ISSN 2616-7433 Vol. 2, Issue 2: 16-21, DOI: 10.25236/FSST.2020.020205

Research on the Location Choice of Chinese Commercial Banks' Internationalization under the Belt and Road Initiative

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ABSTRACT. *Financial globalization and internationalization nowadays may stimulate the outward direct investment of the financial sectors. In the internationalization process, China, as an emerging market, is developing rapidly in economic terms; Chinese banks conduct different cross-border activities to enter into the world market. This paper chooses Chinese state-owned banks as representative cases and analyses the location choice in countries along the Belt and Road.*

KEYWORDS: *Commercial banks; Location choice; The belt and road; Internationalization*

1. Introduction

Chinese banks have been expanding ODI (overseas direct investment) continuously after the reform and opening up, Chinese banks conduct different cross-border activities to enter into the world market. Over the last decade, the Chinese government has concentrated on banking sector reform. This reform and progress include strengthening regulations, reconstructing state-owned banks, improving capital adequacy and so on. Since "The Belt and Road Initiative" that proposed in 2013, Chinese state-owned banks (SOBs) accelerate ODI in countries along the Belt and Road. Chinese state-owned banks include four main commercial banks. According to statistical datas from Chinese the Big Four [1] (ICBC, BOC, CCB and ABOC), the Bank of China, Agricultural Bank of China, Industrial and Commerical Bank of China, Constraction Bank of China have established oversea institutions in 68 countries by the first half of 2018 (with 23,18,20,7 respectively). The business of overseas institutions involve investment, bank insurance etc., however, these institutions are mainly distributed in developed regions or countries, development imbalance of international locational distributions should be concerned.

Regarding to the Big Four banks' international operation issues, this paper mainly focuses on research of location choice in overseas expansion. Thus, choosing the four representative banks as case studies will be beneficial to analyse and summarize the ODI pattern from the specific to the general. Especially, the findings will put forward improvements for commercial bank's international location choice.

2. Literature Review

2.1 Multinational Banks as Service Mnes

Theories that link with manufacturing MNEs have been applied to explain service internationalization, but the strategies of service MNEs may be a little different from those of traditional manufacturing. It is evident that banking is a significant sub-sector of services which are heavily reliant on human skills and knowledge. Ekeledo and Sivakumar (2004) have asserted that the location and entry mode of service delivery are determined by the non-tradability of banking products. As mentioned in the knowledge-based approach, soft technologies like experience, management and technical know-how are the main types of knowledge transfer in multinational banking.

2.2 Dunning's Oli Theory

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Professor John Dunning proposed the eclectic paradigm (ownership, location and internationalization [OLI] theory) (Dunning, 1988) as a theoretical framework which determines the extension and pattern of value-chain operations which companies own abroad.· He intended to explain why firms prefer to serve foreign markets through overseas production rather than through domestic production. Dunning's OLI theory summarizes three conditions that determine whether or not a company should internationalize through FDI. These conditions are as follows: ownership advantage, internalization advantage and location advantage. Each of the three factors has an important impact on investment decisions and interconnects with the others. In order to enter a foreign market successfully, a firm must possess ownership-specific advantages relative to other firms in the business. Firms acquire these advantages prior to entering global markets. Measures of location advantage may include potential demand, differences or similarities in culture, economic, legal, and political systems and so on. Indeed, McDonald and Burton (2002, p. 42) replenished Dunning's (1993) conclusion and argued that "Location advantages are regarded as following the client, specific regulations and entry restrictions".

