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Master thesis

Is “Follow the Customer” an Entry Strategy Aboard?

— Foreign banks follow the automotive corporate customers in China

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Abstract

Our paper tries to verify the relation between international banks' expansion and international automotive corporations' overseas business in China. Pervasive phenomena indicate that foreign banks take following their clients as the initial strategy when they start overseas business in China's market. As many previous literatures analyzed, in the beginning stage in a new foreign market, multinational banks adopted this passive strategy and intended to follow some manufacturing enterprises from their home countries. The Chinese automotive sector is a touchstone of opening to foreign investors since the reform in China. It also gradually becomes an important tie for foreign banks' overseas business. On one hand the multinational banks can afford capital support and financial service for their home country customers. On the other hand they can reduce the risk of expanding into a new market and prepare for grow up at an appropriate time. To achieve our purpose, we study the factors on foreign banks' entry from host country level. We built the OLS regression on total foreign banks assets and added the total asset of the foreign automobile companies and total trade volume in auto sector as independent variables in order to research this relationship. From our analysis, the multinational banks are proved to follow their customers - foreign automobile companies to some extent.

Key words

Foreign banks, Following the customers, Automotive companies, China's financial market, Overseas expand

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1. Introduction

1.1 Background

China is a new emerging market country and it has its own special market economy. The government carefully opens China's market and still controls most of the key industries. Although the foreign enterprises are looking forward to enter this potential market, the state publishes many regulations to retard the foreign enterprises' entry. The bank industry is a typical representative oligopoly industry that the government controls the four major State-owned commercial banks. Before 2001, China did not open the financial market to the foreign banks. But actually there were many foreign banks' representative offices being set in China since reform and opening up in 1979. The number of these offices always keeps increasing year by year. From this phenomenon, many economists researched the strategies using by the foreign banks in China. Then they found the foreign banks explore China's financial market through their customers.

On the other hand, we know that the automobile sector is the main manufacture industry which China opens to the foreign enterprises. Because China is lack of the technologies and product lines, the government encourages the companies in auto sector bringing the foreign capitals and technologies. The foreign auto companies can run many cooperated program of production with China local auto companies, and even there are many joint-venture auto companies emerging. Thus the foreign auto companies enter in China easier and earlier than most other industries. In addition, the auto enterprises also are the main customers of the foreign banks. The foreign banks set the agencies in China to provide the services to these customers.

1.2 Purpose of the study

In this paper we want to verify the "follow the clients" strategy in China through the analysis of the relationship between the foreign auto enterprises and the foreign banks. We put our focus on the effects of the total asset of the foreign auto companies and trade volume of the auto sector on the growth of the asset of the foreign banks. The main question to be solved is that "Whether the foreign banks follow the automobile companies to expand business in

China's market?"

1.3 Method

We run the OLS regressions on 'Total Assets of Foreign Banks' from 1992 to 2006 to establish the relation between the growth of asset of international banks and the expansion new business in international automotive enterprise. We use the total asset of the foreign auto companies and the total trade volume in auto sector as the indicators for the business expansion of foreign auto companies. In order to get the coefficient of the parameters of the model, we collect data from different resources such as the China Automobile Yearbook, Almanac of China's Finance and Banking and so on. Additionally we illustrate the distributions of the foreign banks' branches and representative offices in China. We contrast the locations of the foreign banks and foreign automotive corporations from the same home country.

1.4 Limitations

However, there are several shortcomings in our paper such as the data is not adequate and not good enough to build good models. First of all, the yearly data only covers 14 years, which will demonstrate a low explanatory power on the regression. Because we could not separate the industry-level data of auto sector and bank sector from different home countries, the OLS models could not answer the "follow the customers" question very well. The second problem is that the model is not mature. We just select the volume of auto trade, total foreign auto companies' asset and the total FDI as explanatory variables, as well as some other control variables. The result of the model only explains the "follow the customers" strategy to some extent. So we draw two supplemental tables to compare the locations of foreign auto corporations with the locations of foreign banks.

