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(Wang Chen)

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1. Introduction

As the 2001 World Bank report says, a very decisive point for the sustainable economic growth in a country is whether the financial system operates well or not. A well-operating financial system can contribute to the national wealth. One way to develop an effective financial system with enough competitive advantages is through attracting foreign banks' entry. (See among others, IMF¹ 2000 and Claessens and Jansen, 2000).

Tschoegl (1985) has documented that, foreign banks' entries began as early as in 1920. At that period of time, several foreign banks were allowed to enter only a few developed countries. In the last few decades of the 20th century, the economy became more and more globalized. Therefore, a trend towards worldwide financial integration appeared. More and more foreign banks have entered the developing countries.

According to incomplete statistics, in 2002, foreign banks held up to 33% of the overall shares of assets in banking segment in 104 developing countries, which represents an increase of 15% relative to the number in 1995. And most of these assets were mainly from three regions of the developing world. They are Eastern Europe and Central Asia, Latin America and Sub-Saharan Africa. In Contrast, in East Asia & Pacific, Middle East & North Africa, and South Asia, foreign banks did not do a good job from 1995 to 2002. They held only about 10% of the overall assets in the banking segment and this number stayed unchanged all over the seven years (Micco, Panizza, and Yanez, 2006).

¹ International Monetary Fund.

The empirical studies show that, by October, 2003, foreign banks based in developed countries provided a total of 1.45 trillion U.S. dollars of credit to developing countries. Their lending behavior can be classified into three categories, namely cross-border lending, domestic lending in foreign currency and domestic lending in domestic currency. The first two types of lending accounted for 60% of the overall lending and were therefore regarded as the main credit service of foreign banks. The third type of lending was mainly conducted by local branches and subsidiaries of foreign banks and accounted for only 40% of the overall lending.

China entered WTO on November 10th, 2001 and at the same time announced that, in the following two years the foreign banks would be allowed to do Renminbi² business and in five years the Chinese government would remove all the regional restrictions towards foreign banks. Accordingly, foreign banks would be allowed to do transactions with any Chinese customers. In 2001, in Tianjin alone, the foreign banks had made a profit of 17.86 million U.S. dollars. In 2003, the average ROA of HSBC³ in China had risen to 1.01%, which was only 0.02% lower than the world average ROA. All of these profits were made in the presence of China's relatively restrictive regulation towards foreign banks. It proved that, foreign banks would potentially face a robust financial market.

It is interesting to look at the entries of foreign banks in developing countries, since it's a decisive characteristic of the marvelous changes of the ownership structure of the banking system. This paper is written with

² The Chinese currency.

³ The Hong Kong and Shanghai Banking Corporation.

the following structure: Section 2 examines the factors that affect the entry decision of foreign banks into developing countries. Section 3 addresses the activities and organizational forms of foreign banks' entries. Section 4--the highlight of this paper, attempts to analyze the impacts of the foreign banks' entries in developing countries. Section 5 analyzes foreign banks' entries into China and Poland and section 6 consists of a conclusion.

2. What drive foreign banks into the developing countries?

There are a number of factors that affect the entry decision of foreign banks. Firstly, the economic relationship between the home and host countries of a foreign bank is positively correlated with the scale of its entry⁴. Secondly, the financial markets in developing countries are mainly unsaturated, so there exist many opportunities for foreign banks to make a profit. Thirdly, the regulations⁵ performed in developing countries have impacts on foreign banks' decisions on entry. Fourthly, the geographical proximity, economical similarities, similar culture and habits, and same languages are also decisive for foreign banks' entries.⁶

⁴ It is determined by the foreign direct investment in the banking system.

⁵ For example, preferential tariff treatment.

⁶ Clarke et al. (2003) have also mentioned these factors. Their study focused on the factors that drove foreign banks' entry in developed countries. But we consider the factors that drive foreign banks' entry in developing countries.

2.1 The economic relationship between a foreign bank's home and host countries

Many empirical studies demonstrate that there is a positively correlated relationship between the scale of foreign banks' entries and the economic relationship between the foreign bank's home and host countries. If the host country is economically well integrated with the home country of a foreign bank, the foreign bank will invest a lot in the host country. Some studies analyze foreign banks' activities both in America and in England.⁷ Others focus on the behavior of foreign banks from the same country but into different host countries.⁸ For example, they analyze the performance of foreign banks from England, U.S.A., Japan and Germany in other countries. Generally, most of these studies focus on the relationship between the degree of economic integration and foreign banks' entries. They also reached the same conclusion that "banks desire to serve their customers abroad", the so-called "follow the clients" motivation.⁹

However, most of the studies above only refer to the entry decision of foreign banks in developed countries. In fact, the "follow the clients" motivation of foreign banks is difficult to verify in developing countries. By analyzing the behavior of American banks in 32 countries between 1987 and 1995, Miller and Parkhe (1998) find no positive correlation between the amount of foreign direct investment and the scale of foreign banks' participation in developing countries. Of course, there may be another

⁷ The so called " from-many-to-one-host".

⁸ The so called " from-one-to-many-hosts".

⁹ Clarke, Cull, Martinez Peria and Sánchez (2003).

possibility that in developing countries, foreign banks face relative weaker competition. So they are able to gain more benefits than the domestic banks in the process of providing financial services. From this point of view, the foreign banks may enter earlier than the foreign-funded enterprises in the non-financial sector.

2.2 The profitable opportunities in the host country

Much recent research has shown that foreign banks are mostly attracted by the great profitable opportunities in developing countries. There are several indicators that are relevant to the foreign banks' decision on entering developing countries. Claessens, Stijn and Jansen (2000) have analyzed the data from 1988 to 1995 in 80 countries and found that foreign banks are attracted by the low tariff and high return on capital in host countries. Yamori (1998) shows that Japanese banks always consider the GDP per capita as a decisive factor affecting their entry decision. Brealey and Kaplanis (1996) and Buch (2000) find that the higher the host countries' GDP, the more the foreign banks' entries.

Focarelli and Pozzolo (2000) have used more variables to analyze the opportunities in the host countries. They have chosen 143 banks in 28 countries and each bank has at least one foreign shareholder. Besides the economic relationship between the home and host country and the regulatory barriers in the host country, they have also analyzed the economic prospects and the degree of competition in the host country. They find that foreign banks are willing to enter the countries where the

expected economic growth is high and the efficiency in the banking sector is low. With respect to the expected economic growth, the foreign banks' entries are negatively correlated with the GDP per capita and the inflation rate in the host country. But in terms of the efficiency in the banking system, if the host country has higher average costs, lower net interest margin and larger amount of cash flow,¹⁰ it will be more attractive for foreign banks' entries.

Although most of these 28 countries are developed countries, there are a few developing countries among them, for example, Czech Republic, Hungary, Mexico and Poland. The banking system in developing countries is relatively weak, foreign banks may have obvious competitive advantages. Therefore, their study shows another implication, that foreign banks enter developing countries for the purpose of profitable opportunities. For example, most of the foreign banks in Hungary have developed into retailing banks. They both receive deposits and make loans.

All the mentioned above studies show that the foreign banks are interested in profitable opportunities. Of course, if the foreign banks don't give up some market segments after the entries, for example, the small firms¹¹, the entries can bring the host countries significant profits.

¹⁰ In this situation, the capital utilization is inefficient.

¹¹ They usually receive less financial services than large firms.

2.3 The regulations in the host country

From a political perspective, the strict regulations on the foreign banks' entries into the host countries may form large obstacles for the new entrants. Such strict restrictions don't only hurt the benign competition between the foreign banks and domestic banks, but also protect the inefficient domestic banking system unfairly. Buch and De Long (2004) show that, foreign banks are less likely to consider an international merger with a developing country with a strictly regulated financial system. Focarelli and Pozzolo (2001) have also found similar results. They argue that more foreign investment can be attracted to a developing country with less strict regulations. Barth, Caprio and Levine (2001) find that if the banking sector is less regulated, the net interest margin and the overhead costs will be lower. Furthermore, they have also shown that fewer restrictions towards foreign banks and the banking capital can contribute to a lower probability of banking crises.

Some developing countries formulate some preferential tariff treatments when dealing with foreign banks, for example, Argentina, Chile and China. In China, the income tax rate for local enterprises is 33% which is consistent with the international standard. The income tax rate is 55% for the professional banks, and 33% for the commercial banks. In contrast, the foreign banks can enjoy a preferential income tax rate ranging from 15% to 30%, if they are located in the special economic regions or in the coastal cities. Most of the foreign banks can also enjoy a preferential sales tax.

However, other developing countries make some special regulations, for instance, North Korea and Egypt. According to Hao, Hunter and Yang (2000)¹², the country which is less open to foreign banks can gain more benefits from their entries.

2.4 The similarities between the home and host countries

Many studies have also argued that it is very important to regard the geographical proximity, economical similarities, similar culture and habits and same language as priority for foreign banks to make a decision on entry. Claessens and Van Horen (2006) find that, if the foreign bank's home and host countries are neighbor countries, or the people speak the same language or the host country was historically a colony of foreign bank's home country, the foreign bank prefers to develop new business in this host country.

For the normal firms, they usually expand the scale of their business overseas by using their competitive advantages which results out of prior business experience (Casson, 1987). In which environment can the early experience be applied most efficiently? Undoubtedly it is in a country with a similar environment as the countries where the firms have already developed business. The skills which they are good at can help them do a better business in a similar environment (Buckley and Casson, 1991).

Things are the same for the banks. Many foreign banks have competitive advantages because they can utilize their prior experience

¹² They have analyzed the banking efficiency in North Korea after foreign bank's entries.

formed in the earlier business. Petersen and Rajan (1994) and Rajan (1998) have shown that, in a similar environment, where foreign banks have already successfully developed business, it is easy for them to triumph over the competition.

Generally, the similarity between the home and host countries of a foreign bank includes similar institutional situations, degree of openness and level of corruption. Claessens and Van Horen (2006) argue that, if a foreign bank develops its competitive advantages in an institutionally transparent environment, it will be more likely to use its competitive advantages in countries with a similar institutional environment. Galindo, Micco, and Serra (2003) also find that, if there are large differences between a foreign bank's home and host countries, the costs of foreign banks' entries may outweigh the benefits and finally lead to the withdrawal of foreign banks.

Furthermore, studies such as Claessens and Van Horen (2006) have pointed out another important factor in addition to the institutional differences that affects the entry decision of foreign banks. It is the institutional quality of the foreign counterparts of a foreign bank. By comparing empirical data, which was collected in developing countries, they find that it is very important for a foreign bank to know what its foreign competitors are doing. A foreign bank can have a better start in developing countries, if it can ascertain the advantages of his competitors and update its competitive advantages continuously.

