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The motivation and impact on the foreign banks entrance in China

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Abstract: Since the 1970s, the world economy integration and financial globalization has become an irreversible trend. Each country is facing to opening up or further opening their banking system. The international experience shows that foreign banks' entering has a deep impact on the host country banking sector. With the deepening of China's reform and opening up and the accession to WTO, foreign banks have adjusted and accelerated their development in China. With the continuous expansion and development, foreign banks are playing a dominated position in doing business in Chinese financial market. Therefore, the studies of the efficiency influence by foreign banks entering Chinese financial market become an important research topic.

Key words: foreign banks, banking sector, motivation and impact, opportunities and challenges

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Introduction:

Since 1970s, along with the development of financial globalization and promoting the internationalization of financial services and goods, national banks have achieved multinational business through establishing branches in foreign countries or purchasing the local banks directly. At the same time, financial liberalization is further promoting the internationalization of the banking sector. Until 1980s, many countries began to adopt comparatively loose policy which can help foreign banks access into their markets. In the following more than ten years, the transnational business are growing rapidly and the banking industry has become an example of the world economic integration and interdependence of national economies.

Opening up the banking sector will inevitably cause shocks in local banking system, especially the emerging market countries banking industry seems more vulnerable. The international experience shows that there will have different affect in a result of different national conditions and policies. For example, in the Latin American countries, after opening up the financial industry, many domestic banks have disappeared. In Mexico, there is only one national bank now. While in Australia, domestic banks have fully prepared for the financial opening up by improving the efficiency. Therefore, foreign banks will be eliminated. At the beginning of 1980s, as a part of China's economic reform and opening up and in view of the status of domestic financial development and financial stability, China's banking sector adopted a cautious strategy of gradually opening up local banking industry. Since reform and opening up, foreign banks in China have developed quickly and became a force to be reckoned with in China's financial system. In 1979, the Export-Import Bank of Japan was opened its first representative office in Beijing, which opened a prelude to Chinese financial industry opening up. In the next twenty years, the opening up of China's financial markets has experienced the progress from the coast to the interior and from the foreign currency business to the development of RMB business. In 2001, China formally joined into the WTO. The opening up of banking sector was listed as

one of the initiative opening up areas. Foreign banks have significantly speeded up the pace that entered into Chinese market and launched the all-round competition to the local banks. From 2005, China allowed foreign banks to provide all the Chinese customers with business and remove all geographical restrictions. During the five-year transition period, foreign banks have widely participated in Chinese financial markets both in open area and business scope. Accompanying with the further extent of China's banking sector opening up, the number and asset size of foreign banks were extremely increased. Nowadays, China's domestic banks are facing more and more intense market competition. It will affect the local financial system and economical operation because of a large number of foreign banks accessing into the host country to engage in financial activities. And the most direct and important impact is the influence of the efficiency of domestic banking industry. In the late of 1990s', the issue has caused academic concern and lots of scholars have conducted a preliminary theoretical and empirical research. But on the whole, the opening up of the banking industry is still a new field of study especially in transition countries. Most of the existing researches are not enough in-depth and comprehensive, even there are large differences in the results. Therefore, it is necessary to discuss the topic further.

The eclectic theory of International Production:

J. H. Dunning who is British economist as a representative of the eclectic theory of international production have published an article in 1977 which is entitled "Trade, location of economic activity and the multinational enterprises: A Search for an Eclectic Approach". In this article, it is the first time that put forward the eclectic theory and comprehensively and systematically expounded the theory in the book called International production and multinational enterprises which was published in 1981. The eclectic theory of International Production believed that the enterprises which are engaged in foreign direct investment business must have the advantages in ownership, internalization and location. The ownership advantages also known as "monopoly advantage" or "competitive advantage" which is including two aspects. One is the advantage as a result of exclusive intangible assets such as technology, trademarks, organizational management, sales skills and R & D, etc. The other one is the advantage generated by enterprises' scope economy. Internalization advantages refer to the enterprises internal use their ownership advantages so as to reduce or eliminate transaction costs. The location advantage is not beyond the control of enterprises but determined by a variety factors of host country, which includes

the advantages that conferred by the immovable factors or the formation of systems, policies and infrastructure in host country.

In 1981, Gray used the theory to explain the phenomenon of transnational commercial banks. The ownership advantages of multinational banks are from two factors. One is the importance of certain key currency in international trade and finance. Because these banks have established such a good mechanism of currency transactions and they are easily access to the support from the currency lender as well, customers are willing to do the currency transactions with the banks that belong to currency distribution country. The other one is the importance of none price competition in banking services which is mainly revealed in the multinational banks can create short term advantages through the significant differences in products and get the long term advantages through the differences in foreseeable products (Yannopoulos, 1983). The significant product differentiation can be achieved by the banking service differences and the long term product differentiation is related to the size of banks and credit rating which is hard to trade in the market as well as hard to follow by other banks. Therefore, all these advantages can bring the long term advantages for banks. Location factors includes lots of elements such as the prospection of host country economic development, the different regulatory and supervisory approach to foreign financial institutions operation, the tax reduction and exemption to foreign banks, the political and economic stability, banks setting up branches caused by population movements, information collection and the meaning of acquiring skilled staffs and so on. Multinational banks prefer to set up branches in the area that can bring them maximize profits due to all these factors.

Previous researches:

At present, there is no established universally accepted point of view about the impact of the host country banking efficiency caused by the foreign banks entering. There are two views from the previous researches. The first view is that the foreign banks access can improve the efficiency of the banking system. They believe that the entrance can promote the efficiency directly or indirectly through competition effect and the spillover effect. In theory, there are three ways in affecting the banking efficiency of the host country. Firstly, market competition can improve the banking operation. What's more, the technology transfer of organization and management can improve the efficiency. Finally, the standardization and improvement of banking industry environment is taking an important

part as well. At present, most scholars believe that foreign banks entering help to improve the operational efficiency of the host country banking sector.

In the early 1980s, Gray (1981), Goldberg and Saunders (1981) have paid attention to the topic and analysis it both in theory and experience. Finally, they got the conclusion as foreign banks access help to increase the host country's banking system efficiency, but there is still no specific explanation in pathway. Ross Levine (1996) has done a more detailed analysis and further concluded the benefits from foreign banks entry. He believed that the foreign banks access is the combination between new technologies with better allocation of resources and higher bank efficiency and spread rapidly through competition or imitation. The competition in banking sector can increase the quality and availability of domestic finance service and contribute to the better use of modern financial instruments as well. Besides, it is also expediting banking supervision and legal infrastructure which is good for home country to gain capital from international capital markets, thereby promote the efficiency of the entire banking industry. As following, there is a series of studies coming up on the basis of Ross Levine theory. All the studies are indicating that the entry of foreign banks plays an active role in promoting the efficiency of the host country's banking sector through the market competition (Classens and Glaessener, 1998; Claessens and Klingebiel, 1999).

The second point of view is that the impact of efficiency caused by foreign banks entering is uncertainty because the influence depends on the number of foreign banks, the capacity of demonstration and transmission, the initial conditions of the host country financial opening up and the situation of native supervision. The core idea of the uncertainty theory is that the efficiency improvement of local banks in emerging countries is affected by other factors like initial conditions and path dependence. The efficiency enhancement depending on the foreign banks access will be different due to the differences in domestic economic development, the functioning of capital markets and the financial sector development. Stieglitz, J. (1993) who was the first one putting forward this theory pointed that foreign banks entrance bring the potential costs to local banks, local companies and government, which will offset or hampered the efficiency progress in home banking system. In addition, there will be more competition costs and pressure in local financial institutions when they are competed with large foreign banks, and there will be less financial service for domestic companies because foreign banks prefer to do business with multinational companies. Normally, foreign banks will not be in accordance with the

wishes of the host government or they are not sensitive with domestic wishes, which will result in the deterioration in national economy controlling by domestic government. There is a new point believe that there must be a close link to the initial financial development and whether it will benefit for the domestic banking efficiency by foreign banks entrance (Hermes and Lensink, 2004). If individual initial financial development has been at a high level, foreign banks entering can dramatically reduce the operating costs and operating margin, not vice versa.

Empirical researches:

The theory of the banking efficiency impact of foreign banks entrance lead to a series of empirical researches, the range involves a number of countries and the point of views are not uniform. I use a comparative method to analysis the different efficiency impact of foreign banks access according to the differences in income, geographic regions and open modes in banking sector in order to give a more in-depth definition of the efficiency influence under an international perspective. Finally, I will choose some representative countries as examples to empirical analysis separately.

The comparison among different income countries:

I will divide the different income countries into developed and developing countries (especially emerging markets countries), and analysis the influence in these two types of countries respectively.

There are already some researches in developed countries, developing countries or economic transforming countries and comprehensive research in both developed and developing countries as well. In the comprehensive research, it shows that foreign banks entrance contribute to the efficiency improvement in domestic banking system. Asli Demirguc-Kunt et al (1998) have further study the efficiency influence caused by foreign banks asset size and number, through the mixed data of 7900 banks in 80 countries (including developed and developing countries). The result suggests that the size of foreign banks assets can insignificant influence the efficiency improvement of local banking system. But the number of foreign banks shows an obvious negative correlation in total cost and pre-tax profit in domestic banking sector, which explain the situation that foreign banks entering can enhance the competition and efficiency in banking industry. Along with the path and method, Claessens et al (2001) and other scholars have done the analysis as well.

They use the same data and finally show that foreign banks in the developing countries have higher interest margins, profits and tax payment, while it got an opposite result in developed countries. In addition, foreign banks access has significant lower the total cost of the host banks. It indicates that the foreign banks entrance is indeed bring greater competitive pressures to developing countries and the competition enhance the efficiency. What's more, they found that the effects of efficiency improvement are more related to the number of foreign banks rather than market share occupied by foreign banks.

Most of studies in developed countries indicate foreign banks entering contribute to the efficiency improvement of native banking industry. Terrel (1986) shows the countries which are allowed foreign banks entering usually have contrary low rate, pre-tax profit and operating cost when he analyzed 14 developed countries of which 8 countries allow foreign banks entrance. In other words, though the competition with foreign banks would reduce the shares and profits of local banks, it can perfect the function of the banking market and the overall welfare level.