1.5 Outline of the study

In this paper we will introduce the situations of the foreign banks' expansion in China in second chapter. The third chapter will demonstrate the development of auto vehicle sector with the foreign investment and the relationship between the auto sector and bank sector. The

fourth chapter is the main research of the data, the variables, the methodology and the models.
The final chapter is the conclusion of our paper.

2. Literature review

2.1 The theories of foreign banks expansion

From the 1990s the foreign banks' market shares are raising up in the emerging marketing countries such as the South America and the central and eastern European countries which transformed their economic system. The most obvious change of the financial structure is that many foreign financial institutions coming into these countries' bank system. This reflects the trend that the global banks will integrate recently. However, the internationalization of the financial service industry forces the banks facing the competition of other non-bank financial service institutions such as the securities enterprises. This leads the revenue and net profit margin of the banks substantially reducing (Folker-Landau and Chadha, 1999; Vansetti Guarco, and Bauer, 2000). Meanwhile bank is an information and computer intensive industry, the scale economics and the widened scope of the production will promote the multinational banks to go dabble in other financial fields and to expand overseas (Canals,1997). On the other side the central and eastern European countries with the economics in transition have many difficulties to establish the efficient and stable bank system by their own. Therefore the governments think that the practical plan to solve the bank system transformation is selling the state owned banks to the foreign investors.

Nevertheless we find that in Asia the number of foreign banks is much smaller than the South America and the central and eastern Europe. The previous researchers give us several reasons to explain this special phenomenon in Asia. The first one is that the governments are worried about the foreign banks will largely reduce the local loans speedily when the financial crisis comes. It means the foreign banks cannot support the host country to develop the economy with the steady funds. The other reason is that most of the Asian banks are state or family owned and operated, which is a barrier for foreign banks to come in, because the governments or families always are not willing to transfer the ownership to the foreign investors. As a result the foreign banks should do a lot of inevitable restructuring work in order to come into the Asian financial market (Fitch IBCA, 1999).

Then the researchers raise the hypotheses about the reasons and the patterns of the foreign

banks' entry into the emerging marketing countries. They think that the ratio of the new foreign investors' participation and control is affected by the cost and benefit from both the foreign banks which have already entered in the local market and the local banks. Moreover the local macroeconomics conditions, the structure of the financial system and the government's willing to open the financial market to the foreign banks will influence the degree of the foreign banks' participation. In a sum, the factors which impact whether the foreign banks expand overseas can be separated into two levels: the foreign banks themselves and the host country. Some researchers supposed that the "follow the clients" strategy is a strategy for the foreign banks in an initial stage. When the multinational enterprises expand overseas and establish the branches, the banks will set up the branches and subsidiary banks abroad follow these main customers in order to provide the financial service to the abroad customers. Goldberg and Saunders (1980) researched the situations of expanding to overseas for the banks of America in 1970s, and then they found a positive relationship between the export from America to British and the foreign direct investment from American banks to British. Furthermore the foreign direct investments from non-bank sectors also affect mainly to the foreign direct investment in bank sector. Under the situations such that the degree of the economic integration is high and the economic contact is close between host country and home country, the foreign banks will operate the new business and provide the continuous financial service overseas following the existing customers. The economists always use the FDI from non-bank sectors to describe the degree of the economic integration between the two countries. The results of the precious researches found that the higher the degree of economic integration between the two countries, the more FDI in banks sector. Then the ratio of participation and control of the foreign banks has the positive relation with the raise of FDI. The phenomenon is more obvious in developed countries.

