exportation, overseas direct investment and transnational management. At present, in general, domestic enterprises are in the first or the second stage. Although there are some enterprises that have succeed in overseas operation, compared with some large-scale transnational enterprises, they still lack competitive power. And funds-raising is especially a prominent problem that restricts enterprise's development in the process of overseas operation. On one hand, it's difficult for transnationally-operated enterprises to get the funds-aid from the financial organization of host country, so they need the help from the overseas branches of domestic banks. And on the other hand, domestic banks are deficient in overseas customers, failing to give effective support to domestic enterprise's transnational operation. Under this situation, both the development of transnational enterprises and domestic banks are hindered to some extent.

3. The Internal Motivation for the internationalization Operation of China's Commercial Banks

As financial enterprises, commercial banks also aim at capital appreciation and getting the maximum profit. Therefore, the motivation for commercial banks' internationalization is to realize the maximum profit, to pursue the increase of proceeds and decrease in operation cost.

3.1 To Realize the Internalization Advantage and Scale Economy

First of all, the internalization is one of the effective ways for banks to save cost and increase profit and banks can realize the optimization allocation of the internal resources through the easy—to—control internalized trade. Banks' internalization operation is a favorable way to realize the internalization advantage. If commercial banks set up overseas branches, when launching overseas business, they can turn to their own branches to deal with the transaction through pre-formulated procedure, and thus can save the time and reduce the cost for business transaction.

Then, the scale economy can help to realize banks' pursuit of profit enlargement. As the scale advantage of the bank is quite prominent, it can reduce the cost recovery rate and increase the capital reciprocation rate through large scale extension. For example, the findings of the survey on America's 50 big banks reveal that, after consolidation, the banks' average capital reciprocation rate has increased from 1% to 1.29%, and the general capital reciprocation from 13.6% to 15.9%, which gives sufficient evidence to show the advantage of scale economy. And banks' scale advantage is not only reflected by the scale of its network, but also by the rational distribution of the network all over the world. The rational distribution of the network all over the world enables commercial banks to raise funds from the international market in a convenient way, reduce the funds-raising cost, improve the ability for international clearance, gain market information in a more convenient way, and thus reach the aim of saving cost and increasing profit.

3.2 To Stabilize and then Enlarge the Customers Groups

Customer resources are the lifeline for commercial banks' survival and development. Along with the pouring—in of foreign banks, customers have become the competition focus of the banks both at home and abroad. And as the cultural fusion has become more and more prominent, as well as the day-by-day more frequent participation in international activities of domestic enterprises and citizens, foreign banks that can offer international service will occupy the favorable position in competition and many high-quality customers will move to those foreign banks providing international, systematic financial service from domestic commercial banks. According to bank field's "Two-Eight" theory, that is, bank's main profit flows from high-quality customers, so domestic commercial banks should stabilize and enlarge the customer groups through the realization of internationalization operation, thus to

struggle for development in the competition over customers.

3.3 To Improve the Overall Management Level of the banks

To an internationalized bank, the crucial point for its survival and development is to gain the possibly maximum profit through effective management. And at present, most of the international commercial bank are equipped with scientific management and operation mechanism, and, they are built up based on the good business management and in general , they all comply with the principle of “Benefits Dominate” , and aim at “ To Gain the Maximum Profit”. While the commonly used mechanism in the world is “Capital Balance Proportion” management, that is, along with the change in the operation environment, banks coordinate various capital and liabilities contradiction in the field of interest deadline and structure, and try to realize the rational allocation and optimized arrangement at the aspects of risk and circulation, thus pursue the combination of security, good circulation and profit--making. If domestic commercial banks set up branches in developed countries, they can learn the advanced experience from their financial market, such as the treatment of unhealthy assets, the management pattern, and business processing flow. And at the same time, they can transplant the experience to domestic and other markets to improve the level of management. In addition, there is sufficient financial products line in their financial market, from which domestic banks will learn a lot. Also, the financial market of these developed countries especially that of America, serves as the test field for new products, where the transnational banks often exercise financial innovation.

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