In comparison, the specialized researches on developing countries, especially emerging market countries are fewer and the conclusion is not consistent as well. Most studies show that the efficiency impact on the emerging market countries is uncertain. It may be affected by other factors, and there must be a certain degree of initial conditions and path dependence. Bayraktar and Wang (2004) took 29 countries as sample for compared research and divided them into three groups based on the degree of financial liberalization from 1995 to 2002 (including developed and emerging market countries or regions). They used the ordinary least square including dummy variables to regress the panel data in different countries during this period of time (each country's banking data is based on an annual average) and tested the standard deviation using a fixed effect and heteroscedasticity. They discussed the influence in domestic banking competitive strength which may be affected by the share of foreign banks, domestic macroeconomic variables as well as the national banking industry variables. Finally, they got the conclusion that the insignificant relevance is generally found in emerging countries, which can support the argument that there is no necessarily link between the foreign banks entrance and local banking efficiency improvement in the emerging market countries in some extent. Specific to this point, Hermes and Lensink (2004) did a more in-depth research, conducted a more in-depth research and took a new position that whether the foreign banks access is conducive to local banking efficiency improvement is related to local initial degree of

financial development. If their initial financial development has been at a high level, foreign banking entering will greatly reduce the operating costs and operating margin, while not vice versa.

Zhang and Rong (2006) used the emerging market countries from 1990s (including 7 Latin countries and 9 Asian countries or regions) and analyzed the efficiency impact of foreign banks entrance. The results showed the banking efficiency improvement in the emerging market countries can affect by the initial condition in the host country's financial development, the operating level of foreign banks, the number of foreign banks and their structure in the host countries. Therefore, the emerging countries have to pay more attention to local financial development and effectively nurture a healthy competition environment in banking industry as well as fully achieve the "absorption effect" in domestic banks and the "demonstration effect" in foreign banks.

There is also some other studies showing the banking impact is more obvious in the emerging market countries caused by foreign banks entering. The empirical tests by Berger (1999) and Classens (1999) have a certain degree of representativeness. Berger et al (1999) analyzed the foreign banks and the host countries banks operating costs and efficiency in France, Germany, Britain, Spain and America according to the data from 1993 to 1998. They found that in all these mature market countries, the cost control and profitability in foreign banks are generally not as good as the domestic banks except for the banks of America. Classens et al found that in most emerging market countries, the level of profitability of foreign banks is higher than that in the host banks after the comparative analysis of financial indicators both in domestic banks and foreign banks. While, in most mature market countries, there is no obvious advantage reflected in profitability in foreign banks compared to the local banks. Classens et al explained this phenomenon due to the differences in initial conditions. The mature market countries have loosened the control of banking industry before the study period they selected. The banking industry is not only faced to the fierce competition in interbank market, but also the competition in non-bank financial institutions. The banking operating margin is decreased due to the competitive pressure in local market which force banks to cut down the costs through merge or the application of new technology. Therefore, opening up the banking industry and the introduction of foreign banks is just further intensified the original competition but it will not form a huge impact. On the contrary, in this study period, most of the emerging market countries are just opening their banking industry up or have experienced a severe financial

crisis not long ago. Before, the banking industry in these countries is under the rigorous control such as the strict access condition both internal and external and non-market interest rates. Besides, there is lack of the competition pressure from the non-bank financial institutions as well. The domestic banking industry continues its operation under the low efficiency level by virtue of its monopoly position. In such cases, opening up the banking industry and the introduction of foreign banks is bound to a tremendous impact on domestic banking system. It is possible for foreign banks to achieve higher benefits than local banks rely on their advantages in institutions and globalization.

However, in my opinion, the above researches are only interpreted that the foreign banks is more efficiently entering into the emerging market countries rather than in developed countries, but the high level of profitability that foreign banks access to the emerging market countries does not mean that it will certainly enhance the efficiency of the host country's banking system.

The comparison in different geographic regions countries:

In the past 20 years, increasing number of developing countries were opened the door to foreign banks and more and more foreign banks entered into developing country financial system. From an international perspective, the banking sector is growing very fast over the past 20 years in many developing countries especially the ones in Latin America and Eastern Europe. The foreign banks are active in Central the banking sector in many developing countries over the past 20 years, opening up very fast pace, foreign banks in Central Europe and Latin America, but relatively flat in Asian.

● ***The efficiency impact in Latin America***

In the 1950s, mainstream development economists generally believed that the government should play the dominated role in the banking sector. In the 1980s, this concept started to change by the impact of Washington Consensus and economists have generally believed that the privatization of banks can enhance the operating efficiency of the banking system. The privatization reform of the banking sector is mainly achieved through introducing foreign investment directly, the equity participation of foreign strategic investors or internal transfer in the emerging market countries. From 1980s, Latin American countries began to further open up the financial sector. Especially, Mexico's financial crisis in 1995 gave the opportunity for foreign banks to access to Latin American market. After the Mexican financial crisis, most Latin American countries attract foreign

investment bank as the key measure for banking privatization reform in order to ease the crisis and improve the efficiency of banking operations as well. In this context, the number of foreign banks in Latin America began to increase and reached a peak at the end of 1990s.

The rapid development of foreign banks access to the Latin American region is reflected not only in possession of a large number of market share, but also reflected that the first few banks in the Latin American countries are almost controlled by foreign institutions. For example, foreign banks are always the strong competitors to its domestic banks in Argentina. As early as the end of 1994, the assets under the foreign bank control accounted for 17.9 percent in total assets of domestic banking and the Tequila Crisis accelerate the restructure of the Argentine banking sector. At first, large-scale domestic banks are acquired the bank in the brink of bankruptcy only. From 1997, foreign banks are started to involve and bought the second, third and sixth largest bank in Argentina. In 1998 and 1999, the Argentine stock market was depressed. Foreign banks further their expansion under the cover of banking market value is under estimated. Until the end of 2000, foreign banks have controlled about half of the banking assets in Argentina.

Levy -Yeyati and Micco (2003) analyzed the panel data through 8 countries in Latin America from 1996 to 2002 and finally found that the competition in banking industry declined, but the return on equity were increased accompany with the increase in the share of foreign banks. And the enhancement in market forces is achieved by the reduction of risk in domestic banks but not bring from foreign banks. Zhang (2006) proved there is a positive effect on the efficiency and stability of national banking system after comparing the operational efficiency both in Latin America banks and local banks. However, it is necessary to overcome various restrictions in order to yield a positive effect. Compared with Asian emerging economies, the operating efficiency of local banks is out of proportion to foreign banks, which means that the positive effect brought from foreign banks is not enough.

● *The efficiency impact in Central and Eastern Europe*

The banking system reform of Central and Eastern European transition countries has broadly undergone two steps: the first step is the deconstruction of a unified banking system and the establishment of the secondary banking system constituted by an independent central bank and market-oriented commercial banks. The banking system has to adapt to market-oriented reforms. but since the state-owned commercial banks were

funded solely or absolutely controlled share by the state at that time, the planned economy residues serious, the dishonest behaviors serious as well as a large number of enterprises were bankrupted, the commercial banks and government can not bear the non-performing loans, the privatization reform of banking sector is both inevitable and necessary. The second step is that during the period of early 1990s, the banking crisis emerged in Central Europe. The Central European countries have implemented the privatization reform of banking sector and attracted a lot of foreign investment in order to solve the problems in local banking system. Commercial banks were privatized and opened up the entire banking industry at the same time. As a result of the incomplete and undeveloped financial markets in Central and Eastern European countries, relying solely on domestic financial resources and financial market can not complete the commercial banking reform. Therefore, governments in Central and Eastern European countries implemented a radical opening-up policy. Firstly, reduced or even abolished the restriction for foreign banks entering which means relax the restrictions for foreign banks to establishing their branches. Secondly, allowed foreign banks buy shares of state-owned banks or acquire domestic banks as strategic investors. The large-scale state-owned banking shares selling forms the most significant feature of the present banking industry in Central and Eastern European countries. The degree of opening-up is really high in the banking market and the share of foreign banks is playing an occupied role in domestic banking market. Until 2002, the five countries in Central and Eastern Europe except for Slovenia, the ratio of foreign banks assets taken in total assets in the other four countries was more than 70 percent.

Therefore, compared with the Latin American countries, the penetration and influence caused by foreign investors are more far-reaching in Central and Eastern European countries. What's more, the controlling by foreign investors of these countries banking sector are stronger than any other countries in the world as well. At present, foreign banks have controlled the banking industry in the five countries of Central and Eastern European countries and the positive effect is remarkable.

The foreign banks entrance raises the overall financial efficiency through the promotion of the level of competition. Iiko Naaborg et al (2002) got a conclusion after they analyzed the performance of 12 transition countries as foreign banks have advantages in profitability, operating efficiency and capital adequacy ratio compared with domestic banks. However, the gap is gradually narrowed as time goes by. For example, during the period from 1995 to 1999, the capital adequacy ratio in Czech domestic banks was

significantly lower than the level of foreign banks. But after 2000, reform of the banking system with the increasing depth, the average of Czech banks capital adequacy ratio is rising rapidly accompanying with the reform of banking sector goes further, and caught up and overtook foreign banks in 2002. In Poland and Hungary, although the domestic bank's capital adequacy ratio is still lower than the foreign banks, the gap has narrowed significantly compared to the situation in the middle of 1990s. Hasan and Marton (2003) found that from 1993 to 1998, foreign-funded banks access improves the overall efficiency in the Hungarian banking sector. Green et al (2003) also confirmed that the foreign banks entrance enhances the overall financial efficiency in Central and Eastern European countries.

Chinese scholars did the same research in the impact in Central and Eastern Europe caused by foreign banks entering. Foreign capital played a major role in transformation and recovery of the entire banking system in the eight countries in Central and Eastern Europe (Li, 2006). The capital strength increased dramatically and the quality of capital greatly improved in the eight countries with the support of powerful foreign banks. The growth of capital strength makes up the operating ability and scale of banking industry. The higher management level, perfect risk management techniques and strong marketing development in foreign banks can promote the increase in the entire banking system. Xiang Weixing and Wang Da (2005) pointed out that it also has negative effects besides positive effects. For example, out of the considerations of profit maximization, the foreign banks with solid capital and reputation always pay attention to the large companies and enterprises for these high-quality customers can give long-term stable returns for these foreign banks. And empirical researches also show that big banks have defects in supply relational financing to SMEs with low transparency of information.