From the host country level, the economists find that the government deregulating the entry of the foreign banks will attract the foreign investors. The barriers which are the laws and regulations' restricts prevents the foreign banks coming into the host country, limits the competition in local banks sector and protects the domestic banks which lack efficiency. Focarelli and Pozzolo (2000) found that the foreign banks are more willing to invest in the

countries which have less restricts in banks' operation. The research from Barth, Caprio and Levine (2001) indicated that the strict restrictions on the banks have a relationship with the higher interest differential and the cost of management. Before 1990s most of the emerging marketing countries had more severe limitations to the foreign banks in obtain the operation license, the total number of the branches, the business scope, the share of the stockholding and so on fields. Thus the rate of the participation and control of the foreign banks is much lower in the countries which have stern financial laws and regulations. From the latter half of 90s the emerging marketing countries especially the countries under the financial crisis encouraged the foreign investors bringing much funds in the country to reduce the cost of banks restructuring. With the speedy economic increase and the lower inflation rate in these countries, the profit rate boosts in the host countries' bank sector. Moreover the regulatory environment and business environment improved much better in these countries for the foreign banks, so this leaded a large amount of foreign banks' entry. Due to the local banks service market exists the incomplete information system, thus the foreign banks can gain the advantages of the internalization by following the customers. The foreign banks could internalize the information flow of their customers through establishing the local branches in these countries.

The host country macroeconomic environment getting better will directly improve the investment environment and increase the FDI in the local bank sector. The potential profit-making opportunity of bank sector will rise in these countries. Therefore the foreign banks always choose the areas having better profitable future to invest. The research of Brealey and Kaplanis (1996), Yamori (1998) and Buch (2000) proved that the per capita GDP in host country has a positive relationship with the FDI of the foreign banks. Based on the empirical researches of the emerging marketing countries, the host countries' stably increasing economy will promote the foreign banks' investment. With China's economic annual growth rate average is above 8% and the financial deepening degree is higher, China has a good prospect of the economic development. As a result China provides a wide developing space to the foreign banks and the foreign banks have strong willing to come in China financial market to attain the new profit growth. But China has strict limitations in terms of the market access

and the business for the foreign banks, so that the ratio of the foreign banks' total asset in financial institutions' total asset was much lower than the average level of the industrialized countries and other emerging marketing countries as only 1.5% by 2004.

Wang and Miao (2004) found that the number of the foreign banks' branches have obvious positive correlation with the trade volume between the home country and China and the non-bank FDI from the home country. They are two important factors on the FDI in bank industry. In order to satisfy the need of the existing clients, the foreign banks established branches in China following the home country's customers. Thus the "follow the clients" theory is verified in China. There also some foreign banks come into China's financial market before the clients come in. They provide the inquiry service to the customers such as the information of China's legal environment, the credit rating of the lenders and so on. They assist the clients in accomplishing the preparatory work before entering the China's market.

2.2 The reasons of the foreign banks' expansion overseas

There are two main theories to explain the reasons of the foreign banks expansion. The first one is the internalization theory. In 1976 Buckley and Casson published the book "The Future of the Multinational Enterprise", which indicated that the internalization theory had been formed. The internalization theory has two parts, one is the theory of the firm from Coase and the other one is the location theory. There also are two assumptions of the internalization theory which are corporations' profit maximized and incomplete market. The multinational banks not only provide the final productions to the clients but also sell some intermediate productions through the cross-border banking network by using transfer pricing (Buckley and Casson, 1991). Owing to the incomplete market the banks can not protect their own rights and benefits when they transfer the intermediate productions. Furthermore they also can not guarantee the maximization of the banks' benefits through allocating the resources by the market. So the banks would like to reserve the control right of the intermediate productions by the internal market of these productions. Then the multinational banks put various international market transactions in an entity's internal scope. The banks carrying out the

internalized market is intent to eliminate the defects of the incomplete market. The aim of the internalization is reducing the transaction cost of the competition and gain the profit.