3. What do the foreign banks do in the developing countries?

3.1 Their activities

In the previous section, we have already argued that foreign banks enter developing countries not for the reason of following their clients but because of the great profitable opportunities and a proper institutional and macroeconomic environment. What kinds of activities do foreign banks really undertake?

Several studies have examined the activities of foreign banks in developing countries. They indicate that there exists a strong competition between foreign banks and domestic banks in the banking sector. Foreign banks perform more efficiently than the domestic ones. As proved also by Claessens, Demirgüç-Kunt and Huizinga (2001), Claessens and Laeven (2003), and Claessens and Lee (2003), foreign banks' intelligent way of doing business in developing countries brings them marvelous gains and the early successful operating experiences of doing business in developed countries give them more competitive advantages over the local banks.

According to the neoclassical theory, the growing financial integration can help the growth of the banking segment in developing countries. The reason for this is as follows. Firstly, in developing countries, the savings level is lower, but the growth of opportunities is higher than that in developed countries. The dynamic growing opportunities in the banking

segment attract the inflow of foreign capital. Secondly, the stock market in developing countries is usually not well developed. The number of listed firms is very small (La Porta, Lopez-de-Silanes, Shleifer and Vishny (1998)). Therefore, to a large extent, the new comers on the market and investment contribute mainly to the expected growth. However, if the stock market is inefficient and the investors fail to receive good protection from the unlisted-firms, another path of investment must be found to offset the moral hazard. A most efficient way of funding investment is through the credit from banks (Booth, Aivazian, Demirgüç-Kunt and Maksimovic (2001) and Giannetti (2003)). In a word, foreign banks can help the unlisted-firms go through the tough situation with an invaluable support of capital.

It is easier for foreign banks relative to domestic banks to get foreign capital, so they can stably fund firms externally. However, if foreign banks lend to favored partners, there exists the danger that they may damage the lending in the local banking segment. (Laeven (2001) and La Porta, Lopez-de-Silanes and Zamarripa (2003)) The firms which are favored partners of foreign banks may get investment under any circumstances even if they are inefficient. In contrast, the newly-established firms may only be treated with credit rationing even if they perform more efficiently and have better prospects. In the meantime, foreign banks are usually not well connected with individual customers and the local government. As a consequence, they avoid providing credit to state-owned firms and mainly lend to the firms with better prospects.

According to Clarke, Cull, Martinez Peria and Sánchez (2003), commercial and industrial loans are the main components of foreign banks'

lending portfolio, supporting the argument that foreign banks lend more to large firms. Figure 1 ¹³ shows the classification of foreign banks' business in China. In 2007, 82.5% of the banks regard trade financing as the major area of specialization (increased by 5.35% than in 2005). The corporate and financial banking take the second place with 70% (increased by 10% than in 2005). In the third place are retail and commercial banking with 42.5% (increased by 11.07% than in 2005). The corporate and institutional banking take the fourth place with 37.5% (decreased by 12.5%). We can find the similar situation in Argentina. Clarke, Cull, D'Amato and Molinari (2000) show that, in the last few decades of the 20th century, foreign banks' industrial loans accounted for about 35% of their lending portfolio, 15% higher than the percentage of commercial loans in private domestic banks' portfolio and 25% higher than that of state-owned banks.

On the other hand, asymmetric information and a weak legal system in developing countries are usually obstacles for small firms to benefit from the entries of foreign banks (Acharya, Sundaram and John (2004)). As we have discussed above, it is difficult for foreign banks to develop a well connected relationship with private customers and the local government. Therefore, they can not get adequate local information. To do business with small firms, they should be able to get enough soft-information by decentralization. "The soft-information is the information which is difficult to completely summarize in a numeric score."¹⁴ However, most of the foreign banks have a complicated hierarchy and complicate the decentralization of decision-making power. As a consequence, the foreign banks intend to

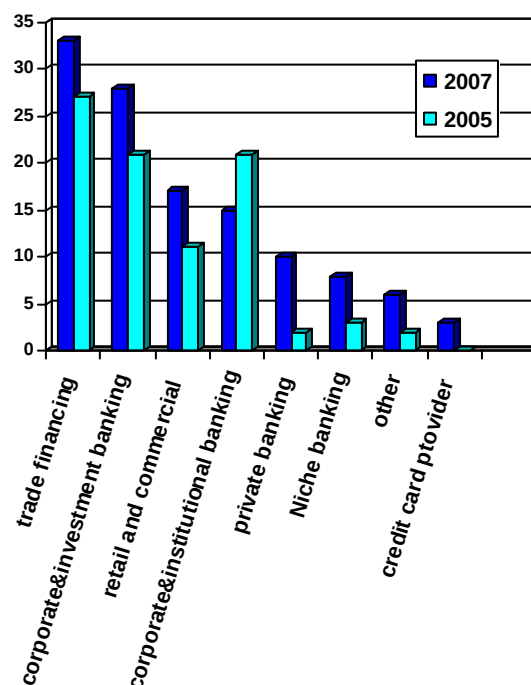
¹³ Mervyn Jacob, 2007, "Foreign Banks in China-Financial Services, Banking and Capital Markets", second Price Water House Coopers Survey. He is the financial services leader for China and Hong Kong. He made a survey of 40 foreign banks in 2007 in China and compared the results with those got in 2005.

¹⁴ M. A. Petersen, 2004, "Information: Hard and Soft".

concentrate on funding large firms. As emphasized by Clarke, Cull, Martinez Peria and Sánchez (2003), foreign banks' entries do indeed bring benefits to small firms. However, in comparison to large firms, these benefits are much smaller.

Figure 1:

Classification of Foreign Banks' Business in China



3.2 The patterns of the entry and the forms of the organization

With the rapid development of financial system, foreign banks update their entry strategy over the time. The main points of their entry strategy

can be defined as the patterns of the entry and the forms of the organization.

As mentioned in the empirical study of Clarke, Cull, Martinez Peria and Sánchez (2003), as early as in 1970s, foreign banks in Egypt were only allowed to enter developing countries in the form of joint ventures with the state-owned banks. Things have been different since in the early years of 21st century. The government has been trying to get rid of the limitation of joint ventures (Caprio and Cull (2000)). In other cases, in the 1990s in China, the banking licenses were limited in number by the Chinese government. In order to protect domestic banks, foreign banks can only either merge with the Chinese banks or buy the licenses from Chinese banks. Nowadays, the Chinese government welcomes foreign banks and allows them to serve all of the Chinese customers in the same way as Chinese banks (Huang and Xiong (2006)).

There are mainly four kinds of entry patterns that foreign banks use entering developing countries: solely foreign- invested banks, joint venture, acquisitions and mergers.

As discussed above, in general, there exists a relatively undeveloped financial system in developing countries. Therefore, joint venture, acquisitions and mergers are three typical modes preferred by domestic banks in the case of foreign banks' entries (Clarke, Cull, Martinez Peria and Sánchez, 2003). For instance, nowadays in china, most of the foreign banks choose joint venture as the entry mode. They share with the Chinese banks the stock ownership in the new unit and the proportion of their stock

shares becomes gradually larger. By the end of September, 2006, there were 29 foreign banks forming joint ventures with 21 Chinese banks. Generally, they were not allowed to form joint ventures with the four largest state-owned Chinese banks, but with the financial reform of the banking sector, the further target joint venture partners of foreign banks are these four Chinese banks.

These three kinds of entry modes benefit the both sides. On the one hand, the important skills of foreign banks, such as the innovation of financial products and risk management technologies, can help the local banks' development. On the other hand, through acquisition, the foreign banks can enter the local market faster and more easily. In some developing countries, joint venture is the only allowable entry mode of foreign banks. Furthermore, the domestic banks are well connected with local customers and the government. Through cooperating with each other, the foreign banks are able to take advantage of the established relation-network to develop business.

A coin has always two sides. Other empirical studies have also shown that foreign banks lend less to small firms than domestic banks. If many domestic banks are bought by, or merged with foreign banks, the small firms will lose the credit provision from these domestic banks and as a result, their business will get into hot water.

There are many arguments about the impacts of the banks acquisition on the credit provision. Several studies have argued that small firms' loss of credit from some domestic banks can be offset by the new credit of other

banks. Because if some domestic banks merge with foreign banks, they will form a larger entity than other banks that haven't merged. They concentrate on lending to large firms. In order to compete with the large foreign banks, the other banks tend to lend more to small firms (Berger, Saunders, Scalise, Udell (1998) and Avery and Samolyk (2000)). However, this kind of "external effect" seems to be doubtable in some other studies. Berger, Goldberg and White (2001) find that, even if the decrease in lending to small firms is offset by the increasing lending of other banks, in the process of building new relationships with new partners, small firms' searching and controlling costs will be higher. Furthermore, the demand of small firms for the term structure of the loans is also difficult to meet until a mature business relationship is fully established between them and the banks.

There are several kinds of organizational forms which can be used by foreign banks after entering. According to Goldberg (1992), the most general and easiest form of foreign bank's organization is the representative office, but it is subject to the most limitations. It can neither accept deposits, nor make loans. It is only the agent of the foreign bank's home country. The main purpose of representative offices is to serve the customers from home countries and to examine the potential opportunity of doing business in the host country. Therefore, they are not resource intensive.

By contrast, the agency is a more advanced form. Although in many countries, it is not allowed to take deposits, it can make loans. One method that is similar to make deposits is to keep the credit balance. This method is

often used by agencies, but foreign banks are not allowed to make payment using this account (Clarke, Cull, Martinez Peria and Sánchez (2003)).

The two forms mentioned above cannot cover the entire banking services in a host country. Therefore, most of the profit and risk brought by foreign banks are due to two other kinds of organizational forms—the branch and the subsidiary.

Branches belong completely to their parent banks. They are preferred because they offer more services than representative offices and agencies. They can provide all the services that their parent bank can. They are often engaged in the wholesale market and their liabilities have an impact on their parent bank's equity (Goldberg (1992) and Miller and Parkhe (1998)). One shortcoming is that their behavior is limited by the regulations both from host and from home countries. It means that they might be less competitive, because the domestic banks face only the local regulations. For example, if the home country of a foreign bank forbids the universal banking, but the host country doesn't, this foreign bank may not choose such a branch as its entry mode.

In comparison to Branches, subsidiaries immerse fully in host countries, but are owned by a foreign company. Their liabilities are not backed by the assets of the parent bank. It means that their behavior is not limited by the regulations in the home country and they can provide the same services as domestic banks. Therefore, they can compete with domestic banks more easily.

Miller and Parkhe (1998) have analyzed the international business of American banks. They find that the host country can affect the entry mode of the foreign bank. If the host country allows diversified business, most foreign banks choose subsidiary as their organizational form, because the branches are strictly regulated. Furthermore, if there are high tariff and strict regulations in the host country, foreign banks may decide on other forms instead of subsidiaries.