● *The efficiency impact in Asia*

In emerging market countries especially the Asian countries, the opening up extent of the banking sector is quite low. Most of Asian countries have set up a variety of barriers for foreign banks to access to domestic market which severely limits the development of foreign banks. After the Asian financial crisis in 1997, some countries have begun to loosen its control of foreign-funded banks, but the process of opening up is still very slow. Only 13 percent of foreign banks hold more than 40 percent banking shareholdings in total assets. There are three reasons are mainly due to the situation. At the beginning, many Asian banks are controlled by household and the interest group reluctant to transfer

ownership to foreigners. In addition, compared with Latin American countries, Asian countries are highly relied on the banking finance which has increased the difficulties for banking restructuring. Therefore, the process of reconstruction and opening up is relatively low in Asian banks. What's more, the development of capital market and internet banking have reduced the value of banking concessions in a certain extent which lead to foreign banks in no hurry to set up branches in local market.

However, Asian emerging countries paid more attention to attracting international capital in order to restructure the domestic industries and enterprises after the Asian financial crisis. The degree of banking sector opening up has improved. It is cancelled the restrictions for foreign investors that the banking share can not exceed 49 percent in Indonesia and allowed foreign ownership own all the shareholdings of non-bank financial institutions including insurance companies as well as guaranteed the foreign ownership of financial institutions in domestic countries inviolable. The foreign share in existing banks and branches are raised to 51% in the Philippines, the same as the upper limits on foreign shareholding in other industries. Korean has been significantly success in banking reconstruction registering as the Korea first bank were sold to Newbridge Capital which was established by two American non-public capital investment companies in 1994. In Thailand, there are four banks have sold to foreign institutions after the Asian financial crisis, which means that the proportion of banking capital holding by foreign institutions has increased dramatically. Hu Xiao (2006) introduced the study of benefits of foreign investment through four Southeast Asia countries which are Indonesia, Thailand, Malaysia and the Philippines and finally got the conclusion that the direct benefits are limited but the indirect impact is obvious. The entering of foreign investment has promoted the competition in banking sector, improving the overall financial efficiency. Besides, the foreign investment brought the advanced management and rich experience in market operations as well which contribute to the competition environment and market services in the host countries and promote the establishment of modern banking system. The spillover effects influence the traditional business operations even brought from small-scale foreign institutions. There were 222 banks in Indonesia in 1997, but in 2005 there was only one left through the fierce market competition and restructuring. Malaysia have combined domestic financial institutions with ten banking group and in Philippines, it is also encouraged the existing 50 commercial banks to merge in order to enhance their capital on stock and get ready to compete with foreign banks. In Thailand, the banks such as Thai

Farmers Bank have slashed wages and actively introduce new financial products like web banks, credit card services. They reinforced customer marketing either to improve the service quality. The domestic banks in Southeast of Asian have learned and imitated from foreign banks which contribute to the improvement in profitability, operating efficiency and technology. And the shareholding structure of banks started to transfer to marketization. the large number of foreign equity participate have changed the original structure and weakened the control of banking system by former major shareholders, which have reformed the internal administration structure in some extent and changed the relationship between banks and government as well as the enterprises. All of these improvements enhance the banking independence and scientificness in decision-making.

Although foreign strategy play a key role in the success of banking restructuring and reform in the four countries, there are a number of actual strategy differ from the expectation of original policy maker and bring lots of unexpected problems also after foreign banks access. First, foreign capital penetration brings the issue of financial security. In Indonesia, the government guaranteed that the deposits of public are paid by the government if the state-owned and private banks were ordered to close by the government. However, foreign banks are neither enjoy this protection, nor participate in banking capital restructuring. All the risk will be afforded by foreign investors or debtor and creditor. Since the financial crisis, there are lots of private banks operated improperly, either ordered to merge or close by the government or nationalized so that people lose confidence to domestic banks and transferred deposits to foreign banks even foreign banks have to face risk by themselves and the interest rates are really low. According to statistics, foreign banks have absorbed 30%-40% national non-governmental funds in 1999 in Indonesia and at least 20% of domestic banking interest rates were controlled by foreign investors. Second, foreign banks have advantages in strength, capital, technology and efficiency. The competition between foreign banks and domestic banks is not the network but the ability to provide financial services. They always focus on a small number of high-quality customers and the business with high risk and high profits as well as the business expanded rapidly such as company business and domestic trade financing. Moreover, foreign banks absorb the backbones of local banks as well as the customers which exacerbated the phenomenon of poor customer expulsion. Domestic banks have to engage in high-risk credit business and retail business with low profit even many banks bankrupted which is not conducive to domestic financial stability. In addition, some scholars support

that foreign banks as agents of change are necessary at the beginning of reform and should be limited then.

The empirical analysis of individual countries:

I select the success and failure experience model in Singapore and Turkey to do the case studies and draw lessons from the two countries in order to help the Chinese banking industry opening up learn from.

● *The experience and lessons of Turkey:*

Turkey is one of the first implementation of the financial liberalization reform and opening up its banking industry country in emerging countries. However, it is almost failure in nearly two decades of financial reform and opening up. The process of Turkey's banking opening up is radically from almost total forbidding foreign banks entering to opening up the foreign financial institutions and local non-financial capital simultaneously. There are a lot of reasons for Turkey's failure. Firstly, the banking market does not fully open, and there are still many non-regulatory and structural barriers. Although the Turkish government has reduced entrance barriers of the banking industry, there are lots of constraints in business and geographical distribution. Foreign banks did not really get national treatment, which means that they can not compete with the local banks equally. In addition, the banking industry is highly concentrated and hardly to form an effective competitive environment. On the one hand, Turkey's state-owned banks are protected its monopolization by the government. By the end of 1996, the total assets of five state-owned commercial banks accounted for 40.7 percent in the total assets of 56 banks, and their deposit balance accounted for 44.1 percent. State-owned banks are still in a dominant position. On the other hand, Turkey's private banks have also formed a monopoly power. By the end of 1998, the total assets held by Turkey's four largest private banks accounted for nearly half of the total assets of all private banks and more than a quarter of all banks. All of these financial institutions with monopoly power have close relationship with enterprises and government, which block or weaken the power of the new market entrants. What's more, the relationship between the government and banks are too close which is revealed in the state-owned banks provide subsidized credit to agriculture and SMEs as well as the government introduces a variety of protective measures to state-owned enterprises. Besides, banks colluded with the relevant government departments and officials to obtain benefits. All these abnormal relations are not only distort the competition

environment, but also lead to the banking non-performing assets. The last but not the least, it was still lack of supervision of the central bank and absent of efficient supervision of violation operation of commercial banks as well. It is quite similar that the officers of commercial banks misappropriate the funds into real estate and stock market and the government just uses the approach of financial support instead of straightening out or requiring quitting.

● ***The success experience of Singapore:***

Since the 1970s Singapore is becoming a regional financial center and has success in absorbing more than 100 foreign banks to enter into based on its strategic location, infrastructure, the economic cooperation in the ASEAN organization and the domestic financial stability as well. After 1997, the Singapore government adopted a series of financial reform measures in order to eliminate the enormous impact of the financial crisis. In May, 1999, Singapore Monetary Authority offered to open up the banking industry which is marking the implementation of banking reform. The opening up of the banking sector has achieved remarkable results in Singapore. The development of offshore financial services was rapidly and Singapore has become the international financial center of the world. The efficiency of the banking system has made considerable progress. From 1988 to 1995, the cost, profit level and deposit and loan interest spread in Singapore banking industry was better than other Asian emerging market countries. The rapid development of the financial sector led a sustained and steady economic growth and Singapore has finally joined into developed countries. There are some experiences help Singapore ride out the Asian financial crisis. As the beginning, there is a conditional and orderly opening according to the national situation. Singapore can be the model for the moderately opening. At the independence years, it opened the offshore financial business and limited the onshore business. This approach did not only help to use the cross-bank capital for local and develop national economy by international financial services, but also avoid the domestic small open economy by external shocks. The Singapore government gave special attention to effectively protect the local banks through the selective introduction of foreign banks and other operational constraints to give a chance for local banks. First of all, only the foreign banks with excellent reputation and rich experiences can enter into the Singapore financial market. These advanced foreign banks can bring senior management personnel and professional knowledge as well which can be imitated and learned from. Secondly, different banks can get different license that both introduce foreign banks and restrict them.

The Singapore government encourages local banks to merge and reform in order to enhance their competitiveness and take the initiative to meet the challenge of foreign banks. Until 2001, there were 9 local banks left and formed 5 major financial groups. In the past 20 years, local banks in Singapore have developed rapidly. Besides learning the advanced technology, improved the corporate governance structure and strengthened the power through mergers as well. Finally, after the improvement of local banks, open-door policy of banking industry came out and supported by domestic banks. The banking efficiency will upgrade accompanying with the further openness of foreign banks. The norms of the credit and risk management contribute to the success either. The commercial banks in Singapore have implemented a strict management in proportion of assets and liabilities and assets risk management in order to improve the operational efficiency. What' more, they focus on the business policy of profitability, security and liquidity and balance them in the operation process. The legal control of punishment is minimizing the risk as well and the ratio of bad debts is controlling fewer than 2 or 3 percent. Thirdly, there is an effective financial supervision. The main management of banking operations contents of capital adequacy ratio, the minimum reserve assets, loan limitation, investment, the preparation of fund and bad debts and so on. In sum, the high level of financial regulation has created an effective operating mechanism for the banking industry and it is the main reason for Singapore's success. The commercial banks do business in accordance with international usage and the local laws and regulations and strengthen the risk management according to the principles of safety, liquidity and profitability.