The second theory is the eclectic theory. The eclectic theory of international production was proposed by J.H. Dunning at 1977 in "Trade, Location of Economic Activity and the Multinational Enterprise: a Search for an Eclectic Approach". This theory includes three close interrelated elements: the ownership advantage, the internalization advantage and location advantage. The economist Gray is the first person applied the eclectic theory to the multinational banks. The local banks have the location advantage because they are familiar with the local customers' preference, they have lower communication cost and they spend shorter travel time. Meanwhile the multinational banks have the capability to compete with the local banks because they have the ownership advantage. We focus on one element of the ownership advantage is the importance of the non-pricing competition in bank service. The multinational banks can create the advantages in short term by the apparent differentiation of the productions and the advantages in long term by the perceived differentiation of the productions (Yannopoulos, 1983). The apparent differentiation of productions could be achieved by the bank service differentiation, but the long term differentiation of productions is difficult to obtain. Because the perceived differentiation of productions is correlated with the bank size, the credit rating and other factors, moreover these elements can not be traded in the market or be imitated by other banks, these differentiations brings long term advantages to the multinational banks. Furthermore, the foreign banks have the unique bank technique and management experience, and most important is that they can integrate the advanced organizational structure with specific local market conditions in host country. These are the basis of the foreign banks making full use of the comparative advantage. Consequently the eclectic theory considers the ownership advantage and the location advantage and so on factors, and it emphasizes on the capability of the foreign banks providing the different productions to the host countries. This theory becomes one of the main theories of analyzing the foreign banks' cross-border operation recently.

2.3 The development process of foreign banks in China

2.3.1 The history of foreign banks' development

The first phase (1979-1990)

Export-Import bank of Japan is the first foreign bank setting up the representative office in Beijing in 1979 by China government approved. In 1981 China approved the establishment of the first branch of the foreign banks which is Shenzhen branch of Nanyang Commercial bank after opening-up and reform. Because of the initial stage of the opening, most of the policies were experimental. Moreover China permitted foreign financial institutions setting up operating financial agencies in special economic zones in 1982. This is the beginning of substantial opening of the China's finance industry. Bringing the foreign banks in China is according to the need of the development of export-oriented economy in special economic zones along coast. In 1985 the government allowed the foreign banks setting up the institutions in Xiamen, Zhuhai, Shenzhen, Shantou and Hainan such special economic zones. However, we find that in this period the foreign banks coming into China were mostly from Hong Kong and partly from Japan, Europe and America which traditionally operated China's business. In these foreign banks, the business was dominated by the Hong Kong's financial institutions which had the closest relationship with the trade of the coastal special economic cities. The obvious characteristic of this stage is that the foreign financial institutions always chose the direct trade intensive areas like Shenzhen and Xiamen to set up the operating branches, while most of the representative offices were founded in Beijing. In this stage, the foreign banks did not carry out the scale of capital investment in China but mainly explored the China's market and had wait-and-see attitude to the China's opening up and reform.

The second phase (1991-1996)

From 1991 to 1997 is the period of rapid expansion and development for foreign banks in China. In these years, the number of new opening foreign banks branches was more than a dozen every year. The reason is that the reform and opening up had already obtained great achievement through ten years' development, and then the foreign banks obviously looked forward to the prospect of the China market economy. In this phase the government took many policies to encourage the development of foreign banks. At first in September 1990 in

order to promote the construction of Shanghai Pudong development zone, Shanghai became the first city besides the special economic zones which is permitted to bring the foreign banks' operating branches in the city by the government. This opening up policy of the most powerful economic region in China led the foreign banks to turn their eyes from Beijing to Shanghai. The Shanghai stock exchange and Shenzhen stock exchange officially opened at December 19, 1990 and July 3, 1991. This is a sign that a new era of China' capital market development has begun. After Mr. Deng Xiaoping's "inspection of South" speech and the State published the policy about fastening the speed of the opening up and reform in 1992, the government decided to open seven more coastal cities to the foreign banks. In 1994, the government decided again to open some mainland cities like Hangzhou and Wuhan to the foreign banks operating branches. At last Beijing was permitted to open in 1995. Besides of these policies encouraging the foreign banks, the 1990s is the period of fastest growth of foreign trade and attracting the most FDI in China opening up history. The strong demand from the foreign enterprises was a good external environment for the rapid development of the foreign banks. Furthermore the overheating development of the China's economy caused the lasting higher domestic interest rates relative to the international market. This attracted lots of the foreign capital coming into China financial market to arbitrage through the operation of the foreign financial institutions. On the other hand, the capital from foreign banks had the cost advantage relative to the domestic banks, thus the foreign corporations had strong preference to seek the financial resource from the foreign financial institutions.