A number of recent papers have focused on the intra-border lending behavior of foreign banks in developing countries (Clarke, Cull, D'Amato and Molinari (2000); Claessens, Demirgüç-Kunt, and Huizinga (2000); Dages, Goldberg, and Kinney (2000); Focarelli and Pozzolo (2000)), but they have not taken the cross-border lending into account, which is also a very decisive source of credit for developing countries. The cross-border lending is defined as an inflow of credit from a financial institution in a foreign country, to a host country. In contrast, if a foreign bank has established a subsidiary in a host country, its lending behavior is called foreign direct investment. Generally, large foreign banks, such as foreign banks from U.S. do both the cross-border lending and the subsidiary services (Christian Weller (1998)). According to Peek and Rosengren (2000b) and Clarke, Cull, Martinez Peria and Sánchez (2003), by the end of 1990s, Latin America had received more credit through cross-border lending than that provided by the foreign banks in Latin-America.

4. What are the impacts of foreign banks in developing countries?

4.1 The positive impacts

As we have discussed above, a number of foreign banks have entered developing countries due to the attractive financial opportunities. They apply proper organizational forms to do a better business and therefore can get more benefits.

By 2001, the assets in foreign banks' accounts have taken 46% of the overall assets in the banking segment in developing countries (Clarke, Cull, Martínez Pería (2006)). For instance, since China has signed the WTO agreement in 2001, there are more and more foreign banks entering the Chinese financial market. By 2007, 74 foreign banks had entered China and in 2007, 186 more representative offices were established. By 2010 the number of foreign banks is expected to reach 85. Even so, China keeps applying an open strategy towards foreign banks. The reason is that by competing with foreign banks, the Chinese domestic banks can strengthen their competitive advantages and reap more benefits (Jacob, 2007).

The major benefits brought by the foreign banks are as follows. Firstly, foreign banks' entries can help enhance the competition and efficiency of the local banking sector. The growth of the competition can also contribute to the decrease on the costs of local banks. Therefore, they can gain more

profits.¹⁵ Secondly, foreign banks are more stable credit providers. They can get more capital from the home countries and can enter the international market more easily. This fact has a big impact on the local financial market. Thirdly, the allocation of the resource of credit can be improved due to the better evaluation and pricing technologies of credit risk (Barth et al (2001)). Fourthly, after the financial crises in host countries, foreign banks tend to reduce the costs of capital in these countries (World Bank, (2002)).

4.1.1 Competition and efficiency

One main point of view of the advocates of foreign banks' entries is that the foreign participation can improve the efficiency and competition in the local banking segment.

According to several studies, foreign banks have strengthened the competition and efficiency in the banking sector. Unite and Sullivan (2002) have shown that the efficiency and competition of the banking segment in developing countries are generally improved by the growing entries of foreign banks and the increasing foreign ownerships of local banks. Foreign banks' entries help reduce the interest rate and the operation costs of domestic banks. As a result, the local banks become more competitive. Denizler (2000) has studied the foreign banks' behavior in Turkey from 1980 to 1997 and found that foreign banks make the overhead costs of the banking sector lower and therefore improve the efficiency and competition

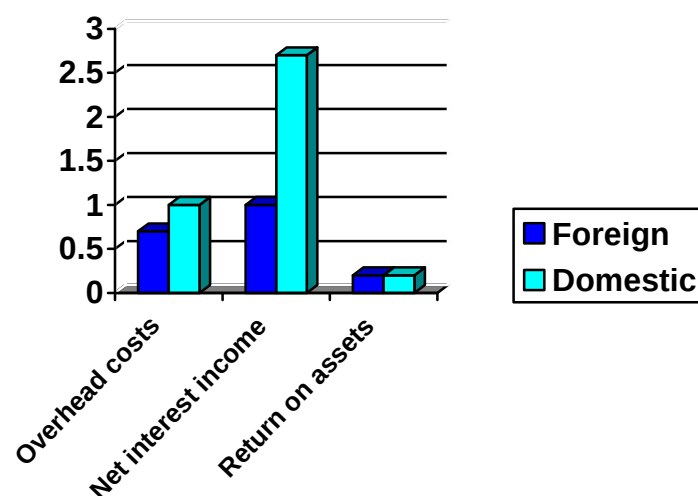
¹⁵ World Bank, 2001, "Finance for Growth: Policy Choices in a Volatile World", Washington, D.C.

in Turkey. Uiboupin (2004) has done a research on the performance of 219 banks in ten¹⁶ Central and Eastern European countries from 1995 to 2001. His findings are consistent with the argument that foreign banks can contribute to lower interest rates and overhead costs.

In the case of Latin America, the fact is that foreign banks' performance is more efficient than domestic banks' due to their lower overhead costs (as showed in figure 2).

Figure 2:

Comparison of the Performance between Foreign and Domestic Private Banks in Latin America¹⁷



In figure 2, all of the three indicators are measured as the percentage of the total assets. We can find that the overhead costs of foreign banks are 0.7%, 0.3% lower than that of domestic banks. The net margin is calculated as the net interest income over total assets. Although the foreign banks' net

¹⁶ They are Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovenia and Slovakia.

¹⁷ Source: International Data Base Calculations.

interest income is 1.7% lower, but their lower overhead costs make them keep the profitability similar to the local banks. For both foreign and domestic banks, the average return on assets is about 0.2%. This diagram shows only the average level, but in fact, the countries in Latin America have different figures. In Argentina, Brazil, Chile, Colombia, Mexico and Peru, foreign banks have lower overhead costs, but in Bolivia and Guatemala, the overhead costs of foreign banks are higher. Colombia and Honduras are the only two countries in Latin America where foreign banks have higher net interest income (Barajas, Steiner, and Salazar, (2000)).

The local banks are likely to find it difficult to protect their profits, because the foreign banks' entry is always correlated with both lower overhead costs and a provision of high-quality loans. As detailed in Barajas, Steiner and Salazar's study (2000), in Colombia, foreign banks are characterized with lower spreads and higher loan quality. Using OLS regression, they find that in order to make more profits, the new entrants, whether domestic or foreign ones, are likely to make lower spreads than the already established banks. Clarke, Cull, Martinez Peria and Sánchez (2003) show that the foreign banks' entries make the organizational forms and the regulatory system of the banking sector in Colombia change. On the other hand, they find that although the non-financial costs are lower for both foreign and domestic banks, domestic banks have more non-performance loans. Furthermore, the new foreign banks can lower the spread only among foreign banks, but the new local banks can lower the spread in the whole banking segment. This implies the fact that, the foreign banks in Colombia provide too limited services in the banking segment to compete with domestic banks completely.

Clarke, Cull, D'Amato and Molinari (2000) and Clarke, Cull, Martinez Peria and Sánchez (2003) have also found the similar trend in Argentina in the late 1990's. Foreign banks don't enter all financial segments. They enter only the segments where they can use their historically successful experience or where they have enough competitive advantages to make them successful in the competition with domestic banks.

In Mexico, no evidence has proved that foreign banks can increase competition and efficiency. Haber and Musacchio (2005) find that in Mexico, the banking segment is very concentrated. Foreign banks' entries reduce the lending. Schulz (2006) has studied the foreign banks' entries between 1997 and 2004 in Mexico and found no evidence that the foreign banks can improve the efficiency of the banking segment. One possible reason is the lack of competition in the financial market.

Some other empirical studies show that foreign banks can lead to lower benefits and net margins of domestic banks (Classens, Demirguc-Kunt and Huizinga (2001)). Analyzing the data in Argentina, Brazil, Chile, Colombia, Costa Rica, El Salvador, Mexico and Peru, Levy-Yeyati and Micco (2007) find that the competition in the banking sector becomes weaker due to foreign banks' entries.

In summary, foreign banks can improve the competition and efficiency of the local banking segment in developing countries, where the financial system is less concentrated and regulated, and the entrance and exit of foreign banks are relatively easy.

4.1.2 Stability

Foreign banks can provide credits more stably. On the one hand, they can enter the international financial market more easily and get more capital from their home countries. On the other hand, if financial crisis happens in host countries, they tend to be more stable lenders than domestic banks. According to Goldberg (2002), the financial crises in host countries haven't influenced the U.S. banks' lending activities. Demirgüç-Kunt and Detragiache (1998), Demirgüç-Kunt, Levine, and Min (1999) and Levine (1999) have also shown that the foreign banks' participation in developing countries can make the probability of banking crises smaller.

In the case of the Tequila crisis in Argentina and Mexico from 1994-1995, foreign banks have been found with higher loan growth rates than domestic banks and helped reduce the credit risk in Argentina and Mexico (Goldberg, Dages and Kinney, 2000). Peek and Rosengren (2000b)¹⁸ and Crystal, Dages and Goldberg (2001)¹⁹ reached the similar conclusions.

During the Asian financial crisis from 1997 to 1998 in Malaysia, all the foreign banks kept the lending behavior (Detragiache and Gupta, 2006). Examining the reaction of foreign banks and domestic banks in ten²⁰ Central and Eastern Europe (CEE) to the financial crises from 1993-2000, De Haas and Van Lelyveld (2006) have found that during crises domestic banks reduced their lending, but foreign banks still kept their lending level.

¹⁸ They analyzed foreign banks' direct and cross-country lending between 1994 and 1999 in Argentina, Brazil, and Mexico.

¹⁹ Their study is based on the data of bank levels in the late 1990s in Argentina, Chile and Colombia.

²⁰ They are Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic and Slovenia.

Foreign banks can facilitate the competition and cooperation between banks in developing countries and therefore stabilize the banking sector. As we have mentioned above, the efficiency of the banking sector in developing countries is weak. After foreign banks' entries, the local financial services become more diversified, and to defeat the competition, the local banks try to improve the management, enhance the efficiency and develop new financial services. They try to reduce their costs and charges and therefore help make the financial system more stable. Levine (1996) argues that after foreign banks' entries, the cooperation between the foreign and local banks helps enhance the evaluation level of the local banks, reduce the financial risk and improve the stability of the whole financial system. By analyzing the data in 107 countries, Barth, Capiro and Livine (2004) and Haber and Musacchio (2005) have also argued that foreign banks help improve the stability of the local banking sector.

On the other hand, foreign banks can help improve the capital base, strengthen the risk management, decentralize the risk and increase the provision for bad debts. They can reduce the risk by providing more capital mobility.

Although in the short term, foreign banks' entries may make the local banking sector unstable, in the long term, by competing with foreign banks, the local banks can gain more valuable experience and loyal customers. As a result, the business environment of local banks becomes more stable.

4.1.3 Access to credit

During the process of foreign banks' participation in developing countries, a debatable point may be whether the foreign banks contribute to the provision of credit, in particular for small firms. Some empirical studies show that foreign banks have a global access to the credit market, are diversified among the local firms and maintain a high level of lending. Although some studies show that foreign banks tend to concentrate on lending to profitable and transparent customers and finance only selectively a few segments of the market, they can make domestic banks move to small firms. As a result, the credit of small firms is enhanced.