The researches in the Chinese context:

China is a developing country as well as a transition country and has gradually grown into the main part of the world economy. An increasing number of foreign banks target China as their potential market in order to strengthen the development of their own. Based on the previous researches and the special conditions of China, I believe that the impact on china's banking sector caused by foreign banks entrance is uncertain which is decided by Chinese special national conditions. Like other emerging countries, China's banking market structure has the characteristics of backward, inefficient operation and lack of management (Ye, 2006). In addition, china's banking system has its own specificity such as the high degree of monopoly of the banking market and the banking property rights still state-dominated due to the financial depression and banking system which is formatted in

the period of china's planned economy are as the important means for government implement industrial policy and payment of state-owned enterprise reform cost during the period of economic development and economic system transformation process(Wang, 2008). Until nowadays, the big four state-owned commercial banks still hold more than 80% market shares which lead to the lack of financial stability (Wen, Cai & Gao, 2000). All of these factors will increase the negative effect on full liberalization of the financial sector. However, foreign banks have absolute advantages in operation and management, asset quality, human resources and product innovation (Li, 2006). For example, foreign banks have many management experiences, flexible business strategies, service network in global range, strong capital strength, high-quality personnel and incentive mechanism suited for the market economy. Therefore, the impact of foreign banks entering is complex in this context. The research is more and more necessary and urgent in order to settle the current difficulties and help the domestic sector facing the challenges. For the cases, taking effective measures and minimize risk which will help to achieve revenues maximization (Li, 2006). There is significant realistic meaning for national economic security, stability of political and social as well.

Method of data analysis for the development of foreign banks in China:

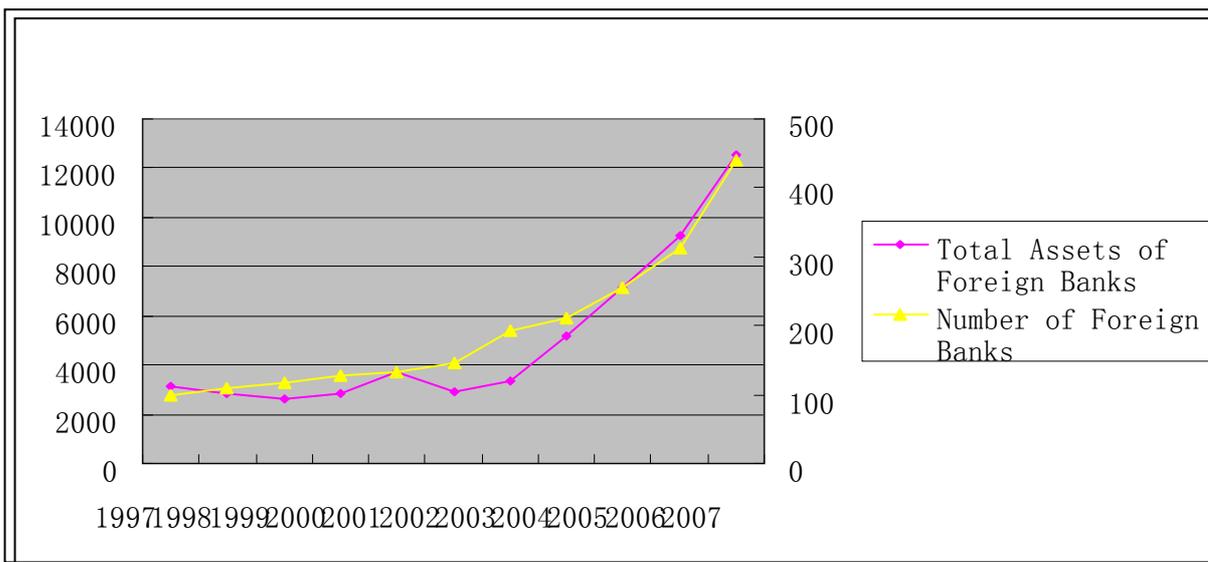
After the reform and opening up, foreign banks were already made great development in China. Until the October in 2007, total assets of foreign banks have reached to 153.9 billion U.S. dollars, and the number of operating agency reached to 426¹. According to foreign banks setting up branches in China, it will be generally separated the development process into four periods (He, Fan, 2004). The first period is called starting stage from 1979 to 1990. In 1979, China allowed foreign banks to establish non-profit representative offices. Export-Import Bank of Japan was born in Beijing firstly and signaled that China have opened its financial industry to the world. In May, 1980, China began to allow the establishment of representative offices of foreign financial institutions. In 1981, China allowed foreign banks to set up profit organizations and engage in foreign exchange financial services in the five special economic zones in Shenzhen, Zhuhai, Shantou, Xiamen and Hainan. In 1985, People's Bank of China was promulgated the regulation called Regulations Governing Foreign Banks and Joint Chinese-Foreign Banks in Special Economic Zones of the People's Republic of China, which allowed foreign banks to set up

¹ The report of international financial market, 2007.

operating agencies in special economic zones officially and open the outside world to Chinese financial industry. In 1990, Shanghai became the first coastal city brought in foreign banks profit institutions. In this period, the development of foreign banks was restricted, but it was moving toward to opening up. The foreign banks that entered into China in this period are almost the traditional banks in Hong Kong or Japan and the United States. What's more, foreign banks can only engage in exchange business in enterprises with three kinds of capital and foreign residents. The business in foreign banks was primarily focused on the domestic enterprises invested in China and the main reason for foreign banks entrance is to following their customers. The number of representative offices of foreign banks was rising rapidly and significantly more than the number of branches of foreign banks during this period. The second period is from 1991 to 1997 which is called the rapid development and expansion period. During this time, China's reform and opening –up has experienced for a decade and has made great achievements. Foreign institutions believe that China will be a promising market. At the same time, Shanghai became the biggest powerful economic region and the first city outside special economic zones attracted foreign banks as well. The opening of Shanghai and Shenzhen Stock Exchange has marked new period for China's capital market development. In the early 1990s, it was the fastest-growing period in foreign trade and foreign direct investment. The big demand for foreign financing is a good opportunity for foreign banks development. Furthermore, the interest rates were higher than the one in international markets caused by the overheating of China's economic development. There were two aspects. On the one hand, this situation attracts a large number of foreign capitals to the Chinese market for higher profits through the operation of foreign financial institutions. On the other hand, foreign banks have a great cost advantage comparing with domestic banks that contribute to foreign-funded enterprises seeking lending and services through foreign financial institutions (Guo, Zhang, 2005). The third period is called contraction period from 1997 to 2000. Since 1997, foreign-funded banks in China experienced three years of contraction, and their total assets in China have been negative growth from 37.92 billion U.S. dollars in 1997 fell to 31.79 billion in 1999. By the impact of financial crisis in South east of Asia, China's foreign trade grew slowly or even negative growth. At the mean while, the domestic economy in trading partner like Japan and South Korea has suffered serious losses so that foreign banks markets in China have shrink down (Berger, et al, 2000). In addition, since 1998, China's macro economy has broken away from the shortage economy

and begun a comprehensive situation of supply exceeding demand. The central bank have cut down the interest rate for nine times in a short time in order to stabilize economy development which means that foreign banks no longer have the cost advantage, and lead to many three-capital enterprises reduced foreign-fund loans and turned to Chinese banks for financing in order to evade the pressure of RMB devaluation. After all, all these reasons resulted in the decline of foreign banks in China. During the period from 2001 until now, it is called the new development period. In 2001, China joined the WTO formally and committed to allow foreign banks began RMB business to Chinese enterprises in two year as well as in five years remove all geographical restrictions and comparing with local banks, foreign banks have the same approval conditions to do business with all Chinese customers and set up their branches. Along with the expansion of operation policy, it is surprised that foreign banks did not show their market occupation but more convergence than before. It is indicated that there are profound changes and adjustments of foreign banks operating and development strategies in China. Until the end of May, 2007, there were 42 countries foreign banks set up their branches in 25 cities in China and there were 186 foreign banks and institutions in China. As a whole, in these years the assets of foreign banks were growing fast, the profitability raised rapidly, the assets quality improved steadily as well. Until the end of 2007, the total assets of foreign banks amounted to 989.6 billion Yuan increased more than 1.62 times compared to 2001. The average annual growth rate of total assets was nearly 19.71 percent. The total RMB assets were 407.7 billion which was more than 7.43 times than 2001. The average annual growth rate in the former 5 years was 46.95 percent. Foreign currency assets reached to 581.9 billion Yuan, an increase of 0.77 times compared to the end of 2001. Non-performing loans rate was 0.6 percent, decreased by 0.18 percent over the previous year and the cumulative rates reduced by 7.76 percent in the former five years. The former five months in 2007, the total cumulative profit of foreign banks reached to 3.05 billion Yuan and raised 42.72 percent than that in 2006².

² Mervyn Jacob, Foreign banks in China May 2007. Financial Services, Banking & Capital Markets.

Table 1 The Development of Foreign Banks in China

Data: China Statistic Yearbook from 1997 to 2007

Table 1 shows the development of foreign banks in China in the view of total assets and number. It can clearly demonstrate that both the total assets and number of foreign banks have a jump from 2001 after China accessed to WTO.³ Since 1997, the number of foreign banks has increased and especially from 2003, the number increased dramatically. It has a growth nearly 2000 new branches were opened for each year which means that the foreign banks have speeded up their development in China. However, the total assets of foreign banks grew in another way. From 1997 to 2001, the total assets have no significant changed because of the ASIAN financial crisis. During the end of 2002, the total assets of foreign banks even have a slightly decrease. However, from 2003, the total assets of the foreign banks have increased dramatically together with the number of foreign banks have increased. And at the end of 2007, the total assets of foreign banks have reached 13000 US dollars and there are more than 400 foreign banks have opened their branches in china.

What's more, the geographical distribution entered by foreign banks expanded gradually. The pattern that foreign banks entering into Chinese market is a gradual manner and the preferred areas are big cities as Beijing, Shanghai and Guangzhou or the developed economy zones like the Bohai Sea, Yangtze River Delta and the Pearl River Delta (He, Fan, 2004). Now, there are more than 20 cities across China have allowed foreign banks to set up their branches or do business. Along with the encouragement of national policy and the expansion of opening up financial markets, foreign banks gradually became aware of

³ China Statistic Yearbook and China Financial Yearbook, 2007..

the advantages of China's vast territory, and will pay attention to the underdeveloped rural areas instead of the economically developed eastern cities. In addition, they will constantly improve their own business scope of services and extends their service to the rural areas in the central and western regions which is called the gaps in Chinese financial market. Table 2 exhibits that the regions that foreign banks choose to do their business in China.