The third phase (1997-1999)

In 1997, the financial crisis in Southeastern Asia broke out. The economy of eastern Asian regions suffered a severe setback, especially Japan and South Korea. Many of the Japanese and South Korean banks emerged large of bad debts, so they had to clear up the investments in China and reorganized their assets. In the following year, these banks closed part of the representation offices and operating branches in China. Therefore from 1997 the foreign banks' China business experienced a three-year's contraction period. Thus the total assets of foreign banks in China also had a negative growth from 37.92 billion US dollars in 1997 declining to 31.79 billion US dollars in 1999. At the same time the financial crisis caused the

various degree of the currency devaluation in the Southeastern Asian countries, and then their competitiveness of the exports had a great raise. Due to the alternative of the trade productions between China and other Southeastern countries, the foreign trade of China had the first negative growth in 1998. The serious damage of the domestic economy in Japan and Korea such trade partners countries aggravated the setback of the China's foreign trade. The decrease of the trade volume squeezed the market space for the foreign banks in China. In addition, the China's economy began to show a comprehensive supply exceeding the demand situation from 1998. With the aim of stimulating the economic demand, the People's bank of China continual reduced the interest rate for 9 times in these years. However, this measure made the foreign banks losing the capital cost advantage, thus the foreign currency loans had the pressure of expected appreciation. In this situation most of the foreign enterprises and joint venture corporations decreased the foreign currency loans and shifted to the Chinese banks for the RMB financing. Therefore in this phase, the business in China had an overall decline for the foreign banks.

The fourth phase (2000-now)

After China formally joined into WTO at December 11, 2001, there was an outside acceleration as well as a deadline for the full opening of China's financial market. Hence the all-around opening up of the China's financial industry began. The government deregulated many limitations to the foreign banks according to the global rules and coordinating the development of China's economy, so that the development of foreign banks is faster. On the other hand, since China joined in WTO the foreign banks changed the strategies of expansion. They expanded the business through establishing the operating institutions and investing in shares of Chinese banks. In 2001, China promised that allowing the foreign banks to handle the RMB business for the Chinese enterprises within two years after joined the WTO. And within 5 years, the government would eliminate the restriction of the regions and allow the foreign banks provide the services to all of the Chinese customers. For example, the government announced the cancellation of the geographic restriction to the foreign banks' setting up the branches, so that the foreign banks can establish the offices in any city. The foreign banks can get the national treatment as the Chinese banks to set up the local branches

in the same city. The State Council promulgated “People’s Republic of China Regulations on Management of foreign financial institutions”, and the People’s Bank of China published “People’s Republic of China foreign-funded financial institutions to manage the implementation of the ordinance rules” and “Foreign-funded financial institutions representative office in China the management approach” in 2002. From then the foreign financial institutions including foreign banks have the explicit management ordinance and regulations in China.

