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What Determine Foreign Bank Entry Mode in China?

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Abstract. This paper examines the determinants of foreign entry mode choice in China's banking sector with a focus on strategic investment and wholly-owned subsidiaries. On the institution side, this paper finds that regulation/deregulation of host country on foreign financial institutions, especially the regulation on business scope and entry requirements, affect foreign entry mode choice. On the resource side, strategic investment provides foreign financial institutions access to location-specific resources, especially customer information, and then the wholly-owned subsidiaries of financial institutions would like to utilize the location-specific resources to do their own business.

Keywords: Institutions-based View, Resources-based View, Strategic Investment, Wholly-owned Subsidiary, Customer Information

1 Introduction

China's accession to the World Trade Organization in December 2001 was highlighted by the promise to open the formerly tightly closed banking system, where foreign financial institutions were guaranteed phased access to the Chinese market with the elimination of all restrictions on their business activities within five years. Moreover, China's economy has been growing about 10% per year in real terms over the last decade, and is projected by some to become the world's largest economy in the coming decades[1]. This rapid growth and large economy would bring large banking market opportunity, especially the bank lending. All these factors attract foreign financial institutions to enter into China from 2001. Many foreign financial institutions adopt wholly-owned subsidiaries and strategic investment[1] to enter into

[1] The China Security Regulatory Commission defined strategic investment as a certain scale and long-term investment in strategic acquisitions. This paper confines foreign strategic investment in China's banking sector to foreign financial institutions acquiring a minority equity stake in Chinese banks and committing to holding the stake for some period, typically a minimum of three years.

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China. And this paper would examine what determines their foreign entry mode choice in China's banking sector.

Several theories can be used to explain foreign entry modes choice such as internalization theory[3-4]; eclectic theory[4]; comparative advantage theory[5]; resource-based view[6-9]; institution-based view[7-11]. In these theories, comparative advantage theory can't explain why one form of entry mode is preferred over another [4]. Eclectic theory does not provide a unified perspective in the explanation and prediction of entry modes choice, and it also does not explain why two firms in the same line of business and with similar ownership, internalization, and location advantages would not necessarily choose the same entry mode in the same foreign market. Furthermore, extant eclectic theory ignores the impact of broad product characteristics, home country factors, and boundary variables on choice of entry mode. For both internalization theory and eclectic theory, it's also difficult to generate testable hypothesis [4].

The resource-based view has not looked beyond the properties of resources and resource markets to explain enduring firm heterogeneity. In particular, it has not examined the social context within which resource selection decisions are embedded. Therefore, the integrated approach between resource-based view and institution-based view has been identified as the insightful theories when probing into emerging economies, especially in explaining entry modes in emerging countries or transition countries[8-9]. As far as we know, no paper has combined institution-based view and resource-based view to explain the determinants of foreign entry mode choice in banking sector, especially on foreign entry into China's banking sector.

Here, this study attempts to make two contributions to the entry mode literature in banking. First, given the obvious importance of entry issues in international business, it is important to examine whether institution-based view and resource-based view are applicable in certain countries, industries, and time periods, especially in China's banking sector. Hence, this study examines the determinants of foreign entry mode choice in China's banking sector over 2001-2012 through following the work by[8-11], which examines whether the institutions and resources determine the foreign entry mode choice. Second, regarding banking sector, previous studies usually argue the entry modes choice between branches and subsidiaries. As far as we know, few of them discuss the entry mode choice between wholly-owned subsidiary and strategic investment. This paper attempts to examine choice between wholly-owned subsidiaries and strategic investment in China's banking sector using institution-based view and resource-based view.

2 Institutions, Resources, and Entry Mode Choice

Institutions include formal rules and informal constraints. Institutional-based view examines the role of social influence and pressures for legitimacy in shaping organizations' actions. When firms entry into a foreign market, institutions of both home and host country would influence the international strategies of firms, especially the foreign entry mode choice into emerging countries[8-9]. Because resources are both heterogeneous across firms and imperfectly mobile[10-11], the resource-based view examines the resources and capabilities of firms that enable them to generate a sustainable competitive advantage, which has significantly influenced recent international business literature. Regarding foreign entry modes, the resource-based view explains the differences in entry mode choice observed across firms in an industry. Institution influences the way firms manage their resources[9] and the resources of firms affect the strategy[10-11] especially the international growth strategy. Regarding foreign entry mode choice, the resource-based view incorporating the institution-based view provides a research framework, which can be seen from Figure 1.

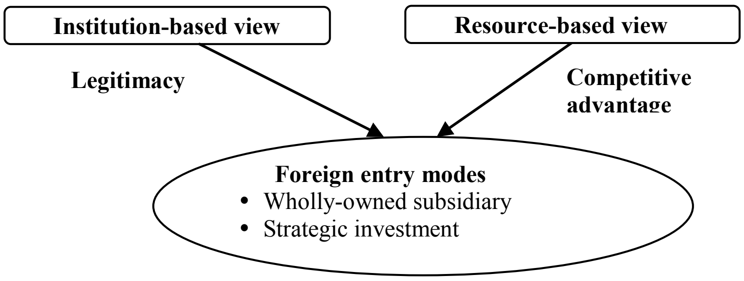

Fig. 1. Conceptual framework of institutions and resources

3 Determinants of Foreign Entry Modes Choice

Foreign entry information is got from CBRC Annual Report, the Almanac of China Finance and Banking (ACFB), Quarter Statistics of The People's Bank of China (PBC). Regulation and resource information is got from the official website of CBRC, PBC, The Wall Street Journal, The New York Times, Financial Times, Bloomberger, some Chinese magazines, and two literatures [12-13]. Before 2001, the business scope of wholly-owned subsidiaries is very limited; also the scale of foreign financial institutions is very small. In addition, strategic investment in Chinese banks is not allowed before 2001. However, from 2001, foreign banks can adopt different entry modes into China's banking sector, and the restriction on business scope is eliminated. Therefore, this study focuses on the foreign entry modes over 2001-2012.