Table 2 *The distribution of the number of foreign banks and total assets in China*

region	number of foreign banks	proportion of total number of foreign banks	total assets(billion Yuan)	proportion of total assets of foreign banks
Shanghai	114	25.90%	7370	58.84%
Shenzhen	38	8.60%	637.7	5.10%
Beijing	111	25.20%	1052	8.40%
Guangzhou	28	6.40%	541	4.30%
Tianjin	23	5.20%	452	3.60%
Xiamen	18	4.10%	364	2.90%
Dalian	9	2%	185	1.80%
other western cities	25	5.70%	486	3.90%

Data: The research report of china's banking sector, 2007.

As it is shown in Table 2, the major regional distribution that foreign banks do their business focus on the areas which are the fast economic growth or the ones are wealth accumulation areas because their effectiveness of institution is caught foreign investors' attention. However, with the policy which encourage foreign financial institutions provide support for the development of the west regions and revitalizing the northeast rust belt went deepen as well as the expansion of Chinese financial services region, the geographical distribution of foreign banks will extend to the central and western regions in China. What's more, from table 2, we can easily see that the biggest proportion of total assets of foreign banks is Shanghai, which accounted for almost half of the total assets. Shanghai and Beijing play dominated role in the number of foreign banks. The number foreign banks in these two cities accounted for half of the total number of foreign banks in China. We have to pay more attention to western cities as well. Although the number of foreign banks

in the western regions is not too many, the total assets of this region are about 486 million dollars. Foreign banks have transferred their attention from the fast economic growth areas to the central and western regions in China.

The motive analyses of foreign banks enter into China:

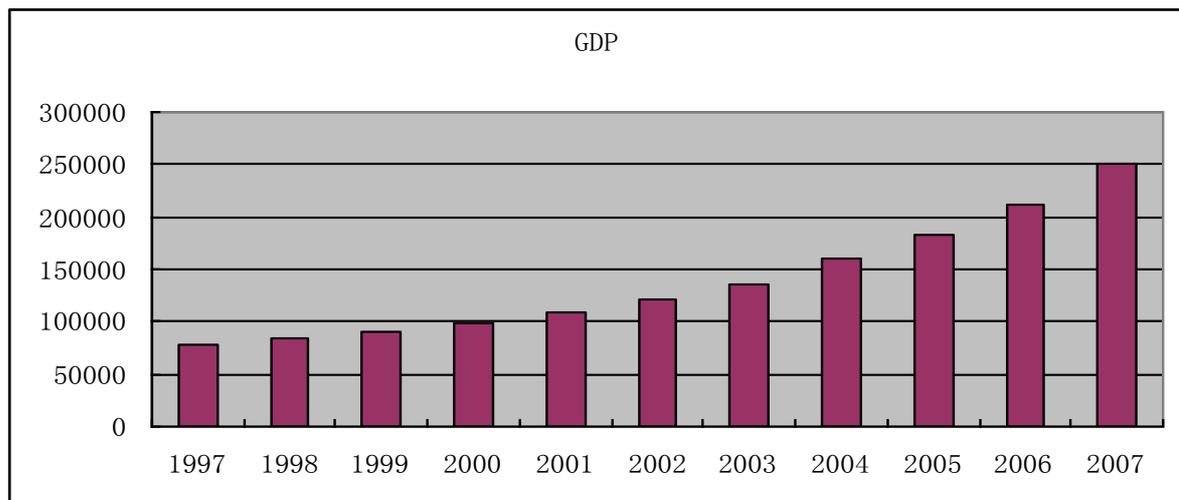
The definition of foreign banks entrance is that foreign banks operate business in the host country through establishing branches or set up subsidiaries in the host country (Huang, Xiong, 2005). There is close economic and trade relations between the countries that foreign banks choose to access and the home countries such as the extent of the market opportunities and the restriction on absorbing foreign investors. All these factors will affect the pattern and timing of foreign banks entrance (Li, 2006).

Combined with China's specific circumstances, the first foreign-funded banks entering into China are basically the internationally renowned institutions with a long history and good credit reputation. These foreign banks have been relatively well developed in their home countries and the development spaces reduced as well as they have absolute advantages in the amount of customers. The market in their own countries has not able to meet the needs of its profit advancement. In order to pursuit the interests of their needs; they are constantly searching opportunities for expansion. Nowadays, they pay more attention to the global market and seek opportunities to enter into foreign markets which will help them to achieve the internationalization goals.

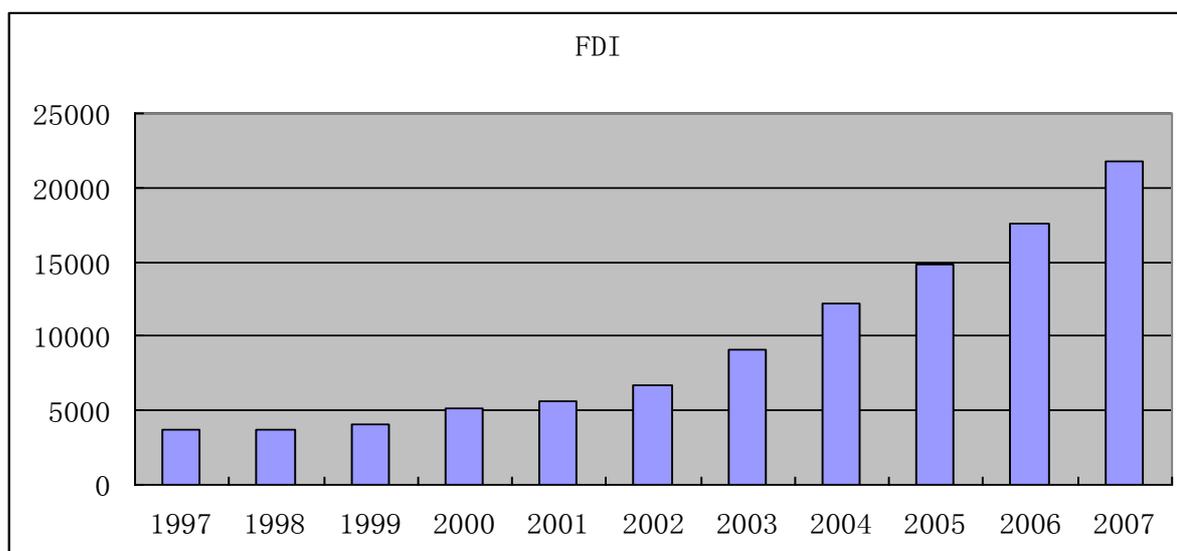
One of the main reasons that foreign banks choose China is because the economic and trade relationship is increasingly close between the home country and China (Huang, Xiong, 2005). With China's reform and opening-up, the Chinese economy began to take off. Especially after 2001, China have joined into WTO, Chinese economic construction is further developed and the cooperation with foreign partners was getting closer and closer through the keeping opening up on different industries. Accompany with the increasing number of foreign banks, more and more foreign clients do trade and investment in China. The foreign banks come to China to establish branches in order to retain the customer resources that are searching for overseas investment opportunities. In a word, it is the pattern called following the client-based access (Hu, Zhang, 2004). Another reason for foreign banks access is to strive for the enormous market opportunities in China. There are a large number of wealthy residents accompanied by Chinese economic development. In addition, more and more people joint into the economic and trade sector; the wealth is ever-

increased which means that the national income is corresponding growing. However, as a result of the non-maturity of the Chinese economy, the CPI is really high and the inflation rate is higher than the actual saving interest rate which means that the funds are continuous depreciation in fact. Therefore, the residents will find new investment opportunities to the purpose of capital appreciation. It will be more diversified investment opportunities by foreign banks entrance in order to meet customers' needs. From the macro perspective, it is given an opportunity for foreign banks because of the reduction of entrance restriction and the resistance is definitely decreased. The access restrictions usually reduce the degree of competition, thereby protecting the benefits of domestic banks in some ways. With the gradual relaxation of access restrictions from semi-open to the process of opening up, Chinese began to welcome foreign investment institutions to China and domestic banks have begun to participate in international competition. It is the smaller shield that provides favorable conditions to foreign banks.

Table 3 *China's GDP growth from 1997 to 2007*



Data: China Statistic Yearbook, 2007.

Table 4 *China's FDI growth from 1997 to 2007*

Data: China Statistic Yearbook, 2007.

As the above two tables show, it is the GDP and FDI data of China from 1997 to 2007. During the decade, both of China's GDP and FDI have dramatically increased especially after 2001 that China entered into WTO. The GDP and FDI were 78973 and 3704.2 in 1997 and reached to 251483.2 and 21737.3 in 2007. All these evident show that the Chinese economy has already rapidly developed and China have attracted foreign banks attention to enter in.

Method of comparative analysis:

The entry of foreign banks has undoubtedly brought about profound effects to Chinese banks, but also brought about unprecedented opportunities and challenges either. Chinese banks can directly absorb the advanced management methods, innovative financial products and excellent services of foreign banks. At the mean while, it is an opportunity for Chinese banks to clear recognize the advantages of their own and make up their own deficiencies. According to World Bank (2002), the benefits contributed by foreign banks entering were summarized. Firstly, foreign banks entering into the domestic banking sector will help to improve the efficiency of local banks, and the competitive pressure could reduce the cost of domestic banks which will increase profits (World Bank, 2001). Secondly, the allocation of credit resources in private sector is expected to be improved because credit risk assessment and pricing will be further improved (Barth et al, 2001). Thus it helps to promote economic growth. Thirdly, foreign-funded banks' entrance will

good for improving the regulatory and legislative framework of national banking system. Fourthly, foreign banks are able to provide a more stable credit resource because they can turn to the home country bank to get more money as well as they are more likely to enter into the world market. On the contrary, the domestic financial market is more vulnerable to shocks. However, the situation in China has its own characteristic. As following, I will compare the advantages and disadvantages between foreign banks and Chinese banks available from the four aspects.