Therefore the development of the foreign banks enters a new and legal-regulated stage. The proportion in FDI accounted by the direct investment from foreign banks to China including paid-up capital and equity investment has increased year by year. The direct investment from foreign banks to China accounted 23.82% in 2005 which compared with 2001 raising 17 percentages. In December 2006, China has promised the full liberalization of the financial industry to the abroad so that the foreign financial institutions could receive the national treatment as the Chinese financial institutions. At May 2007, there were in total 75 foreign banks from 42 countries establishing offices in 25 Chinese cities. These institutions included 12 foreign corporate banks which had been approved to restructuring and 186 foreign banks operating agencies. And there were 86 foreign banks branches and 12 corporate banks being permitted to access the RMB business. When the State owned banks reformed and reorganized the asset, there were 16 foreign banks participating in the process and becoming the shareholders of the Chinese banks. The RMB assets of the foreign banks increase rapidly. The amount of total assets was 989.6 billion RMB Yuan which was 1.62 times of the amount in 2001. And with the number of the operating foreign banks offices for the RMB business increasing of 67 than December 2001, the deposit and loan business expand speedily. The total deposits of foreign bank in both foreign currency and national currency stood at 305 billion RMB Yuan which has an increase of 4.27 times relative to the end of 2001. Nevertheless, with the expansion of the operation scope allowed by the policy, the foreign banks do not aggressively occupy the market as the government expected and worried. Instead, the development strategies and business arrangement and such fields of the foreign banks have been undergoing the profound changes and adjustments in China, so that the

foreign banks restrain their own actions in China. They slow down the expansion speed and explore this new area gradually and solidly.

Foreign banks expansion				
Year	Representative Offices	Branches	Total	
1986		154		154
1987		163		163
1988		166		166
1989		173		173
1990		179		179
1991		181		181
1992		310		310 ^{*1}
1994		393		393 [*]
1996		285		285
1997		275		275
1998		257		257
1999		247	156	403
2000		233	158	391
2001		213	159	372
2002		211	146	357
2003		216	157	373
2005		240	192	432
2006		242	209	451

Table 2-1 Foreign banks expansion

Data resource: Almanac of China's Finance and Banking from 1993-2007

¹ * The data includes all the financial institutions.