As showed by Berger, Klapper and Udell (2001), Detragiache, Gupta, and Tressel (2005), and Mian (2006), most foreign banks limit their lending services only to large firms.²¹ By comparing the available data on loans of different sizes of banks in Argentina in 1998, Berger, Klapper and Udell (2001) show that it is more difficult for small firms to gain credit from foreign banks. Using the data of lending portfolios in Pakistan over seven years, Mian (2006) finds that domestic banks in Pakistan lend more to small firms. Detragiache, Gupta and Tressel (2005) argue that if foreign banks focus on serving the high-end customers, they need to be more high-tech and therefore they are subject to less aggregate credit, higher operational risk and lower benefits.

²¹ These foreign banks are so-called "cherry pickers", because they serve only the profitable and transparent customers.

Some other studies have discussed the indirect impacts of foreign banks on the credit provision to small firms. On the one hand, foreign banks can facilitate the financing environment. Using the data of the foreign banks' lending behavior, Clarke, Cull, and Martinez Peria (2001) have analyzed the impacts of foreign banks on the credit of local firms and find that foreign banks help improve the competition, reduce the interest rate and enhance the financing conditions in the developing countries. Giannetti and Ongena (2005) show that the firm sales, assets and leverage ratio have been improved by foreign banks' lending, but large firms benefit more than small ones. Using the data of a survey of foreign banks' lending behavior in more than 3000 firms in developing countries, Clarke, Cull and Martinez Peria (2006) find that due to foreign banks' entries, firms will face less restrictions of financing.

On the other hand, foreign banks can affect the lending behavior of local banks. Bonin and Abel (2000) show that, because of the growing participation of foreign banks in Hungary, some local banks enlarge their lending to medium and small firms. By analyzing the results of a survey about the lending behavior of local banks in 78 countries, Jenkins (2000) finds that 44% of the investigated local banks enhance their credit provision to small firms due to the strong stress from lending to big firms.

We can find some more convincing arguments from Clarke, Cull and Martinez Peria (2005). Using data from four Latin-America countries²², they find that foreign banks indeed lend less to small firms than local banks. However, no data is available about the different lending behavior between

²² These four countries are Argentina, Colombia, Chile and Peru.

the large foreign and local banks. It is possible that small firms may gain more credit from large foreign banks than from large domestic ones.

To summarize, small and opaque firms may get less credit from foreign banks than the large ones. Foreign banks, however, can improve the financing environment and make the local banks lend more to small firms. Therefore, they indirectly facilitate the credit provision.

4.2 The negative impacts

In the short term, foreign banks' entries may also bring the host countries some unstable factors. Firstly, foreign banks may transmit the financial shocks from the home to the host countries and make the local financial system unstable. Secondly, the foreign banks' strategies may be inconsistent with the sustainable development strategies of host countries. The sudden withdrawal of investment leads to instability. Thirdly, the increasing entries of foreign banks may lead to the reduction of the franchise value of local banks. Therefore, the domestic banks may do some risky business (Hellmann, Murdock and Stiglitz (2000)). Fourthly, the increasing entries of foreign banks may lead to the excessive liberalization of the local financial market and cause the financial crisis.

4.2.1 Transmitting shocks from home to host countries

Several studies have argued that foreign banks can be affected by the shocks in their home countries and transmit them to the host countries. The regional disputes, political issues and financial crises can make foreign banks insolvent and go bankrupt. Analyzing the international economical situations and the characteristics of the capital mobility, we know that the financial incapability of a country, even of an institution can force local banks and their foreign partners into tough situation.

Martinez Peria, Powell and Vladkova-Holler (2005) have analyzed the lending behavior of foreign banks from the seven most important lenders²³ of Latin America from 1985 to 2000. They find that the banks transmit shocks from their home countries to the host countries. Although they have verified that the lower growth rate of the financial market and the less profitable opportunities in developed countries make more and more banks expand their business in developing countries, the economic depression and financial crises in the home countries can result in the deterioration of the capital sources and the decline of the credit provision. Furthermore, the low real interest rate in home countries makes banks lend riskier and higher interest rate loans to developing countries, and it leads to the instable provision of the credit.

Goldberg (2001) has also studied the lending performance of U.S banks in developing countries from 1985 to 2000. He finds that the shocks happening in the U.S. affected the U.S. banks' foreign lending a lot. The

²³ They are Canada, France, Germany, Japan, Spain, the UK, and the U. S..

lower the U.S. GDP growth and the U.S. interest rate, the less stable the U.S. banks' credit provision.

4.2.2 The inconsistent developing strategies

Foreign banks in host countries must follow their parent banks' international strategy. Therefore, they are to a large extent affected by the parent banks and may be harmful to the stability of the local financial system.

Agenor (2000) has shown that many foreign banks are not familiar with the local markets, especially the emerging markets. Once they encounter large difficulties, they may withdraw and leave the local financial market unstable. The withdrawal of investment of foreign banks is different from the bankruptcy of local banks. The purpose of foreign banks is to make profits, and they don't care much about the sustainable development of economy and society and the benefits to the host countries. Therefore, foreign banks may violate the operating disciplines in the local market, especially when the financial supervision is weak. In order to attract the foreign investment, many developing countries relax the supervision over foreign banks. It leads to the unfair competition.

According to Ma (2004), there are several illegal activities taken by foreign banks in China. Firstly, they transfer profits from host to home countries and make the local government suffer heavy revenue losses. They ask the parent banks for high interest rate loans, and in the

meantime, they remit the locally received low interest rate deposits to the parent banks. Secondly, they absorb local deposits excessively. Generally, the deposits received by foreign banks in China can't be more than 40% of their total assets. However, many foreign banks receive deposits exceeding this level largely. Thirdly, many foreign banks don't have the required operating capital. Some foreign banks keep their operating capital in the home countries or reallocate it time after time. The current assets of many foreign banks can't reach the level of the minimum requirement. According to the Chinese Banking Law, the proportion of the current assets to the deposits of foreign banks can't be higher than 25%. In fact, in many foreign banks, the proportion is just around 10%. Fourthly, they use some illegal competition ways in the settlement services, for example, charging for lower handling fees and inviting customers to travel abroad. In the process of the remittance service, some foreign banks allow the absence of some important identification, and even accept fake certificates. Fifthly, they don't pay the deposits reserves to The Bank of China on time or don't pay the full amount.

All of the mentioned above illegal activities of foreign banks impact the fair competition and the financial stability negatively in the local banking sector.

4.2.3 The decrease of local banks' franchise value

As we have discussed above, the "Cherry Picking" strategy is widely used by foreign banks in developing countries. They focus on serving the

profitable and transparent customers and may lower the franchise value of local banks. Foreign banks compete dramatically with the local banks for serving the high-level customers. As a result, the profitability of local banks decreases.

Comparing with local banks, foreign banks have many competitive advantages. Firstly, according to Miller and Parkhe (1998), in comparison with local banks, foreign banks are good at providing diversified and high-tech financial products, intermediary services, foreign exchange services and innovative services. They are diversified among the customers and have advantages in the field of capital mobility management, advanced financial services and consulting management. Their aim is not to serve all the customers, but to concentrate on the profitable and solvent enterprises. Secondly, foreign banks follow the international conventions and their business is basically not intervened by the government. Thirdly, they are mainly with a large scale, a strong capital base and well performing loans. According to Tao (2002), in 2000, the total capital of the U. S. Citibank Group was about 700 billion U.S. dollars, which was as much as the overall capital of the four largest state-owned banks in China. Its earning before tax was ten times as much as that of all the four largest state-owned Chinese banks. The proportion of the non-performing capital of American commercial banks accounted for only 0.67%. However, the large proportion of non-performing capital made the Chinese banks operate inefficiently and riskily. For example, in 2000, the proportion of non-performing capital of Tian Jin Commercial Bank²⁴ was 31.9%, which was 7.6% higher than that in 1999.

²⁴ It is a stat-owned bank in China.

In order to keep the market shares, the local banks may enlarge the amount of risky loans. It leads to the increase on non-performing loans and operational risk.

4.2.4 The excessive liberalization of the financial system

The growing entries of foreign banks make lots of foreign capital flow into host countries and improve the local liberalization of the financial system. However, the excessive liberalization may make the local banking sector unstable and stimulate financial crises.

Take Thailand as an example, before the Asian financial crisis happened, the local government advocated the liberalization of Thai financial system actively. More and more foreign banks entered Thailand and improved the liberalization process. In the meanwhile, they brought some unstable factors which could speed up the financial crises. Firstly, large amounts of inflow of foreign capital made the proportion of short-term foreign debts account for more than 50%. Secondly, lots of foreign capital flowed into real estate business. The financial institutions lent more than 25% of their loans in this field. Most of the houses were vacant and the house-sellers faced the exchange rate risk. They received foreign currency from the foreign banks, but the customers paid with Satangs²⁵. Thirdly, there were few regulations for foreign banks. They could withdraw the investment at any time. All of the factors above lead to the Asia Financial

²⁵ Satang is the currency in Thailand.

Crisis in September, 1997. As a result, Thailand suffered heavy losses. Only between September, 1997 and January, 1998, the Satangs depreciated by 56.7% and the price of houses fell by 35%. After the crisis, 63 out of 91 Thai financial institutions were taken over or shut down. The number of private banks reduced from 15 to only four, which were not taken over nor controlled by foreign banks.

5. Case studies of foreign banks' entry in developing countries

All the mentioned above sections concentrate on the general analysis of foreign banks' participation in developing countries. In this section, I will take a close look at foreign banks entries in both China and Poland.

5.1 The entries of foreign banks in China

This case study analyzes foreign banks' development periods, the factors affecting their entry decision and the operational strategies of foreign banks in China. The focus of this case study is the adjustments and changes of foreign banks' behavior since China signed the WTO agreement on November 10th, 2001. Then by analyzing these changes, I try to summarize foreign banks' general strategy in China. Next, I compare some empirical analyses of foreign banks' performance in other developing countries and argue the short-term effects of foreign banks' entries on the local banks.

5.1.1 The development of foreign banks in China

With the high speed of development of the Chinese economy, the financial system has already been the main pillar of the national economy and become the decisive factor which determines China's economic future. As early as in the 1970s, foreign banks entered China, their performing situation, strategies and behavior highly attracted the attention of the international finance circles. Nowadays though, foreign banks' market shares make up only a small part of the Chinese financial market, they have strong competitive advantages in some financial segments and show big interest in developing further services.

Affected by China's reform and open-up strategy and Chinese policies, foreign banks have performed differently in each period.