Critically analysed, Dunning's OLI theory makes a contribution to and explains the relationships between the incorporation of location theory, market entry motives and international production. However, firstly, it has been claimed that the explanatory variables identified by the paradigm are so numerous that its predictive value is almost zero. Although Dunning's OLI theory has been regularly updated in dynamic empirical research, it places greater emphasis on framework and the model is too sparse to provide detailed advice on research design or hypothesis testing (Buckley & Casson, 1998). Secondly, it is just point to a methodology and to a generic set of variables which contain the ingredients necessary for any satisfactory explanation of particular types of foreign value-added activity. Thirdly, as this theory relies on three advantages, Dunning also admitted that because of the generality of eclectic theory, it has limited power to explain particular kinds of international production. Thus, OLI theory is more general. More importantly, Dunning originally proposed the supposition and framework based on investigating US manufacturing companies which invested abroad; although he updated some relevant theoretical research that linked with the financial sector, OLI theory still lacks a specific model and empirical testing on banking internationalization. Especially, OLI theory has few explanations regarding when banks prefer to expand overseas and how they operate their overseas activities.

Finally, sharing the same characteristics with traditional ODI research on the financial sector, Dunning developed his theoretical and empirical investigation on the enterprises of developed countries; he evaluated the ODI patterns of these enterprises in less-developed countries. For this study, it is necessary to link the O, L and I advantages referred to above with Chinese banks' ODI patterns.

2.3 Internalization Theory and Its Extensions

"The internalization theory explains the internationalization of MNEs based on the opinions of firm specific advantage and market imperfections" (Buckley & Casson, 1976, p. 86). According to Buckley (1988, p. 90), "The internalization decision should be based on a careful examination of overall costs and benefits in relation to particular markets at specific points of time and across limited economic space". Internalization theory insists that cost is one key factor of total costs versus total benefits.

Critically, Rugman (2006) also treats "spatial cost saving" as an internalized firm-specific advantage. He argues that location advantages are involved in internalization decisions and are balanced between internal and external markets. Usually, countries prefer to invest in a host country whose structure is close to their own. According to Rugman's opinion, location advantages are crucial for internalization decisions.

2.4 Location Choice

Buckley et al. (2007, p. 477) have insisted that "Developing countries firms invest preferentially in psychically and geographically close location where relational assets can be exploited most effectively". At the same time, other authors have also proposed that FDI occurs in culturally and geographically close countries. In one empirical study of Asian firms, it was found that firms prefer to invest in markets geographically close to home (Lau, 2003).

In conclusion, these authors have examined cultural and geographical influences on entry location selection; the argument by Buckley et al. (2007) in particular is based on research of developing countries' ODI behaviours. However, they only emphasize cultural and geographical elements as determining factors of location choice in ODI. Based on Buckley and Lau's arguments of ODI in developing countries, Asian firms, especially emerging countries' enterprises, prefer to invest in markets geographically and culturally close to the home country. They will then select other regions based on the distance factor.

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It is obvious that the location of financial centres is found to be closely related to a bank's location choice in foreign markets (Chan & Wong, 1999; Leung, 2000). Buckley et al. (2007) have argued that developing countries over time have increasing target investment opportunities in more advanced countries.

Some researchers have proposed that MNBs prefer to expand in countries which have strong and close trade/FDI cooperation with the host country. Brealey and Kaplanis (1996) found that trade and FDI have a significant impact on MNBs' location selection abroad. As China has joined the regional blocs, it may have a close relationship with Asian countries through multinational agreements. So, it would be meaningful to examine whether FDI and trade factors have a crucial effect on the location decision of Chinese multinational banks.

3. Analysis of the Chinese State-Owned Commercial Banks' Odi in Countries Along the Belt and Road

3.1 Entry Timing

Under the Belt and Road Initiative in 2013, there is an increase trend in the amount of Chinese commercial banks' overseas institutions within recent years. Generally, it can be proposed that Chinese Big Four banks' ODI in countries along the Belt and Road developed dramatically from 2013 to 2018. Especially, the amount of the Chinese Big Four banks' ODI in countries along the Belt and Road raise sharply between 2013 and 2014.