Firstly, foreign banks operation strategy and capital strength was accumulated in the development process that they have been developed in the host country for nearly a hundred years or even longer. Therefore, the profitability of foreign banks is much higher than Chinese banks (Ye, 2006). At the beginning, in the manner of management, foreign banks are based on market-oriented principle and use the market movements as their operation concept which will contribute to flexibility and innovation (Ye, Feng, 2004). While Chinese-funded banks have been implementing the operation mode under the unified business model of People's Bank of China and the operation ways has changed until the reform and opening up. However, due to the long-term government intervention, the management approach is rigidly and there is still lack of management system. Foreign banks have already completed the transformation from industries managed respectively to industries managed overall and have extensive experience in the mixture operation mode as well. The foreign banks that entered into the Chinese market are comprehensive international banks rich in capitals and operations (Tan, Ding, 2005). Besides, they have developed a global network of branches and customers. They are providing foreign exchange deposit and credit and settlements to the customers as well as providing clients with mergers and restructuring service in a short period of time because of their advanced technical support and network converge, flexible way of risk control and convenient and fast service program. While, compared with foreign banks, Chinese-funded banks can now implement separate operation only. They can only provide customers with a relatively narrow range of services and the technical level is relatively backward which is hard to form strong network coverage. Even if some of the services have become the form of networking, but as a result of costly procedures, there are still few customers would choose such a service for business. In addition, in the management aspect, foreign banks have been keeping the principle of people-oriented. It is employees that are principle-oriented with a flexible and effective management. They advocate active working environment and

actively encourage and adopted the ideas and reasonable proposals put forward by staffs. At the same time, it is implemented employees encouragement principles that all the employees contributed to the corporate have the opportunity for promotion and pay rise. In addition, the internal setting and division of labor in foreign banks are relatively elaborated. There are different senior managements to charge different departments. It does not only need more professional staff, but also limit the scope of management responsibilities to prevent potential risk in management confusion. And the Chinese management way is quite simple and old. The division of rights and liabilities is not clear and even the phenomenon of the right to cross-sector is common (Pei, Shi, 2004). Therefore, the lack of management is the important reason for criminal violation and corruption. What's more, in the employing mechanisms, foreign banks attract the bulk of the outstanding financial professionals to join in because they can provide their employees with a broader platform and the personal development space. They will provide the opportunity of training abroad timely to continuously improve the level of operations and deeply implant the corporate culture in the hearts of each new employee when they are just orientation. Moreover, the mechanism of competition is also popular in foreign banks and the internal recruitment is really common in the case of job vacancies. Through competition based on individual ability and personality of their own, it will maximize their own potential and it will good for the corporate operation as well. However, the management of Chinese banks is relatively old mode and it is incoordination in employee needs and job placement. The phenomenon of "back door" and "Guanxi" in job recruitment is nothing new (Li, 2005). Table 5 shows that the foreign banks have their own corporate culture for their development in China.

Table 5 Different corporate culture of foreign banks

Banks	Banking service tenet
HSBC	Long term customer relationship under the ethical standards; higher productivity in group work; creation in the best self-confident feeling; international features and cautious attitude; creativity and strong market perceptive ability.

Citi Bank	Respect employees in both work and leisure activities; all consider for customers; individual and coordination; honesty and trustworthiness; continuous learning and remain open attitudes for different ideas and new things; honor and always hold of quality products and services.
JPM	Mission, targets and values.
Bank of America	Justice; mutual trust and team spirit; compatible coexist; seek common ground while reserving different, victory, leadership.
BNP Paribas	Responsibility; creativity; ambition; reaction ability.
Deutsche Bank	Performance; innovation; take the customer as the center; teamwork; honesty.
Bank of Tokyo-Mitsubishi	The basic principle of trust and reliable; offer a wide range of financial service; bring prosperity for customers from domestic and abroad; continuous create social and economic value.
Hang Seng Bank	Service is supreme, customer first; bank staff is the most important assets; taken from society, with society.
Standard Chartered Bank	Courage; responsibility; internationalization; creativity; sense of trust.

Data: Chinese web pages of foreign banks and the World Culture Net

Secondly, as the host country, the Chinese banks have large number and widely range of service coverage as well as a large number of client resources (Liang, 2005). The client's market share is over 90 percent before the allowance of foreign banks entrance. However, with the Chinese market gradually opens, foreign banks increased the pace of competition and resulted in a situation of seize market share. Foreign banks entered into Chinese financial market in the way of establishing legal institutions, setting up branches and representative offices and the form of mergers and acquisitions to achieve their profit purpose. And all these means gradually open the door to China's financial markets.

Table 6 *The case of foreign equity participation in Chinese banks*

Banks	Foreign equity participation	Share of ownership
Bank of Shanghai	HSBC, IFC, Hong Kong Shanghai Commercial Bank	18%

Nanjing City Commercial Bank	IFC	15%
Shanghai Pudong Development Bank	Citi Bank	5%
Xi'an City Commercial Bank	Bank of Nova Scotia, IFC	24.90%
Industrial Bank	Hang Seng Bank, IFC, GIC	24.98%
China Everbright Bank	ADB	1.90%
Shenzhen Development Bank	Newbridge Capital	17.89%
Bohai Bank	Standard Chartered Bank	19.90%
China Construction Bank	Bank of America	9.10%
Bank of China	Royal Bank of Scotland	5.16%
Bank of Communications	HSBC	19.90%

Data: The foreign banks equity participation in Chinese-funded banks' annual report, 2007.

From Table 6, it is easy to see that the scale and importance of participated banks are gradually improved, transforming from the city commercial banks and joint-stock commercial banks to the state-owned commercial banks. At the same time, the object of equity participation expanded from commercial banks to other financial institutions which aim to evade the Chinese mixture operation restrictions and obtained the comparative advantage in the competition with domestic banks. In addition, the ways to participate in local banks are diversify. As the implementation of QFII mechanism as well as the speed up of listing process of Chinese commercial banks, it is hard for foreign banks to merger through the stock market (Guo, Zhang, 2005). The influence of bank equity participation is gradually deepening as a result of the share of foreign equity is constantly increasing. What's more, foreign banks prefer to customer-centric strategy instead of market share of product-centered strategy sine foreign banks have constraints in sparse network (Yi, 1997). At present, the major customers absorbing foreign banks are corporate customers such as the large corporations in major industries, multinationals and large-scale private enterprises, institutional customers including banks, insurance, securities and investment funds and individual customers which are almost the high-end customers in well-developed areas. Since 80 percent of banking profit comes from the 20 percent high-end customers, it is necessary for foreign banks to seize these high-end customers to maximize profits. For

example, providing consultation, analysis and program design to high-end customers for financial management, investment and financing, mergers and acquisitions, asset and debt restructuring and business development strategies. All these services will play the advantages of mixture operations of foreign banks. It can not only upgrade the service level of high-end customers, but also gain sizeable advisory fees. In addition, the credit risk faced to the financial operations of the high-end customers is also less than the ordinary customer. Therefore, the target for foreign banks is the development of high-end customers. In July, 2007, Standard Chartered Bank private bank was opened in Shanghai, the target population is who the one with more than one million U.S. dollars of assets. It is a very good description of the market position of foreign banks.

Thirdly, since foreign banks have a number of outstanding personnel in the financial sector who are returning from overseas, they always provide strong support for knowledge and able to grasp the market trend, then develop financial products meet the market demand in the first time (Lu, 2005). Foreign banks entrance brings more mature financial products to china, at the means while they develop some special products and service in accordance with the actual situation of the Chinese market. The high profit and high tech products always attract foreign banks attention such as the trade finance services, cash management, credit card business, online banking, financial derivatives business and other financial products agent. However, we have noticed that foreign banks now are trying to monopoly on technology products except for introduction of financial products. One of the major means is setting up patent barriers through the application of financial products patents. Now, personal financial services have become the most important RMB business in foreign banks RMB business. At present, some powerful foreign banks have started personal financial service like “Premier” and “Priority financial management” in Beijing, Shanghai and other cities (Chang, 2001). In my opinion, foreign banks are concerned about the international market and grasp the market trend in the first time. But in the domestic market, the only way to arouse interest of foreign banks is the foreign listed enterprises with potential development. Compared with foreign banks, state-owned commercial banks only concerned with domestic A-share market and the financial product is relatively simplified. There have risk prevention and circumvention in foreign financial products. For example, one of the recent financial products introduced by Standard Chartered Bank is a non-insurance financial product focusing on the ASEAN region. Although it is a financial product, but the link is related to the four funds in order to spread

the investment risk. And the product character is that it is the hedge funds and leveraged investment. In other words, when it is in a bull market, the Fund will hold a 1.2 times zoom. While, it will selling the corresponding index in a bear market in order to ensure the appropriate investment revenue. This is the second investment risk separation. But for the fund products in Chinese banks, there are almost no risk aversion measures. The final fund net is determined by the market. It is the reason for lots of funds net value declined rapidly in the recent stock market and even below the net value of one Yuan. For the abroad financial business of foreign banks, they have a comparative advantage in comparison to the Chinese-funded banks. Foreign banks can be more direct to get more financial products from the offshore banks and master the first chance to provide more diversified overseas financial products to customers. For example, a foreign exchange financial product focus on agricultural introduced by the Bank of China recently was similar with the one of financial products linked index of agricultural launched by Standard Chartered Bank but it was as early as two months ago. Grasp the timing of the market, it is clear that foreign banks are more hypersensitive than domestic banks which will affect the virtually earnings of investment products (Kumbhakar, S., and Wang, D. 2007). What's more, foreign banks can make direct investments in foreign currencies like Hong Kong dollars, U.S. dollars, Australian dollars and achieve higher return than RMB as well as the direct investment in such a manner can circumvent exchange rate risk caused by exchange rate fluctuations.