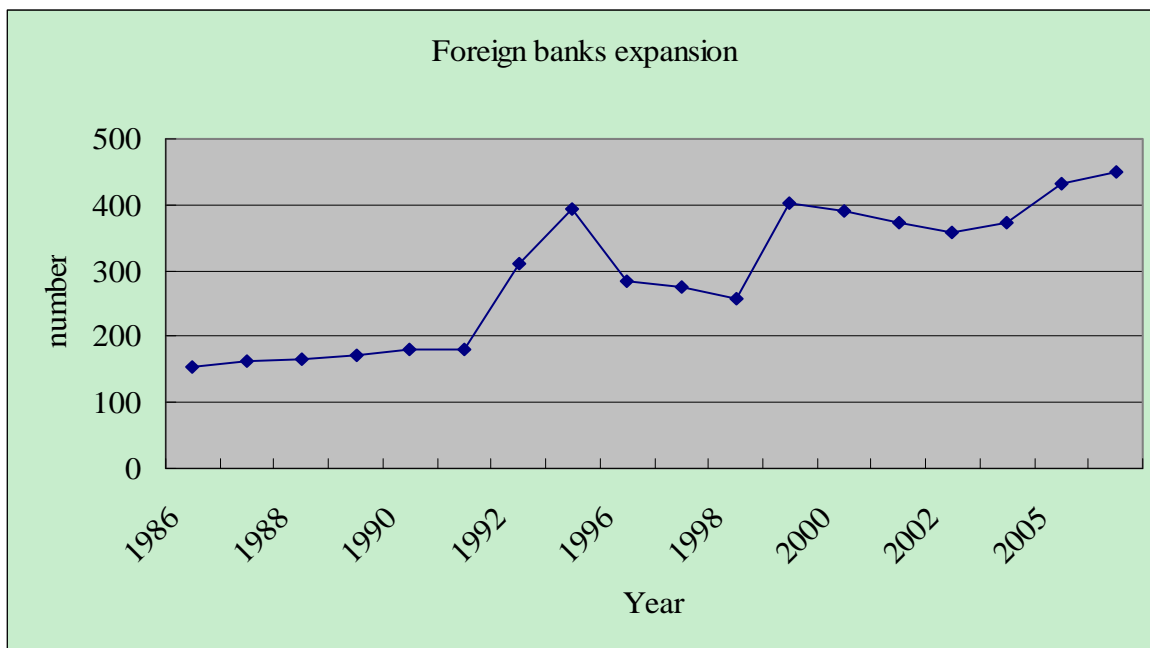


Chart 2-1 Foreign banks expansion

Data resource: Almanac of China's Finance and Banking from 1993-2007

2.3.2 The distribution of foreign banks

When the international enterprises expand business into China, the location choice is a critical issue. It is the same to the foreign banks. Li and Park (2006) examined three sorts of factors of location selection of FDI in China, including agglomeration economies, infrastructure environment and institutional changes, all of them are exerting strong effects on FDI. The conclusion is that the choices of FDI location focused on the opening coastal cities in the earlier period. The Special Economic Zones (SEZs) in China are listed separately in the national planning including financial planning by political authority and they even have city-level autonomy. Such areas are generally benefited from more favorable government treatment and have other political capital advantages, which may affect economic performance better and better (Victor & Sonja, 2007). Due to such a series of advantages in the open cities, the unprecedented growth of FDI including foreign banking investment occurred and assembled in these special locations. At the same time the government permitted the foreign banks setting up the offices in special economic zones such as Xiamen, Zhuhai, Shenzhen, Shantou and Hainan. Therefore, the foreign investments concentrate in SEZs and build a cluster of multinational corporations' branches there.

Later, Chinese coastal cities open to the outside world gradually. They have been enjoying more the city-level autonomy and fewer restrictions to foreign investment. For instance, in order to assist to development of Pudong area, the State permitted the opening to the foreign banks in Shanghai in 1990. With the deepening of the opening-up and reform process, there are seven cities along the coast Guangzhou, Tianjin, Dalian, Fujian, Qingdao, Ningbo and Nanjing authorized to open to the foreign banks in 1992. The earlier multinational banks in China had to establish branches or representative offices in the open cities because only those districts were opened to foreigners. After the government canceled the geographic restriction of the foreign banks, the banks can build the institutions in any city. Meanwhile the RMB business was opened to the foreign banks, and then the different foreign banks choose different patterns to expansion. So from that time there is no regular pattern in the locations of the foreign banks' branches and offices.

The Table2-2 and Table2-3 below demonstrate the preference of foreign banks' location choice. From the two tables we can easily find the Beijing, Shanghai and Guangdong province are the most popular choices for the foreign banks to expand business in China. Furthermore, Jiangsu, Zhejiang and so on coastal cities are the second location choice for overseas investors. This is contributed to that those cities as the more agglomerated economic zones have attracted more foreign investments.

Bank branches distribution in 2006							
No.	City	Province	number	No.	City	Province	number
1	Shanghai		57	13	Shantou	Guangdong	4
2	Beijing		27	14	Suzhou	Jiangsu	4
3	Shenzhen	Guangdong	22	15	Hangzhou	Zhejiang	3
4	Guangzhou	Guangdong	19	16	Nanjing	Jiangsu	3
5	Tianjin		13	17	Shenyang	Liaoning	3
6	Xiamen	Fujian	9	18	Wuhan	Hubei	2
7	Chengdu	Sichuan	7	19	Xian'an	Shanxi	2
8	Dalian	Liaoning	7	20	Wuxi	Jiangsu	2
9	Qingdao	Shandong	7	21	Yantai	Shandong	2
10	Chongqing		5	22	Kunming	Yunnan	1
11	Fuzhou	Fujian	4	23	Haikou	Hainan	1