The first period is from the end of the 1970s to the end of the 1980s. In this period, China performed the economic reform and many policies were made with only a short period in mind. Foreign banks could not find obvious profitability. Therefore, only several foreign banks entered China. They were mostly from Hong Kong, Japan, America and Europe. Another feature in this period is that foreign banks always chose to establish branches in the cities where they had partners of processing trade, for example, in Shenzhen and Xiamen. If they wanted to establish representative offices, they always decided on Beijing, with only a few exceptions. Foreign banks' behavior in this period implied that to a large extent, they held the attitude of looking on and had not decided to invest in China on a large scale.

The second period is the expansion period of foreign banks' entries into China, which was from 1991 to 1997. At this time, China had already gained some successful experience from the reform and open-up strategy, and there was an obvious boom in the Chinese economy attracting foreign banks' attention. In the meantime, excluding the Chinese special economic regions, the most robust Chinese economic entity—Shanghai became the first location of foreign banks' representative offices. Shanghai stock exchange market and Guangdong stock exchange market were established one after another. This event symbolized a new period of Chinese capital market. In 1992, the Chinese government announced that China would continue to develop the reform and open-up strategy more rapidly.

Besides all the factors mentioned above, the last decade of the 20th century was also the time when China opened up to the foreign market to improve its foreign trade and to attract more foreign direct investment. The large amount of capital requirement desired by the foreign companies provided foreign banks the possibility to develop their external environment. Furthermore, the rapid economic development in China led to an increase of the interest rate. The higher interest rate of local banks attracted a large inflow of foreign capital through foreign banks and made the foreign banks more capital advantageous. As a result, more and more foreign companies went to foreign banks to seek credit support.

The third period is the contraction period of foreign banks' entries into China, which was from 1997 to 2000. The overall assets held by foreign banks were decreased from 37.92 billion U.S. dollars in 1997 to 31.79

billion U.S. dollars in 1999 (Huang and Xiong, 2006). Due to the Southeast Asia financial crisis in 1997, the growth rate of Chinese foreign trade decreased. Meanwhile, China's main trade partners—Japan and South Korea were subject to large losses. This had an impact on the business scale of Japanese and South Korean banks in China. In 1998, China's supply exceeded the demand excessively. In order to stabilize the development of the Chinese economy, the Chinese Central Bank historically, for the first time, reduced the interest rate nine times within a short time period. As a result, foreign banks were not capital advantageous any more and many foreign-invested enterprises turned to borrow from local banks and the business scale of foreign banks decreased.

The fourth period is the new developing period of foreign banks. In 2001, China signed the WTO agreement and announced that in two years foreign banks would be allowed to do Renminbi business with Chinese enterprises and in five years all of the regional restrictions imposed on foreign banks would be removed and foreign banks could provide services to all Chinese citizens. They could enjoy the same treatment as Chinese banks in application processes. In 2002, the Chinese state council announced several special regulations in banking segment, which provided foreign banks with a more detailed and exact legal base. With a more loosely legal environment, foreign banks did not expand their business largely as people expected but did business more cautiously. It implied that foreign banks were adjusting and changing their organizational and operational strategies.

5.1.2 The general situation of foreign bank development

As early as in 1979, the first foreign bank--Export and Import Bank of Japan was allowed to establish representative offices in Beijing. In 1982, China began to import some pilot projects from foreign banks and in the meantime, Hong Kong Nanyang Commercial Bank was allowed to launch Branches in Shenzhen. In 1985, the four economic special regions--Xiamen, Zhuhai, Shantou and Hainan were also open to foreign financial institutions. In 1992, seven Chinese cities--Dalian, Tianjin, Qingdao, Nanjing, Ningbo, Fuzhou and Guangzhou were open to foreign banks. In 1995, there were a total of 24 Chinese cities open to foreign banks.

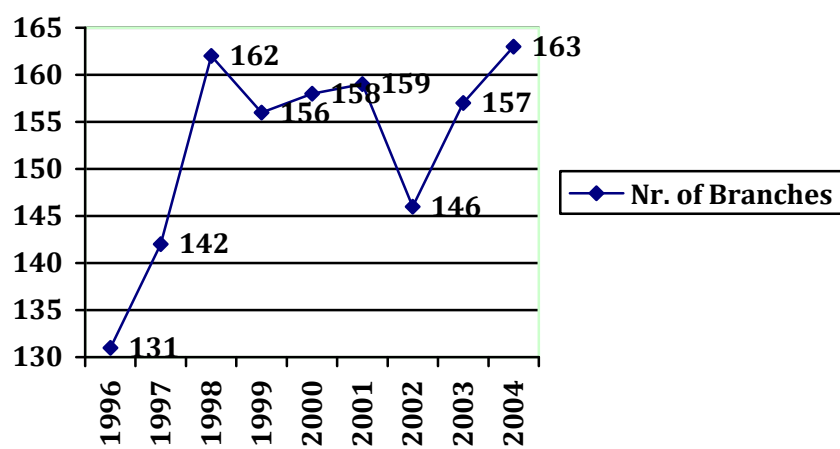
As shown in the following Figures 3 and 4, the number of branches and representative offices of foreign banks has changed dramatically in China from 1996 to 2004. In the period from 1996 to 1997, the number of branches increased from 131 to 142 and the number of representative offices increased from 527 to 543. In July, 1998, the Chinese government removed the regional restrictions of opening institutions for foreign banks and as a result, the number of foreign branches increased to 162.

On December 11th, 2001, China signed the WTO agreement and at the same time the Chinese government removed the restrictions of the exchange service for foreign banks and they were allowed to do Renminbi business formally in Shanghai, Shenzhen, Tianjin and Dalian. In 2004, 42 foreign banks from overall 19 countries and regions built 163 branches and 223 representative offices in China. By the end of 2006, there were a total

of 74 foreign banks from 22 different counties and regions in China and they had established 200 branches in 25 cities (Mervyn, 2007).

Figure 3²⁶:

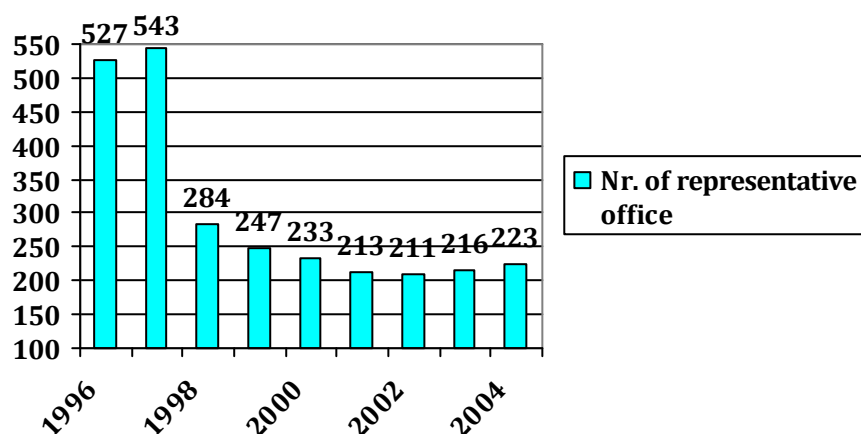
The Number of Branches Established by foreign banks in China from 1996 to 2004



²⁶ Source: China Statistics Bureau, 2004.

Figure 4²⁷:

The Number of Representative Offices Established by foreign banks in China from 1996 to 2004



5.1.3 The characteristics of foreign bank distribution

Foreign banks' home countries are mainly Asian and European countries. As shown in Figure 5, by the end of 2004, 49.18% of the foreign banks in China were from Asia, 34.51% were from Europe, and only 13.86% were from North America and Oceania. In Figure 6, we can see that, by end 2004, the most foreign banks were from Japan (65), followed by Hong Kong (58), America (38), French (25), England (23), Germany (23), Singapore (16), Thailand (15), South Korea (12) and Netherlands (11).

²⁷ Source: China Statistics Bureau, 2004.

Figure 5²⁸:

The World Distribution of Foreign Banks' Home Countries by End 2004

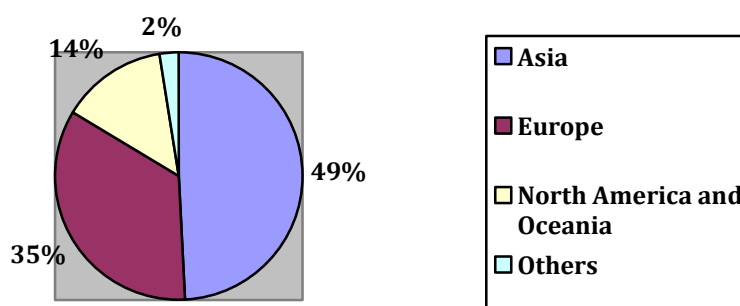
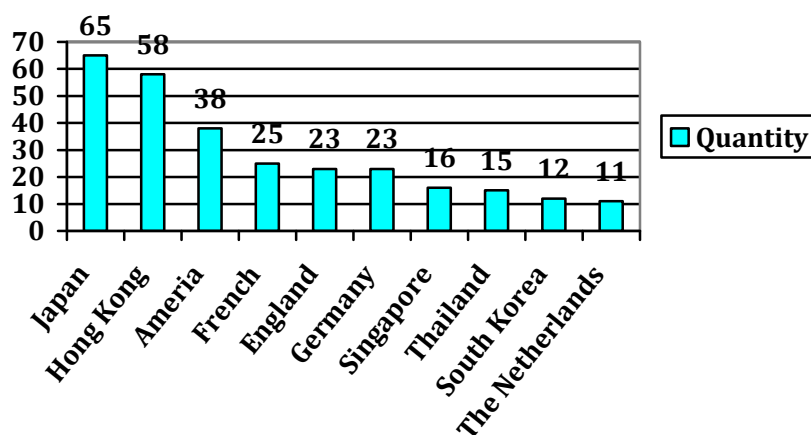


Figure 6²⁹:

Top-10 Home Countries of Foreign Banks by End 2004



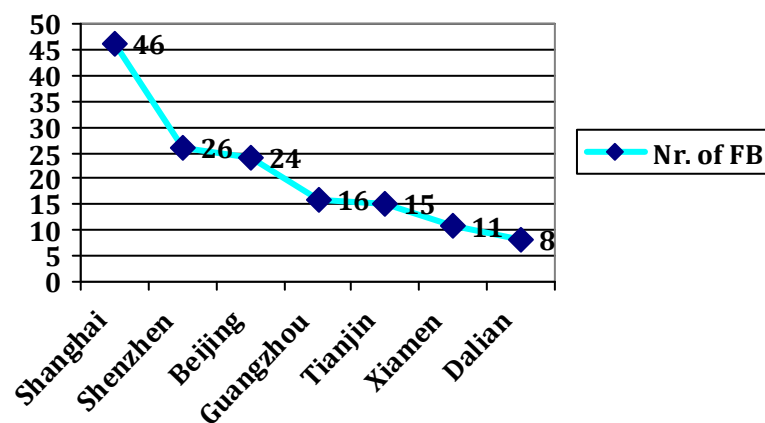
In the meantime, foreign banks have mostly moved to the coastal cities. We can clearly find in Figure 7 that, foreign banks concentrate their

²⁸ Source: China Statistics Bureau, 2004.