Fourthly, foreign banks are emphasis on the quality of service to customers as a result of their people-oriented principle. Therefore, service is very humanization in the process of customer (Guo, Zhang, 2005). Foreign banks can provide a more comfortable negotiate environment and one-on-one independent communication space which will offer a more professional and privacy environment for customers. The one-on-one service means that each guest will have a financial manager with rich investment experience which will offer a more professional service. The manager will more accurate and comprehensive grasp the customer needs through long-term cooperation and provide more professional and targeted recommendations. The work efficiency is effective contributed by their clear division of labor that other officers will give backward support in flow of work (Leung, M. K. 2000). All the contents have to fulfill by customers under the client manager administration. The risk will be revealed in the contract either. All the cash business will do with a signature rather than transaction password. On the one hand, it can ensure the interests of banks and avoid risk. On the other hand, it can ensure the safety of customers' funds. In the view of

customer management, each manager has to establish a special customer management system based on the customer's investment style and risk partiality. It will good for them to provide income return on the product and new product introduction to the customers regularly to meet the various needs. Foreign banks are paid more attention on the latter customer maintenance to experience their humanized service. However, the service in Chinese-funded banks is lagged behind with lower efficiency and lack of post-maintenance services. The software and hardware have to be improved either.

Through the above comparison of four aspects, it shows that foreign banks has a clear advantage not only in the management philosophy and supervisor mode, but also in service level, service means, the capacity of financial innovation, human resources and the profitability. Chinese banks should seriously learn from the comparative advantages of foreign banks and exert their own advantages of good conditions in high-impact, large number of branches and high market share in order to promote the development of China's banking industry, so as to service for China's economic development.

Successful cases of foreign banks in China:

- ***Citi Bank:***

In April 2007, Citibank as one of first batch of foreign banks in China established its local corporate bank called Citibank (China) Co. Ltd. and 4 billion RMB registered capital are wholly-owned to Citibank of America. Citibank (China) has eight branches of wholesales banks in Beijing, Tianjin, Shanghai, Chengdu, Guangzhou, Shenzhen, Hangzhou and Dalian and two representative offices as investment banks both in Beijing and Shanghai as well as 24 branches of personal consumption banks providing internal software development, technical services and data processing business. The number of staffs in China was from 150 in 1999 raise to 3500 nowadays. Citibank China gained QDII qualifications in 2006 and allowed to do the international investment on behalf of the Chinese companies and individuals. At the mains time, it is allowed to provide overseas financial management services and safeguard and administration to Chinese financial institutions.

In the capital market and corporate banking business, it deeply involved in the Chinese restructure, privatization and IPO process, and completed the IPO business with China Life Insurance and China Netcom successfully. Besides, it helped China Coal and China CITIC Bank to be listed one after another. Citi bank became global expansion

strategy consultant of Chinese state-owned enterprises and provides financial advisory services to Petro China Company Limited. In 2007, the record of Citi global transaction in China achieved another peak and maintained its leadership in cash management, trade services, securities and fund business. In addition, Citibank China is the first foreign bank to obtain qualification of QDII and serve as the market maker for Chinese overseas-listed A-share funds. What's more, Citibank China maintain close cooperation with the four major state-owned banks including mutual clearing arrangement which will help Citi Bank use 26500 branches in China and more than 100,000 national point- of sale for RMB business and the four major state-owned banks could use to Citibank's global network and facilities to engage in foreign fund business. Finally, Citibank is the leading bank in trade finance services for importers and exporters and domestic traders as well as maintain its leading edge through advanced trade financing program, the largest funds team in foreign banks and the qualification of foreign exchange market maker in interbank market.

In the individual consumer finance business, Citibank China cooperated with Metropolitan Life Insurance to launch an investment connecting to insurance in 2007 and introduced QDII open-end overseas mutual funds which help it to become the first foreign bank to offer mortgage service. In 2005, the cooperative relations were established between Citibank China and Bank of China which lead to the usage of UnionPay cards and international of Citi Banks in the global wide. Chinese business now include do international and foreign currency transactions through various channels, comprehensive account business and foreign currency investment products.

To sum up, Citibank China have achieved outstanding accomplishments in China. In 2007, its operating income increased 99 percent and reached to 2.2 billion RMB, net income was 665 million RMB. In 2007, deposit and credit raised rapidly. Compared to 2006, total credit increased 30 percent and total deposit jumped 70 percent. At the end of 2007, the rate of non-performing loan was 0.2 percent and the ratio of loan-to-deposit was far lower than 75 percent which is the standard of regulatory requirements. Until Dec 31st, 2007, the total capital adequacy ratio reached to 11.34 percent⁴.

- ***HSBC China:***

HSBC China that wholly owned by Hong Kong and Shanghai Banking Corporation Limited were opened in April 2nd, 2007 and the head office was located in Shanghai. Hong Kong and Shanghai Banking Corporation is one the largest investment bank in the

⁴ Annual report on the competitiveness of China's commercial banks (2008) and citi bank official website.

mainland and become a shareholder in Chinese financial institutions. The total investment is more than 5 billion USD, of which 19 percent stake in Bank of Communication, 16.8 percent of Ping'an Insurance and 8 percent of Bank of Shanghai.⁵

On the one hand, as the full liberalization of Chinese financial markets, HSBC China has provided RMB service in 15 cities including deposits, mortgage loans and a range of investment products, which is the foreign bank with most widely geographical scope of RMB service in China. At the same time, it has also provided a wide range of foreign exchange services to local residents, foreign-owned enterprises and compatriots in Hong Kong, Macao and Taiwan. There are more than 15,000 employees in the company, of which 98 percent are local talents. HSBC focuses on the cultivation of local talent and the "trainee banker" is committed to developing local talents in banking business with international experience. On the other hand, HSBC provides customers with a variety of financial and banking services (Brian, 2006). Firstly, for the enterprise and business services, HSBC China arrange RMB and foreign currency financing for large Chinese enterprises and institutions including working capital, international trade, fixed asset financing, project financing, syndicated loans and the group commissioned loans. Secondly, it provides RMB business to local companies and foreign investment companies in all the branches in 17 cities⁶. Simultaneously, all the domestic companies can get foreign currency service in each branch. Thirdly, HSBC China draw up all-round funds administration for enterprises to enhance their operational efficiency and provide flexible account services through HSBC' network and improve liquidity management as well. At the same time, it cooperates with local banks to speed up the customer's trust through the usage of local bank clearing system and network. Fourthly, HSBC China supply variety of import and export trade services and trade finances services which is included factoring services, import letters of credit, export letters of credit notification, transfer and non-recourse discounting bills and so on. Fifthly, HSBC China has rich experiences in hosting services and the service area distributed in the offshore banking services of commercial banking services, B shares trusteeship and settlement and the security depository provision of A shares. It has leading market share in custodian services of B shares and QFII and provides trusteeship service to inter-bank bond market and the overseas and domestic insurance companies. Sixthly, as the market maker of Mainland foreign exchange, HSBC China fulfills its duty for the RMB and foreign currency transaction in the interbank foreign

⁵ Annual report on the competitiveness of China's commercial banks (2008).

exchange market. In addition, HSBC offers a wide range of financial services including foreign exchange, currency derivatives, fixed income products and professional consultation. Seventhly, the personal bank of HSBC focuses on the “HSBC Premier”, which is the global wealth management brand that can help customers enjoy convenient online banking services and whole day the telephone banking services. In September 2007, HSBC China launched a new version of “HSBC Premier” which is further strengthening the excellent financial services; HSBC Premier Customers can obtain a global identity authentication through this service.

The influence of Chinese banks caused by foreign banks entrance:

Through the comparison between foreign banks and Chinese banks, it is showed that foreign banks and Chinese-funded banks have their respective advantages in many ways, and influence to Chinese banks caused by foreign banks entrance is a "double-edged sword".

On the one hand, foreign banks entrance brings some positive impact. Firstly, it reflects foreign banks access is the need for opening up China's financial sector. Foreign banks access break Chinese banks monopoly in the banking sector (Berger, Zhou, 2009). It will help Chinese banks to raise the overall level of funding and provide the opportunity to enhance their international competitiveness. What's more, it is conducive to recognize the international banking market in order to adapt to the international market development trend and speed up financial market opening up as well as promote the financing mechanisms transition in the process of integrating with the world market. At the same time, it is necessary for Chinese banks accelerate their pace of improvement to the joint-stock banks and transform from separated operation to mixture operation as soon as possible (Guo, Zhang, 2005). It is a must for Chinese banks to draw valuable experience of foreign banks in the competition in order to adapt to international requirements. In addition, with the entry of foreign banks, there are some challenges brought by their advanced management experience, business philosophy and full range of service level. Besides, it is available for Chinese banks learn from their valuable experiences to improve the management and service levels all-round and truly in line with international standards (Huang, Xiong, 2005). What's more, Chinese financial market is not so perfect that the foreign exchange market and the stock market are deficient. As the main business of

⁶ <http://www.hsbc.com.cn/1/2/hsbc-china/hsbc-china/community>.

foreign banks is in foreign currency business, it will be good for the development and promotion of Chinese foreign exchange market either. Secondly, foreign banks' entrance will intensify competition in the banking sector and accelerate the innovation and usage of advanced financial technology because they have extensive experience in both traditional and emerging banking business. Chinese banks' introduction of all these advanced technologies will help them to improve the type and quality of financial services as well as the type and quality of the efficiency in the use of funds. There will be always new challenges come up from the foreign banks' access which will benefit to improve the banking efficiency and the pressure of competition can reduce costs and increase profit (Huang, Xiong, 2006). It will bring about a more comprehensive risk assessment system which will help to improve Chinese credit mechanism and enhance risk control in order to contribute to the promotion of economic growth. As a result of the participation of foreign banks, the regulatory mechanism of Chinese banks will be changed also (Kumbhakar, 2007). The improvement of internal incentive mechanism and the supervision mechanism will help to enhance the transparency of the banking sector, the profitability and optimize the allocation of resources as well, so that the Chinese-funded banks will take to the track of healthy development. Thirdly, it is conducive to improve the utilization of foreign capital (Liang, 2005). The capacity of Chinese banking industry was constantly increased and the national economy continuously developed contributed to the driving force of injection of foreign banks. Foreign banks' entrance expands the space and scope of financing to the Chinese-funded banks, which will help them to raise, control and work funds in the greater scope and avoid and guard against financial risks as well. At the same time, the entry of foreign banks will provide favorable conditions for the financing of Chinese enterprises because foreign banks always focus on large-scale enterprises when they are entering and Chinese banks will lose these customers. However, this situation will be conducive to transfer Chinese banks' attention to the small and medium-sized enterprises and provide loans to them, which will promote the loan transaction in any scope of Chinese enterprises.