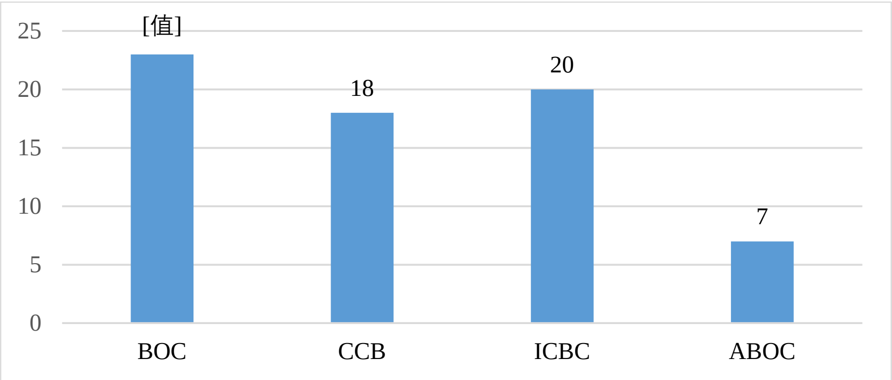
3.2 Number of Institutions and Countries That Established Along the Belt and Road

To accelerate the internationlization process, the Big Four banks tend to enhance their expertise and professional skills in international banking. Bank of China started its internationalization process through establishing a long-term subsidiary in international financial centre--Hong Kong in 2004. It became the first Chinese commercial bank listed in both mainland China and Hong Kong. In particular, the Bank of China (BOC)'s ODI possesses great performance and the amount of countries along the route that reached at 23 in 2018. The number of countries and institutions that Big Four banks' internationalization process along the Belt and Road are shown in Fig 1 and Fig 2 below.

Following by BOC, the Industrial and Commercial Bank of China (ICBC) had set up 129 institutions in 20 countries along the route by the first half of 2018. ICBC invested 129.6 billion dollars in non-financial FDI for 20 countries along the Belt and Road, these countries include: Thailand, Singapore, Laos, Pakistan etc.

The Construction Bank of China (CCB) established variety of institutions in Russia, Dubai and other regions, constituting perfect "the Belt and Road" network that along with institutions in Hongkong and Vietnam. By the first half of 2018, CCB had built up 50 business projects and 129 institutions with 18 countries along the Belt and Road.

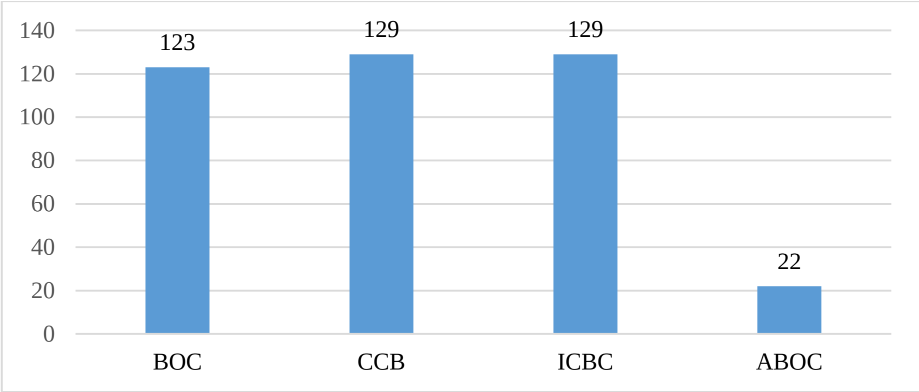
Compared with other three SOBs, the Agricultural Bank of China (ABOC) presents weaker trend in ODI in countries along the Belt and Road, it had established 22 institutions in 7 countries along the route by the first half of 2018. ABOC offers long-term project loan, letter of guarantee and offshore bond issuance businesses for overseas clients, these clients and businesses contain 45 countries that come from the Belt and Road.



Source: Big Four banks' annual reports

Figure.1 Number of Countries That Big Four Banks' Invest Along the Belt and Road by the First Half of 2018

ISSN 2616-7433 Vol. 2, Issue 2: 16-21, DOI: 10.25236/FSST.2020.020205



Source: Big Four banks’ annual reports

Figure.2 Number of Big Four Banks' Institutions That in Countries Along the Belt and Road by the First Half of 2018

3.3 Location Choice

3.3.1 Country Choice

It can be summarized that the Big Four banks had set up the great amount of institutions in Five Central Asian countries from 2013 to 2018. However, the ODI pattern should be improved. Secondly, each region along the Belt and Road possesses different advantage due to different investment environment. Finally, the Chinese Big Four banks possess complementary cooperation with Five Central Asian countries.

