FINANCIAL RESTRUCTURING AND FOREIGN BANKS

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Why the Increasing Foreign Ownership?

The outbreak of the financial crisis in November 1997 revealed the weakness of credit allocation in the Korean financial system. Various banks and non-bank financial institutions in Korea became insolvent and needed external aid in order to be protected from bankruptcy. Different financial institutions have already been restructured but further work has to be done. Some domestic financial institutions already have foreign shareholders. This allows the restructuring of financial institutions without the burden of government financing or, maybe even more alarming, increased chaebol's influence on financial intermediation. But increasing foreign influence in the Korean financial system may also be an advisable choice because of another reason. It allows combining different competitive capabilities (domestic and foreign) and, thus, can cause a synthesis in order to increase the competitiveness of the domestic financial system.

Different Competitiveness of Foreign and Domestic Banks

In a comprehensive study on foreign banks' market performance in Korea (forthcoming

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〈Table 1〉 Competitive Advantages and Disadvantages against Domestic Banks From Foreign Banks' Point of View[a)]

	Advantage	Disadvantage	Neutral
Regulation	-	18	6
Network			
- domestic	-	23	-
- international	22	1	1
Human capital			
- for domestic customers	6	10	6
- for foreign customers	16	2	5
- for specific services	14	1	6
Technology	18	1	5
Reputation			
- domestic	5	15	3
- international	20	2	1

a) 24 foreign banks were asked where they saw their advantages and disadvantages in competition with domestic banks. The numbers in the table indicate how many foreign banks evaluate regulation, domestic networks, etc. as their competitive advantage, disadvantage or as neutral.

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in 1999) it became obvious that foreign banks were, both in allocative and in technical regard, more efficiently intermediating funds but had only limited market shares. The study was based primarily on data provided by the Bank of Korea and, moreover, on a survey which was realized with Bank of Korea's assistance and included 24 foreign banks as well as 11 nationwide commercial banks (representing more than 80 per cent of all assets held by foreign banks and nationwide commercial banks). One of the main topics of study was foreign banks' relative competitiveness compared to domestic nationwide commercial banks. Tables 1 and 2 present the results. Obviously, foreign and domestic banks' assessments of their relative competitiveness correspond to the different kinds of competitive capabilities -- except for a different assessment by foreign and domestic banks regarding the impact of regulation on each's competitiveness.

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Foreign banks enjoy comparative advantages especially because of their international networks, which enable them to mobilize funds from various parts of the world and international financial centers more easily than Korean banks (despite the growing international activities of Korean banks). 22 of the 24 foreign banks saw their international networks as a comparative advantage in competition with domestic (Korean) banks and, correspondingly, 10 of 11 domestic banks saw a disadvantage for themselves in this respect (only a single nationwide commercial bank saw neither an advantage nor a disadvantage and valued its international network as neutral in competition with foreign banks).

Moreover, foreign banks have a higher international reputation as the corresponding assessments of both foreign and domestic banks in Korea (as Tables 1 and 2 demonstrate). Similarly, comparative advantages exist for foreign banks regarding their technology and human capital to do business with foreign customers (who operate in Korea) or for their human capital to offer specific financial ser-

〈Table 2〉 Competitive Advantages and Disadvantages against Foreign Banks From Domestic Banks' Point of View[b)]

	Advantage	Disadvantage	Neutral
Regulation	2	6	2
Network			
- domestic	10	-	-
- international	-	10	1
Human capital			
- for domestic customers	9	1	1
- for foreign customers	1	9	1
- for specific services	1	8	2
Technology	1	9	-
Reputation			
- domestic	9	1	1
- international	1	9	1

b) 11 nationwide commercial banks were asked where they saw their advantages and disadvantages in competition with foreign banks in Korea. The numbers in the table indicate how many nationwide commercial banks evaluate regulation, domestic network, etc. as their competitive advantage, disadvantage or as neutral.

vices. Regarding the latter, foreign banks profit from their international presence which enables them to offer financial products just recently innovated and introduced in other national or international financial markets.

On the other hand, domestic banks are superior because of their larger (national) network inside Korea (domestic network) and enjoy a higher domestic reputation compared to foreign banks in Korea, who are relatively small in branch presence and less known (and strange) to Korean customers. Furthermore, domestic banks have better human capital for doing business with Korean customers because foreign banks are run frequently by foreigners who are less familiar with Korean customs and have less contacts with Korean business partners. Thus, especially retail banking is difficult to be realized by foreign banks. Only for regulation do the assessments of foreign and domestic banks differ as Tables 1 and 2 indicate. Obviously, both foreign and domestic banks interpret (despite deregulation) the remaining differences between regulation of foreign and domestic banks in a way that each party thinks to be more restricted by regulation than the other.

Synthesis by Combining Foreign and Korean Capabilities

Finally, it can be concluded that neither for foreign nor for domestic banks does a general superiority in competition exist. Foreign banks may be able to allocate funds more efficiently as foreign banks' higher profitability and a smaller burden of non-performing loans throughout the 1990's indicate. Moreover, they are more efficient in a technical regard because of competitive advantages in technology. But the limited domestic network, a lower domestic reputation and the weakness in human capital for doing business with Korean customers significantly limit foreign banks' ability and capacity for business, especially in retail banking. Only Citibank, which runs various branches in Seoul and Pusan, is engaged in this business field. Consequently, foreign banks' overall market shares remain small and competition with domestic banks limited.

At the same time the above analysis gives evidence that there are various capabilities which Korean banks can learn from foreign banks and, thus, profit if a partnership would be implemented. Already in 1998 various domestic banks got foreign shareholders or partnerships. Furthermore, since the early 1980's, with the founding of Shinhan Bank (founded by Koreans which had lived in Japan) and KorAm Bank (founded as a joint-venture between Korean partners and Bank of America), banks with a strong international background have existed in Korea. In the past especially Shinhan Bank has proved to be highly competitive and more successful in business than other Korean nationwide commercial banks. Here it is also noteworthy that these two banks with their international background differ in some questionnaire-results from ordinary domestic nationwide commercial banks presented in Table 2 by evaluating some capabilities as competitive neutral in which other nationwide commercial banks assess as disadvantages in competition with foreign banks.

Thus, for the Korean government it is worth considering to allow further acquisitions of equity shares in Korean banks by foreign banks compounded with a stronger foreign influence on the management of these formerly domestic banks. By building joint-ventures between foreign and domestic banks a new quality of financial institutions can be established and a new quality of banking can be achieved for Korea. VIP

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