3.1 Deregulation and Wholly-owned Subsidiary

After December 11, 2006, the foreign wholly-owned subsidiaries in China's banking sector can do the RMB business to Chinese individuals, but the branches of foreign banks just can receive a time deposit of not less than RMB 1 million each sum from a Chinese individual. For foreign financial institutions, a wholly-owned subsidiary is a good choice when they want to do the RMB business to Chinese individuals. Thus, when deregulation on business scope of wholly-owned subsidiaries is promulgated at December 11, 2006, 16 wholly-owned subsidiaries are set up in 2007, 4 in 2008, 5 in 2009, and the number of 2007 is more than that of previous 16 years, which can be seen from Figure 2. The dotted line means the deregulation on wholly-owned subsidiaries at December 11, 2006. These results show that the deregulation on foreign wholly-owned subsidiaries obviously encourages foreign banks establish wholly-owned subsidiaries. The deregulations on wholly-owned subsidiaries in China's banking sector highly affect foreign institutions' entry mode choice.

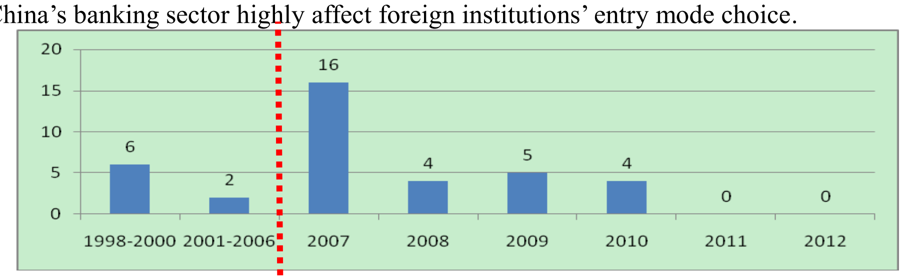

Fig. 2. Wholly-owned subsidiaries in China's banking sector

3.2 Deregulation and Strategic Investment

Although foreign financial institutions can adopt strategic investment in Chinese banks from 2001, the activities are subject to approval of cases, and the proportion of single investor investment should not exceed 15% and all investors should not exceed 20%.So, there is just Bank of Shanghai and Shanghai Pudong Development introduces foreign strategic investment over 2001-2003. However, on August 25, 2003, the Chairman of CBRC, Mingkang Liu, publicly encourage foreign strategic investments. Later, CBRC promulgated a regulation on foreign strategic investments which give a clear requirement on qualifications of foreign banks and the equity scope foreign bank can control.

Because of these encouragements, many foreign financial institutions undertake strategic investment in Chinese banks after 2003, which is shown in Table 1. In 2004, 4 Chinese banks introduced foreign strategic investment; in 2005, 10 Chinese banks introduced foreign strategic investment; in 2006, 7 Chinese banks introduced foreign strategic investment. The time distribution shows that the deregulation on strategic investments lead foreign financial institutions to undertake foreign strategic investments. Therefore, the deregulations on strategic investment in China's banking sector highly affect foreign institutions' entry mode choice.

Table 1. Time distribution of foreign strategic investment in Chinese banks

Year	*N*	Percent (%)
2001	1	3.8
2003	2	7.7
2004	4	15.4
2005	10	38.5
2006	7	26.9
2007	1	3.8
2008	1	3.8
Total	26	100.0

3.3 Resource Augmentation and Strategic Investment

Through undertaking strategic investment in Chinese banks, foreign banks can access to the local customer base and use the huge branch networks of Chinese banks. Moreover, they can not only cut down on the time, effort and money needed to build a network of branches and attract customers, but also learn about the market and gain experience that can be applied to building their own brands and doing their own business in China, which can also be seen from the interview with David Marshall by The New York Times, a banking analyst with Fitch Ratings.

Several strategic investment cases can explain their motivation on augmenting location-specific resources more clearly. For example, the Bank of Communications and HSBC have set up a credit card unit, which would sell credit cards under the HSBC brand, which means that HSBC is expanding its customer base through local partners. Another example, Industrial and Commercial Bank of China Limited (ICBC) will market and issue cards with an American Express logo. ICBC would provide American Express with customer support, and customers will be able to use the cards at any of the merchants in ICBC's existing network. Moreover, the cooperation on credit card between Citigroup and Shanghai Pudong Development Bank can also interpret the aims that foreign banks undertake strategic investments to use Chinese banks' resource. Taken together, strategic investments provide foreign banks access to augment location-specific resources.

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