²⁹ Source: China Statistics Bureau, 2004.

entries on the southeast coast of China. As the most important economic city in China, Shanghai attracted the most foreign banks' entries. Shenzhen was at the second place due to its important position in China's reform and open-up Strategy. Beijing is not a coastal city but it is the capital of China which was highly economically developed. All the other cities shown in Figure 7 are coastal cities.

Figure 7³⁰: The Distribution of foreign banks in China
By End 2004



5.1.4 The changes of foreign banks' strategy in China

As early as in the 1980s, foreign banks began to practice foreign lending in China. By experiencing so many difficulties in the past decades, foreign banks have understood the Chinese financial market more deeply and accordingly they have formed their own operational strategies. The

³⁰ Source: China Statistic Bureau, 2004.

different histories, cultures and economic situations of the home countries make foreign banks use different strategies in China.

Firstly, foreign banks change from geographical distribution to benefits-seeking distribution. Foreign banks reacted very slowly to China's entry into the WTO. Comparing with the active entry of foreign banks in the 1990s, they performed passively in recent years. They established even less representative offices, especially the internationally famous banks. They expanded almost no business in China from 2001 to 2006. The established organization structure and the stagnating foreign investment have demonstrated the mature distribution of foreign banks. However, the slow speed of foreign banks' expansion made more highly trained employees stay in domestic banks.

In order to keep the promise made in the WTO agreement, many restrictions towards foreign banks are abolished. The financial environment for foreign banks is improved and foreign banks are beginning to enhance the performance of local branches and remake them as new profit-centers. For example, in 2001, in Tianjin, foreign banks survived the deficits for several decades and made a profit of 17.86 million U.S. dollars. In 2002, most of the foreign banks in Shanghai made a profit as high as 100 million U.S. dollars. Another important point is that, some of the foreign banks in China made a profit almost as high as the world's average level. Take HSBC as an example, in 2003, HSBC's ROA in China was 1.01%, only 0.02% lower than the world's average level. Such profit was made under the Chinese strictly regulated situation. Meanwhile, these figures showed foreign banks a potentially strong financial market in China.

On April 23rd, 2007, The Hong Kong and Shanghai Banking Corporation (HSBC), National City Bank of New York, Standard Chartered Bank and The Bank of East Asia opened to local customers to do Renminbi business. It implicated that foreign banks gained a new channel to make profits in China.

Secondly, the focus of foreign banks has changed from competition to cooperation with local banks, aiming at making up for their disadvantages.

The main competitors of foreign banks are the four largest state-owned Chinese banks—Industrial and Commercial Bank of China, Agriculture Bank of China, Bank of Construction and Bank of China. In the process of competing with Chinese banks, foreign banks face two main difficulties. The first one is the obstacles in the retail banking segment. The other one is that it is hard for them to find a stable source of capital in terms of Renminbi. The solution to both difficulties is a multi-dimensional retail network. Some empirical studies have also shown that foreign banks can't beat the retail banking competition with Chinese banks, because they don't have a well-connected relationship with local customers as the Chinese banks do.

The experience of the development of the international banking system demonstrates the significance of retail banking for commercial banks. Foreign banks from Europe and America experienced the tough adjustment period in the last decade of the 20th century. They reduced their branches and provided services focusing on multi-dimensional financial

services and network-banking. They applied this new kind of financial structure to the Chinese market gradually. By now, they are scrambling for the Chinese financial market by means of cooperation, buying stocks from domestic banks and making joint ventures. These are wise decisions which can help them make up for their disadvantages.

More and more foreign banks become joint stock partners of Chinese banks. On the one hand, they focus on long-term operational strategies. On the other hand, they also have short-term goal to take advantage of Chinese banks' less-regulated financial environment and better-connected banking network to enter the retail banking segment. For example, the cooperation between HSBC and Shanghai Bank resulted in the birth of international Shanghai credit card on January, 2004. National City Bank of New York and Shanghai Pudong Developing Bank have also cooperated to issue the dollar & Renminbin credit card china wide.

Thirdly, foreign banks fully use their advanced technologies and efficient management to strengthen their competitive advantages.

Generally, in comparison with Chinese banks, foreign banks have obvious advantages in terms of financial technology, products and management. What they are short in is their knowledge of Chinese customers and the financial market. However, as early as foreign banks began to make profits in China, they had basically been used to the Chinese market. In the process of competing with Chinese banks in the future, foreign banks will analyze the demand of Chinese customers using their technological and managing advantages to continuously develop new

kinds of services to meet the demand. In fact, foreign banks have overtaken Chinese banks in terms of certain services and continue to expand their competitive advantages.

On the one hand, personal wealth management has become one of the most important services of international banking. With the dramatically rapid development of the Chinese economy, there are more and more rich people in China. Therefore, the personal wealth management will be the most attractive banking service in the Chinese financial market. Some of the foreign banks have already provided such kinds of service in Beijing, Shanghai and Shenzhen. Because of the international well-know reputation, the experiences and the good access to foreign capital, foreign banks are always the first choice for Chinese when it comes to personal wealth management.

On the other hand, foreign banks own a large capital base and most of the capital is well-performing capital. They have advanced international branches and customer networks. Therefore, they are good at foreign lending and foreign settlement. In these kinds of market segments, foreign banks are continuing to expand and are more successful than Chinese banks. An advanced hardware and software system, highly developed technology and international business scope are all the main factors of intermediary business. Foreign banks are obviously better at doing intermediary business. Furthermore, using flexible risk management measures, convenient service processes and lower lending limits, foreign banks are welcomed in many contractual joint ventures, cooperative ventures, solely foreign-funded enterprises and some Chinese

well-performing firms. By using the advantages, foreign banks can rapidly restructure the financial products and provide the customers with diversified and innovative products.

Most of the foreign banks in China are big and famous worldwide. They have many successful experiences with capital management, investment banking and derivatives. On the one hand, the demand of Chinese customers for financial services is becoming more and more diversified. On the other hand, many foreign banks, for example, The National Bank of New York, are trying to form a monopoly in financial technology by applying patents to several financial products. Therefore, the Chinese banks face large stress competing with foreign banks.

Fourthly, foreign banks apply diversified styles and strategies in China.

Foreign banks apply different operational strategies depending on their different business styles. They fully use their advantages and focus on several financial services. In general, the multi-dimensional foreign banks use fully development strategy, wholesale banks continue to expand financial market and some others concentrate on special services. For example, The Bank of New York only does trade settlement business. It issues no single credit. Foreign banks from Europe and America are usually market-correlated. In contrast, most of the Asian foreign banks are banking-correlated. Many South Korean and Japanese Banks have established long-term cooperated relationships with some Chinese industries and companies to realize mutual benefits, therefore, they focus on wholesale banking. This is to say, the South Korean and Japanese

banks use the strategy of “follow their clients” in China. In contrary, the European and American banks get used to financing well-performing firms and providing multi-dimensional services. Their aim has been transferred from “follow the clients” to share the benefits in the highly developed Chinese economy.

Fifthly, foreign banks keep using their corporate culture and operational characteristics to ensure their stable development in China.

If we look back of foreign banks’ performance in recent years, we can find that foreign banks have served the Chinese customers better than the local banks. However, the flexibility of foreign banks’ performance depends on its corporate culture and operational characteristics which were gradually formed in its long-term operation in China. Foreign banks don’t seek innovation blindly but try to keep their established styles which have been firmly embedded in the mind of their employees. Because foreign banks maintain their corporate cultures and operational characteristics, they have formed the same sense of value in products and services.

5.1.5 The impacts of foreign banks in China

By analyzing the data from the four largest and ten other Chinese banks between 1996 and 2003, Huang and Xiong (2006) find that the local banks reacted very slowly to the growing number of branches and representative office of foreign banks. During these seven years, a number of foreign banks have expanded their business and formed a large network

in China. However, this fact has not been paid much attention by Chinese banks. Therefore, they have not adjusted their operational strategies a lot. On the other hand, the study shows that foreign banks' entries did not affected the net interest income of Chinese banks significantly. On contrary, the non-interest income, the operating charges, and EBIT³¹ of the Chinese banks increased consistently with the entries of foreign banks (Guo and Zhang (2005) and Ru and Ding (2005)).

Foreign banks have several impacts on the Chinese financial system.

Firstly, the growth of the quantity of foreign banks has affected the Chinese financial system significantly.

Some studies find that the increasing entries of foreign banks can influence the efficiency of local banks in host countries (Claessens, Demirgüç-Kunt and Huizinga, 2001). In some developing countries, the impact of a larger number of foreign banks' entries in the Chinese banking system has even overwhelmed that of their increasing market shares.

Generally, it takes foreign banks time from entering a new host country to establishing branches. At the first stage, foreign banks try to enlarge their distribution, but their market shares are still small. At this time, some sensitive Chinese banks are aware of this change and apply some countermeasures accordingly. In contrast, there are lots of local banks that respond too slowly to the change and as a result, they will lose their market shares. Therefore, the lack of response by Chinese banks to the increasing

³¹ EBIT is the abbreviation of the earning before interest and tax.

participation of foreign banks just reflects their slow reaction to the changes of the market.

The main reason for Chinese banks' slow reaction is the inflexible operational system of the Chinese financial market. In the management segment of Chinese banks, there is a lack of strategic and crisis senses. Furthermore, the Chinese financial market is marvelously big, but there are only a few Chinese banks. It is relatively difficult for them to find significant changes and respond to them at once.

Secondly, the net interest income is not affected by the growing participation of foreign banks.

It is due to the interest rate in China being loosely market-correlated. Although Chinese banks are flexible in setting prices of loans, the Chinese banking sector is inelastic. There are drastic competitions in pricing and strong externalities of interest revenue. Though the Chinese interest rate is becoming more and more market-correlated, the authority of pricing has only begun unregulated in recent years. The setting of the interest rate for deposit and loans of commercial banks was always controlled by the Chinese central bank. Local banks' lending behavior is largely regulated by the Chinese government. It results in the fact that Chinese commercial banks have almost no right to control and adjust interest margins.

Thirdly, the non-interest income is positively affected by foreign bank's entries. By analyzing foreign banks' performance in Eastern Europe, Uiboupin (2005) shows that the growing entries of foreign banks result in

the decrease of the non-interest income of local banks. The difference in the relationship between non-interest income and foreign banks' entries in Asia and Eastern Europe is due to the low degree of integration among Chinese financial segments.