On the other hand, there will be some negative influences caused by foreign banks' entrance as well. Firstly, there will be the loss of customers and personnel in some ways (Hu, Zhang, 2004). The banks that entered into China are always large multinational banks with strong financial strength and reputation. They will compete with Chinese banks in customers by virtue of their strong financial management system and excellent management services. The main customer resources are these large customers, large

enterprises with three kind of capitals and powerful funds enterprises. Foreign banks attract all these customers transfer their investment from Chinese banks with their own advantages as well as provide their service to fit for customer needs, so that part of the Chinese-funded banks loses customers resources. And foreign banks have advantages in employment mechanism as well. They recruit the excellent staff with full banking experience and marketing talent by organizing training abroad and high payment which will drain outstanding financial professionals as well. Besides, foreign banks entrance will increase the risk of financial markets. The advanced products and service will attract some high-end customers to invest in foreign banks and increase the potential market risk in providing service simultaneously. At the main while, as the loss of customers, Chinese banks may prefer to engage in some high-risk activities or operate a number of irregularities to retain customers which will increase the financial risk as well (Hu, Zhang, 2004). In addition, accompanying with foreign banks entrance, it will be possible for foreign banks to bring problems or unhealthy tendency to the Chinese market as well. As a result of the imperfect of Chinese financial market regulatory system and management mechanism, the ability of fend off financial risks is still weak, therefore, it will increase the risk. What's more, the Chinese financial market is not mature (Ye, Feng, 2004). When foreign banks find it is difficult to resolve the difficulties in the development in china, they may withdraw out of Chinese market immediately, which will further exacerbate Chinese financial market risks.

The solution for Chinese-funded banks:

Foreign banks bring unprecedented opportunities and challenges to Chinese banks accompanying with their access (Wen, Cai & Gao, 2000). It is not only provide opportunities for Chinese banks to learn advanced management experiences from foreign banks, but also reduce the market share of Chinese banking industry which means that there are more stakeholders in the financial market. It requires domestic banks clearly understanding their own advantages and disadvantages to deal with the impact of foreign banks rationally. There will be two ways to begin their strategies.

On the one hand, Chinese banks have to implement the strategies in macroscopic way (Li, 2006). At the beginning, they have to accelerate the pace of share-holding system continuously. At present, the four major state-owned banks still hold more than 80 percent of market shares and the entire financial system is so simple as well as the financial structure is imperfect. It is a must to do the reform in order to improve gap in the existing

financial system and the structure. The Chinese banks will set up a diversified and socialized ownership structure through recruit legal person or individual and foreigners to participate into share holders under the condition of ensuring the state-owned holding (Zhang, 2006). As following, it is available for Chinese banks to transform their operational strategy to implement market-oriented principles and break away from the unreasonable government intervention from policy-based changed into market-oriented type (Xu and Lin, 2007). It has to abolish the interest rate controls gradually and implement interest rate marketization. Nowadays, the current Chinese interest rate is still depended on central banks and the difference in interest rate is really rare. Chinese banks have to use the interest rate marketization experiences of foreign banks and provide more favorable interest rates to high-end customers (Pei, Shirai, 2004). It will not only benefit to attract more high-end customers, but also raise the capital adequacy rate of Chinese banks so as to enhance their competitiveness. In addition, the regulators have to innovate the supervision mode and diversify the means of regulatory through remove the direct restrictions of operating assets and liabilities and autonomy in management to small and medium-sized banks. As a result of the risk management and regulation technology is not strong enough; Chinese banking supervision is still based on compliance (Li, 2006). It is necessary for Chinese banking regulation institutions to improve the methods and means of supervision to enhance the ability of guarding against financial risks continuously. The last but not the least, the financial innovation is necessary for Chinese financial transformation. Foreign banks have stronger ability to innovate and the profits of intermediary service are outstanding. Compared with foreign banks, the ability of innovation of Chinese-funded banks is poor and most of the profits are relied on the interest rate balance between traditional deposit and credit. Therefore, the Chinese-funded banks are required to increase the strength of financial innovation and introduce more intermediary business besides of traditional business (Zhang, 2006). The transition from separated operations to mixture operations is also important. Chinese banks have to use the long-term experiences to open up control and speed up the pace of reform in banking, securities borrowed from foreign banks. Besides all these foreign banks advantages, Chinese banks have advantages in market demand and customer resources as well to yield their experiences of local banking operations and the understanding of domestic market. They will introduce more financial products with Chinese characters and improve the technology in financial instruments and services in order to improve operational efficiency and raise their core capital for avoid risk.

On the other hand, it is available to improve strategy in microscopic way (Li, 2006). Firstly, it is important to optimize the internal management level of Chinese commercial banks constantly and abandon the execution in the traditional management and organization form. They are available to accelerate the internal division either and implement the separation of rights and liabilities which is learned from foreign banks operating management experience (Hawkins, John and Dubravko, 2001). The mutual support and restriction among the various departments will not only improve the efficiency of the operation and management as well as saving customers' time but also reduce the risk of financial operations. Another way to enhance Chinese banking system is to expedite the training mechanism to enhance the core competitiveness and establish a rational personnel incentive system to maximize retain their talents (Yi, 2003). At the same time, they have to training young talent and hold nichetargeting international exchanges and training timely and especially the language and modern financial training as well to strengthen their professional knowledge hierarchy. In particular, regulators' training is also important and besides the training for highly technology talents, they should pay more attention on increasing the development of human resources and recruit a number of outstanding professionals both with domestic and international experiences in order to reserve personnel for participating in the international market competition. In addition, it is a must to use competition mechanism according to the needs and characteristics of employees to maximize their ability for work and get rid of all unhealthy practices. Last but not the list, it is necessary for Chinese banks to optimize the level of service and should implement customer-oriented principle in order to optimize business processes and accelerate the pace of electronic banking business (Hu, 2004). While strengthen the division among different department to enhance the efficiency of banking services. It is more important to establish a unified customer management system for customer information supervision and understand customer needs as soon as possible to provide all-round service which means that it is necessary to improve customer after-sales service to provide the return of products and new suitable investment products introduction timely. In the promotion of financial management process, it is significant to increase the risk announcement and emphasize the awareness of risk prevention in order to avoid unnecessary loss (Leung, 2000). They should pay more attention on professionals training especially the professional financing talents and improve their professional capabilities constantly to provide more professional

advisory services to clients and establish long-term stable cooperative relations with customers.

Conclusion:

Foreign banks entering into the banking market in emerging countries can strengthen the competitiveness of the host banks, which means that it will enhance the efficiency of financial services. The encouragement of innovation can raise the opportunity for the eligible borrowers to obtain financing, which can increase the release loans and promote its growth. All these influences can expedite the formation of competitive and efficient banking system. At the same time, the close link between central bank political interest rate and the rate of deposit and loan can improve the effectiveness of monetary policy transmission mechanism. In addition, foreign banks can provide financial strength when one country is experiencing or have experienced a financial crisis.

In this paper, we found that the foreign banks in Singapore are more successful than the ones in Turkey or Latin American through the comparative analysis of foreign banks development in many emerging countries. Singapore's success is mostly attributed to the gradual open up policy of its domestic banking sector. The advantage of this policy is that it gives time for the domestic banks to absorb the advantages in both local banks and foreign banks. The new stable banking system formatted contributed by the gradual policy. The successful experience of Singapore's banking sector can be draw by China, although the development of foreign banks in China has its own characteristics.

Since China accessed to WTO, the number, the size and the scope of foreign banks are constantly expanded. The entry of foreign banks has brought development opportunities to in China's banking sector. At the same time, a full range of attack is faced to China's banking sector by virtue of the advantages of foreign banks in size, structure, mechanisms, products, financial strength and international networks. All these impacts affect the stable operation of China's banking sector. Since 1979, accompanied by a gradual opening up of China's reform, we found that foreign banks in China have achieved rapid development in the aspects of number of agencies, asset size, business line and territorial scope. However, based on the prudential considerations of financial openness, foreign banks have suffered a number of restrictions in the process of entering. Thus, until now, foreign banks development in China is still in a shallow level and the effects are still preliminary. It is also shows the necessary of further study for the foreign banks' entrance

on the basis of historical study and combined with post-WTO reality of economic and financial development. Through the motivation analysis of foreign banks entering China, we found that at the present stage the main motivation for foreign banks is obeyed the "market opportunities of host country" hypothesis (). It means that foreign banks entering China is mainly to occupy more market shares and obtain more benefits in China. As a group with specified advantages, the overall high efficiency is one of foreign banks characteristics. The entry of foreign banks bring about a positive impact on China's banking sector, such as competition effects, technology diffusion effect, institutional innovation effect and the effect of human resources. However, it has also brought some negative impacts. For example, foreign banks' entrance increases the vulnerability of China's banking sector and the short-term operating costs of domestic banks grow quickly, which will bring a certain attack to Chinese banking sector.

As the specificity of China's national conditions, China must be to open its financial market in Chinese characteristics. The foreign banks full entrance has become an irreversible trend in the Chinese banking system and how to face the challenge becomes more and more important. China's banking industry has to transform their operational mechanism and absorb the advantages of foreign banks as well. At the same time, Chinese banks have to optimize the structure of the organization and management constantly based on its own comparative advantages in order to maximize profits. It is also necessary to establish a stable financial system to ensure the stability and development of China's banking sector. Therefore, the influence of foreign banks entrance to the Chinese banking industry is uncertain. It can not only provide the advantages of foreign banks for Chinese banks to learn and emulate, but also challenge the Chinese banking sector which will face the risk of merger at any occasion. How to solve all these problems and constitute coping strategies faced to the challenge is the mean key for china's banking sector development. To face the foreign banks entering, China's commercial banks should comprehensively enhance its core competitiveness. In order to meet the challenge, it should improve business and business competitiveness by strengthening risk management. What's more, it is also necessary to strengthen the financial team building and nurture a strong competitive talent to enhance the competitiveness of innovation and constantly improve its international competitiveness to integrate into the international financial markets.

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