The Chinese Big Four banks set up institutions in 12 Asia countries along the Belt and Road. BOC also established the largest number of branches in Asian countries, these 11 Asian countries include: Thailand, Mongolia, Malaysia and so on. ICBC invested in 7 Asian countries, these countries also include: Indonesia, Thailand, Malaysia, Singapore, India, Kuwait and CIS Russia. The number of CCB’s overseas institutions account for 9.3% of the Big Four banks’ total overseas institutions, it invested in 4 countries along the Belt and Road, these are Singapore, Malaysia, Vietnam, Indonesia. Moreover, ABOC possessed the least percentage of institutions in 2 Asian countries along the Belt and Road, only including Singapore and CIS Russia.

3.3.2 City Choice

According to the analysis, the Chinese Big Four Banks all prefer to select the more developed cities or capitals as initial ODI’s destinations. These four banks have set up branches or subsidiaries in financial centers of Asian and European countries. In particular, the Big Four banks all had invested in Moscow of Russia by the first half of 2018; The BOC, ICBC and CCB have set up institutions in capitals of Vietnam and Poland continuously, these are Ho Chi Minh and Moscow; the BOC and ICBC all a have established more institutions in Thailand due to following their trade customers.

4. Problems of Chinese Stated-Owned Commercial Banks’ Location Choice

4.1 Lower Degree of Internationalization

The Chinese Big Four banks’ international market businesses have increased; while

the degree of internationalization is low. These four banks’ net profits have grown steady; however, the increase rates are lower compared with other multinational banks in developed countries. Taking the BOC as an example, the net profit was only about1924 billion RMB in 2018.

4.2 Single Location Layout

From the analysis above, Chinese commercial banks’ ODI location selection concentrate on the countries that

ISSN 2616-7433 Vol. 2, Issue 2: 16-21, DOI: 10.25236/FSST.2020.020205

are close to China or some developed countries. The Big Four banks' ODI patterns in Africa and Latin America are weaker. Most commercial banks would follow their overseas clients who are mainly located in financial cities of developed regions. Also, due to geographical factor and similar cultural factor, commercial banks prefer to invest in Asian regions undoubtedly.

4.3 Risking Overseas Investment Risk

Chinese stated-owned banks (SOBs) are supported and controlled by government in some strategic choices. However, there exist country risk and market risk in ODI process. Thus, SOBs may meet asset and business competitions with host banks. Chinese state-owned banks may take different political conflict, logical restriction factors into location choice consideration.

5. Suggestions for Location Choice of Chinese State-Owned Commercial Banks' Internationalization under the Belt and Road Initiative

5.1 Strengthening Trade Cooperation with Countries Along the Belt and Road

Under the Belt and Road initiative, China has enhanced the cooperation with countries along the route. According to the data, the total amount of import and export that with countries along the route was 1.3 trillion dollars in 2018. China has built close relationship with countries along the Belt and road in cultural, political and economical field. To strengthen the trade cooperation with countries along the Belt and Road, Chinese state-owned banks may have priority to invest in host countries so that can avoid political risks.

5.2 Considering Institutional Factors in Location Choice

It is essential to consider the institutional factors when Chinese state-owned banks choosing the location. As the host countries and home countries are quite different in many aspects, especially in politics, culture and economics. It is suggested that SOBs may establish branches in the countries that possess similar institutional factors with home country.

5.3 Establishing Risk Awareness and Improving Management Level

Chinese state-owned banks' international management level is still lower than multinational banks in developed countries. The SOBs should establish risk awareness and build a systematic risk aversion system. The government and financial institutions need to take supervision measures so that could ensure the efficient risk management.

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