According to the classical theory, in developing countries, if some local banks fail to compete in some segments, they intend to transfer their losses to their customers by increasing the price of products in other segments where they have competitive advantages. It applies perfectly to the Chinese financial market. With the development of the Chinese capital and currency market, the traditional savings and lending services don't appeal to the customers as much as before. Therefore, in the process of competing both with other local banks and with foreign banks, most of the Chinese banks make efforts to enhance other services to gain more non-interest income.

Under the circumstances of separated supervision on the Chinese financial market, foreign banks are still not allowed to enter the market segment that the non-interest income depends on. Moreover, due to the lack of a well-connected network with Chinese customers, it is still difficult for foreign banks to penetrate the retail banking segment.

Recently, the Chinese banks concentrated on expanding their intermediary services and some of them have even gained the underwriting right of short-term financing bonds. In the meantime, they have improved their technologies of retail banking by providing various kinds of services of built-up personal wealth management with the help of some financial

holding companies. The most attractive change in the Chinese banks' services is that they charge fees for some services which were originally free. For example, they charge annual fees for bank cards and managing fees for small-amount deposit accounts.

Fourthly, the growing participation of foreign banks leads to higher operating charges for Chinese banks. Together with the more and more competitors in the banking system, the local banks have largely introduced high-tech and new installations to change their original operating structure and organizations, in order to make up for their shortcomings compared to foreign banks. Furthermore, the Chinese banks have invested heavily in the training of employees. All of these factors mentioned above require higher operating charges. This effect of foreign banks' entries has also been found in Eastern Europe (Uiboupin, 2005).

Lastly, because the non-interest income is significantly positively correlated with foreign banks' entries and this increase overwhelms the increase of operating charges of Chinese banks. Therefore, the income before tax is also significantly positively correlated with foreign banks' entry.

To summarize, foreign banks are trying to fully develop their competitive advantages to make great profits in the big Chinese financial market. In contrast, the Chinese banks are still strictly regulated by the Chinese financial and economic system. During the competition with foreign banks, they can not adjust the strategies in time. Therefore, foreign

banks' entries have some different impacts on the Chinese banking sector than in other developing countries.

5.2 The entries of foreign banks into Poland

In comparison to China, Poland's situation of foreign banks' entries is influenced by the privatization process of Polish banks.

Before 1989, the banking system in Poland was highly controlled by the Polish government in a planned economy. The interest rate and banks' lending behavior were decided by the government. By the end of 1988, there were three state-owned banks, two shareholding commercial banks³², one cooperative bank and 1663 small local cooperative banks. Under the centralized control of the Polish government, although there were several professional banks, the National Bank of Poland contained the features of both commercial banks and of central banks and played a multi-dimensional role in the banking system. In 1989, the planned economy in Poland turned to market economy, and there was a reform in the banking system. The process of economic transition and the reform of banking system lasted from 1989-1992.

³² They were 100% state-owned banks.

5.2.1 The three reform periods of the banking sector in Poland

Similar to other Eastern Europe countries, the reform of the Polish banking system can be divided into two periods. In the first period, the centralized banking system was transformed into two segments: central bank and commercial banks. The commercial banks are based on the market. In the second period, Poland has performed a privatization reform of banks and decided to abolish the regulations towards foreign banks gradually. In general, the entries of foreign banks and the privatization of Polish banks were the most important contents of the reform in the Polish banking sector.

There are three periods of the reform.

The first one was from 1989 to 1992. The New Banking Law, which was issued in 1989, only regulated the basic guidelines in the chapter of “the establishment of new banks”. Therefore, it opened “a wide way” to foreign banks which tended to invest in Poland. Between 1989 and 1992, there were in all 70 banks established in Poland and foreign banks were regarded as weaker competitors by the local banks. Between 1990 and 1992, the Polish government published several preferential policies in terms of tax and foreign currency holding in order to provide foreign banks with a better investment environment. At that time, however, most of the foreign investors were not willing to invest in Poland because of its risky financial environment. There were only a few foreign banks in Poland: The National City Bank of New York, Creditanstalt Bankverein of Austria and The Commercial Bank of Netherlands. The intention of their entries was to

“follow the clients” and the business scope was only limited to the basic transactions related to international trade, for example, international settlement etc. They invested just because of the requirement of international trade and took almost no consideration of strategic investment. In this period, seven foreign banks entered Poland.

The second period is from 1993 to 1997. As mentioned above, in the first period, the New Banking Laws were without effective regulations in terms of establishing new financial institutions. As a result, most of the new-established financial institutions were incapable. They had a low capital level and weak operating strategies. If these regulations were implemented unchangeably, the whole banking system would also become unstable. Therefore, at the end of 1992, the chapter of “the establishment of new banks” was abolished. Meanwhile, to avoid foreign banks’ expanding their business scope in the fields where they had competitive advantages, for example, consumer loans, leasing and mortgage loans and to protect the local banks with weak competitive advantages, the Polish government only allowed foreign banks’ entries conditionally. Foreign banks were allowed to enter, only if they promised to finance the incapable local banks.

In order to improve the efficiency of Poland’s banking system and to help local banks set up a modern managing system, the local banks in Poland began the process of privatization in 1993. The main characteristic of the privatization process was the further strengthening of the openness of Polish banks to foreign banks. They sold a small part of shares of stated-owned banks to several foreign investors on the stock market, and

the government still kept its control over Polish banks through holding the majority of shares. We can see from Figure 8 below, that from 1993 to 2000, there were nine Polish banks that separated from the state-owned banks group and five among these had performed the privatization by selling their stock shares.

Figure 8³³:

The Process of Privatization of Nine Polish Commercial Banks (1993-2000)

Name of Banks	Years	Way of Privatization	Capital Shares
Wielkopolski Bank Kredytowy SA	1993	Issuing stocks	EBRD (28.5%), State (30%), other small shareholders (34.75%)
Bank Slaski SA	1994	Issuing stocks	The Commercial Bank of Netherlands (25.9%), State (33.2%)
Bank Gdanski w. Gdansku SA	1995	Issuing stocks	Big SA (24.07%)
Bank Prezernyslowo-Handlowy SA	1995	Issuing stocks	State (46.61%), other small shareholders

			(53.39%)
Powszechny Bank Kredytowy SA	1997	Issuing stocks	State(33.3%), other small shareholders (66.7%)
Bank Zachodni SA	1999	Selling FB most stock shares	AIB European Investment Limited (80%), State (4.29%), others (15.71%)
Powszechny Bank Gospodarczy SA	1999	The merger with Bank Polska Kasa Opieki	
Bank Depozytowo-Kredytowy SA	1999	The merger with Bank Polska Kasa Opieki	
Pomorski Bank Kredytowy SA	1999	The merger with Bank Polska Kasa Opieki	

In this period of privatization, although the foreign investors could only gain a small part of shares which must be less than 30%, through taking part in the management of local banking sector, they were able to learn about the market environment of the host country, wait for new chances of further development and prepare for expansion in the future. Between 1993 and 1994, EBRD³⁴ and The Commercial Bank of Netherlands had one after another become the shareholders of Polish state-owned

³³ Dong, W. 2006, "The Privatization and Introducing Foreign Banks in Reform: Poland's Experience", The Banker, 06.

³⁴ EBRD is the abbreviation of European Bank for Reconstruction and Development.

banks—Wielkopolski Bank Kredytowy SA and Banks Slaski SA. In both case, the shares of investment were less than 30% (28.5% and 25.9% separately). However, the reconstruction of the three other state-owned banks went not very successfully in terms of attracting foreign investors. In a word, due to the passive participation of foreign banks from 1993 to 1997, the process of privatization of Polish banks didn't depend a lot on foreign banks.

The third period of the reform in the Polish banking segment was from 1998 to 2000. This period was also the second part of the privatization process. To perform the duties as a member country of OECD³⁵ and to prepare for the entry into the EU in May, 2004, the Polish government gradually abolished the regulations towards foreign banks' entries. The government chose the well-performing foreign banks and sold them a large part of stock shares of state-owned banks.

This change of Poland's policy was fully reflected by the Acquisition Act of foreign banks in 1998. In this year, the government sold more than 30% of the stock shares of Bank Prezemyslowo-Handlowy SA and The Powszechny Bank Kredytowy SA to HVB³⁶ and Creditanstalt Bankverein of Austria. It was the first time that the foreign strategic investors were able to control the Polish financial institutions. In 1999, the state-owned bank Bank Zachodni SA was controlled by AIB Investment Limited of Ireland holding 80% of the stock shares. Although the assets and capital shares held by foreign banks did not change fundamentally in 1998, the new policy performed by Polish government made foreign banks gain more market

³⁵ OECD is the abbreviation of Organization for Economic Co-operation and Development.

³⁶ HVB is the abbreviation of Bayerische Hypo- und Vereinsbank AG.

shares. By the end of 1999, the assets and capital shares of foreign banks were respectively up to 47.2% and 50.2%.

Another attractive phenomenon in 1998 was that most of the Polish banks merged with foreign banks. Since 1998, besides a few local banks leaving the banking segment due to bankruptcy, the number of local banks had been decreased dramatically, because too many mergers and acquisitions were led by foreign bank. The Polish banks, however, welcomed the merger and acquisitions, because they wanted to strengthen their market position. For example, in 1999, Bank Polska Kasa Opieki SA merged with Powszechny Bank Gospodarczy and other two banks which separated from the Polish state-owned banks group in 1989.

In 2000, the process of the Polish banking system's privatization was finished, but the merger and acquisition between the foreign and Polish banks had not been ended. Especially after 2000, foreign banks had merged with local banks actively. For instance, Bank Austria Creditanstalt SA merged with Powszechny Bank Kredytowy SA and Bank Handlowy w. Warszawie SA merged with Citibank (Poland) SA.

After the privatization of the Polish banking sector, foreign banks' market shares in Poland were very stable. The number of banks in Poland's banking system declined gradually. But the high degree of concentration contributed to the development of the banking sector. Many financial indicators, for example, ROA, ROE, earning and cost ratio, interest margin etc, were improved continuously. The banking sector in Poland developed stably and soundly.

5.2.2 The successful experience of Poland's banking sector reform

Poland has succeeded in the privatization process of the banking sector. Which experience can be learned by other developing countries?

On the one hand, the regulations of the local government affect the entry decision and operational strategies of foreign banks. The regulations can also determine the role of foreign banks in the host countries. A proper policy can help improve the competition in the banking sector and push the local banks to facilitate their efficiency and strengthen the management. On the contrary, the conservative and radical policies can not only mislead the local banks but also make them lose their dominant position in the banking sector. Poland's sound and stable banking system is largely due to the Polish government's wise policy in the 1990s.

On the other hand, the supervisors of the banking system must watch the process of foreign banks' entries seriously. For example, in 1998, the stress from the negotiation with EU and the promise to perform OECD agreements made the Polish government change its attitude towards the participation of foreign banks. It encouraged the well-performing foreign banks to enter Poland. The Polish government kept a proper pace of introducing foreign banks' entries. It regarded the entries of foreign investors as an effective way to stabilize and strengthen Poland's banking sector. In order to ensure the quality of foreign banks in terms of capital adequacy and advanced technology, the supervisory department in Poland selected foreign banks carefully. Meanwhile, to avoid the banking sector being controlled by a few foreign countries, the Polish government paid

high attention to the degree of decentralization of foreign banks' home countries. For example, if a Foreign Bank was from a country which invested in Poland for the first time, the Polish government was willing to make an exception to accept its investment application. Furthermore, if the foreign bank innovated a new kind of service, for example, automotive financial services, the supervisory department would also encourage it and provide preferential conditions.

Finally, in the process of the banking sector's privatization, it is very important for the transitional countries to introduce strategic foreign investors. Although only introducing foreign banks is not enough for the reconstruction of the banking system, the participation of foreign banks can optimize the ownership structure of commercial banks, improve the level of risk management of local banks and strengthen the innovation of the banking services.

5.2.3 The impacts of foreign banks in Poland

Foreign banks have positively affected the Polish economy.

Firstly, by taking part in the privatization process, foreign banks have stimulated the transition of the Polish economy. Between 1990 and 1998, there were 244 state-owned enterprises realizing the privatization. 87 firms of them were 100% foreign-owned. 16 firms were joint ventures and through the auction of their stock shares, they participated in the privatization of thousands of small firms. By the end of 1999, the amount of

the foreign investment was about 120 billion U.S. dollars, accounting for 49.7% of the overall capital of the Polish commercial banks. The proportion of the private banks rose from 23.4% in 1998 to 25.4% in 1999. The deposits received by foreign banks accounted for 45.7% of the non-financial deposits. In the meantime, they made loans which were 50.9% of the overall amount of net loans in the Polish banking sector. (Wu, 2002)

Secondly, foreign banks have improved the employment and the qualification of the employees in the banking sector. In 1998, there were about 840 thousand employees working in foreign banks, accounting for 15.6% of the overall amount of employees in Poland (Wu, 2002). Foreign banks brought advanced technologies, modern marketing concepts and successful organizational and managerial experiences. They strengthened the management and organization of the human resource, and improved the professional skills of the employees. After holding or controlling the stock shares of the state-owned banks, in order to improve the qualification of the employees, foreign banks restructured the recruitment process and the training mechanism, and provided the aspirants with further education chances. As a result, the efficiency and the managerial level of the Polish banking sector were significantly improved.

Thirdly, foreign banks have improved the innovation of financial services. They had advantages of providing high-quality services, diversified products and up-to-date financial information. Most of the foreign banks owned good reputations in Poland, and they brought innovative financial instruments, high-tech services and advanced

operating styles into Poland. According to Yi and Guo (2002), The Bank of East Asia from Japan provided the installment payment service of housing for the first time. It improved the reform and development of housing in Poland. In the meantime, in order to spread risk, foreign banks made also bank consortium loans. The new services and managerial skills helped enhance the efficiency and reduce the risk in the local banking sector.

On the other hand, foreign banks have also brought some problems.

Firstly, foreign banks brought only limited technologies and they lend mainly to the Polish traditional enterprises instead of the high-tech industries. The reason was that the high-tech industries in Poland were riskier and on a small scale. For example, in 1999, 7.5% of the foreign investment flowed into high-tech industries and only 1.2% was into the machinery department which played an important role in high-tech industries. This phenomenon was not consistent with the macroeconomic strategy of improving Polish industries' technological level through attracting foreign investment.

Secondly, most of the foreign banks used the "Cherry Picking" strategy. They compete with local banks for serving the high-end customers. Foreign banks had many competitive strengths comparing with local banks in Poland. They had a fully developed management system, a flexible operating mechanism, advanced and standard services, and strict financial supervision. In the field of international capital business, derivatives services and intermediary services, foreign banks had advantages. In the meantime, they enjoyed many preferable treatments.

Therefore, many local customers preferred to deal with foreign banks. According to Wu (2002), 80% of the profits in the Polish banking sector were from high-end customers, and most of the high-income individuals and high-end customers turned from local to foreign banks.

Thirdly, a large number of highly trained employees in local banks went to foreign banks. In order to expand their market shares, foreign banks allured the excellent employees with some attractive benefits, for example, high salaries, many extra profits, high position and training chances in foreign countries. As a result, the local banks lost the experienced and skilled employees and the gap between the foreign and local banks became larger. The outflow of the employees could also lead to the loss of some good customers.

In summary, foreign banks bring some challenges to the Polish banking sectors, such as their limited services, the intense competition and the outflow of the employees, but continuing to attract foreign banks' entries is still a very significant strategy followed by the Polish government. Foreign banks can help improve the banking efficiency, spread the financial risk and enhance the capital allocation.

6. Conclusion

This paper has analyzed the entries of foreign banks in developing countries. Firstly, I have generally examined the factors affecting foreign banks' decision on entries, their activities, their entry patterns and organizational forms, and the impacts on the local banking sector. Then I

try to have a close look at foreign banks' participation in both China and Poland.

Foreign banks consider many factors when they expand to developing countries, such as the economic relationship between a foreign bank's home and host countries, the profitable opportunities, the local regulations and the similarities between the home and the host country. Firstly, the more economically integrated the home and host countries are, the more the foreign banks invest in the host country. Secondly, foreign banks are attracted by the great profitable opportunities. High GDP, high economic growth and low banking efficiency are all indicators of the potential profitability. Thirdly, the regulations used in the host countries also affect the entry decision. A strictly regulated banking sector is less attractive for foreign banks. Fourthly, the geographic proximity, economic similarities, similar culture and habits, and same language are also important factors taken into account by them. They intend to use their competitive advantages formed in their early business in a similar environment.

Once foreign banks enter developing countries, they need to compete with the local banks intensely. Although they perform more efficiently, the local banks are better connected with the local customers and the government. Foreign banks tend to lend more to big firms rather than the small ones, because the small firms are usually with asymmetric information and a weak legal system.

There are four main kinds of entry patterns of foreign banks in developing countries: solely foreign-invested banks, joint venture, acquisitions and mergers. Joint venture, acquisitions and mergers are the most common patterns for the reason of the existence of a less developed banking sector. If many local banks are bought by or merged with foreign banks, there will be less provision of credit for small firms, but this fact can be offset by the increase on credit provision by other local banks that haven't merged with foreign banks.

There are four types of organizational forms used by foreign banks entering developing countries: representative offices, agencies, branches and subsidiaries. The latter two forms are preferred, because they can offer the same services as their parent banks do. However, branches are too much regulated. They suffer the regulations both from host and home countries.

Foreign banks' entries in developing countries bring benefits to local banks. It improves the efficiency and stability, helps speed up the privatization of the local banks, and enhances the local access to foreign credit. Of course, in the short term, they bring also some unstable factors into host countries, such as transmitting shocks from home to host countries, following the inconsistent developing strategies, competing with local banks for high-end customers and making the local financial system excessive liberalized.

In China, the banking sector is highly regulated by the government. Therefore, the Chinese banks can't react to foreign banks' performance in

time. However, the big financial market and the high growth rate attract more and more foreign banks into China.

In Poland, foreign banks' entries are together with the privatization of Polish Banks. The Polish government have facilitated the banking efficiency and improved the managerial technologies. More and more strategic foreign investors enter Poland. In the meantime, foreign banks' business is highly supervised. All these factors make the privatization process successful. Although foreign banks provide limited services, compete for high-end customers and lead to the outflow of highly trained employees, they have stimulates the privatization process and improve the banking efficiency in Poland.

Regarding the developing trend of financial integration, there will be more and more foreign banks entering developing countries. Therefore, further theoretical and empirical analyses of foreign banks' motivations, modes and impacts are absolute necessary.

The most important topic given international attention is that what impacts the foreign banks have on the host countries after entering. Because no matter what factors make them enter and no matter what organizational forms they take, the aim of foreign banks is to make profits. It depends on a banks' objective function of the profit maximization. However, no general theories can tell us what the situation of the economical development, the financial stability, the development of local banking sectors and the local access to credit will become, after foreign banks' entries. One implication may be that there exist no general rules

available to explain the impacts of foreign banks. Both the positive and the negative effects are determined by the degree of the economical development, the market conditions and the degree of financial supervision in host countries.

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Appendix

A) Abstract

This paper analyzed the entries of foreign banks in developing countries. There are many factors that affect the entry decision of foreign banks, for example, the economic relationship between the home and host country, the profitable opportunities and the regulations in the host countries, and the similar features between the home and host countries. After entering, most of the foreign banks choose branch or subsidiary as the organizational forms. Foreign banks bring the local financial system both positive and negative impacts. In short term, they may make the local banking sector unstable, but if there are sound economical policies and effective financial supervision in the host countries, in long term, foreign banks' entries can help improve the efficiency and competition in the local financial system, strengthen the stability of the banking sector and facilitate the provision of credits to the local customers. In both China and Poland, foreign banks have improved the efficiency and strengthened the competition in the local banking sector.

Keywords: foreign banks' entries, the host country, domestic banks, impacts.

B) German Abstract

Diese Arbeit analysiert die Expansion ausländischer Banken in Entwicklungsländer. Es gibt viele Gründe für die Entscheidung ausländischer Banken, in Entwicklungsländern zu investieren, wie zum Beispiel die wirtschaftliche Beziehung zwischen Heimat- und Gastland, die profitablen Möglichkeiten und Bestimmungen in den Gastländern und die ähnlichen Eigenschaften der Gast- und Heimatländer. Nach der Expansion entscheiden sich viele der ausländischen Banken für die Organisationsform einer Filiale oder Tochtergesellschaft. Auf das lokale Finanzsystem haben ausländische Banken sowohl positive als auch negative Auswirkungen. Kurzfristig können sie den lokalen Banksektor destabilisieren, wenn aber die Gastländer über eine intakte Wirtschaftspolitik und eine effektive Finanzüberwachung verfügen, kann die Expansion ausländischer Banken langfristig dazu beitragen, die Effizienz und den Wettbewerb des lokalen Finanzsystems zu steigern, die Stabilität des Banksektors zu stärken und die Bereitstellung von Krediten für die lokalen Konsumenten zu vereinfachen. Sowohl in China als auch in Polen haben ausländische Banken die Effizienz gesteigert und den Wettbewerb im lokalen Banksektor gestärkt.

Schlüsselwörter: Expansion ausländischer Banken, Gastland, heimische Banken, Auswirkungen.

C) Curriculum Vitae



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