12	Zhuhai	Guangdong	4	24	Dongguan	Guangdong	1
			Total				209

Table 2-2 Bank branches distribution in 2006

Data Resource: Almanac of China's Finance and Banking of 2007

Bank Representative Offices distribution in 2006							
No.	City	Province	number	No.	City	Province	number
1	Shanghai		95	13	Fuzhou	Fujian	2
2	Beijing		82	14	Hangzhou	Zhejiang	2
3	Guangzhou	Guangdong	17	15	Haerbin	Heilongjiang	1
4	Shenzhen	Guangdong	6	16	Kunming	Yunnan	1
5	Dalian	Liaoning	5	17	Chongqing		1
6	Tianjin		4	18	Nanjing	Jiangsu	1
7	Shenyang	Liaoning	4	19	Zhuhai	Guangdong	1
8	Suzhou	Jiangsu	4	20	Kunshan	Jiangsu	1
9	Xiamen	Fujian	4	21	Nantong	Jiangsu	1
10	Wuhan	Hubei	3	22	Ningbo	Zhejiang	1
11	Chengdu	Sichuan	2	23	Qingdao	Shandong	1
12	Dongguan	Guangdong	2	24	Quanzhou	Fujian	1
			Total				242

Table 2-3 Bank Representative Offices distribution in 2006

Data Resource: Almanac of China's Finance and Banking of 2007

3. China Automotive Industry

3.1 Rapid development of auto sector with the policy changing

3.1.1. Chinese Policy in the beginning of market economy

China's automotive industry has been gradually regarded as a pillar sector of economy since China change into the market economy system in 1992. On January 20th 1992, Domestic Automotive Meeting was held in Beijing. The spokesman has announced: "To develop the automobile industry, we must follow the strategy--deepening reform and opening up, shifting focus to adjusting industry structure, enhancing economics return ,appreciating scientific promote and educating knowledge and skills to the workers." The subsequent conference of importation and exportation of Auto Industry, aiming to face the possible pressure and competition in the international market, has pointed the importance of market segmentation and market specialization (1993 China's Automotive Industry Yearbook). To emulate the success of Korean and Japan Automotive Industry manufactures, Chinese government also depended on the auto export-oriented strategy in the 80s of last century. However, the passive development model restricted the Chinese Vehicle Sector. It did not change until they found that the inability of the JVs (Joint Ventures) to meet the word-level quality standards and government prohibited compensating exports (Eric, 1995). Therefore the domestic private market sale is gradually fostered since the carmakers have to focus on domestic market.

Due to the fast growth of GDP, low labor cost and large potential domestic market, multinational enterprises recognized China as a favorite hosting country (Zhou, 2008). The inflows of FDI continuously increased and many scholars therefore analyzed and summarized that the rapid growth in Auto sector should be contributed to the technology transfer by FDI. The foreign investors have three forms to entry into Chinese Vehicle market: Sino-foreign Cooperative Corporations, JVs and wholly Foreign-owned Corporations. That different form applicable to the various sizes of multinational companies or the diversifying requirement of multinational companies has encouraged much more FDI inflows. Nevertheless, there were abundant problems retarding the development of the foreign ventures. For instance, the government prohibited the wholly Foreign-owned Corporations operating in the complete car manufactures. Some leaders opposed the trend of foreign economic participation. Despite of

some JVs could breathe in China's market, but the quasi-ministerial level rather than chief system were not advantageous to foreign investors (Eric, 1995).

As the FDI can help to reduce the financial burden and bring R&D spillovers, the doubts from Chinese top leader towards to FDI gradually diminish and China's government emphasizes on the integration of foreign ventures. The minister of Vehicle Industry, He Guangyuan, remarked three changes in the Domestic Automotive Meeting in 1992. First, policy would steer the attention of Chinese vehicle carmakers away from the heavy trucks to the lighter vehicles and passenger small-cars, in case of the family cars incapable to meet the demand when peoples live in a higher life standard in future. Second, accelerating the integration of the car assembling manufactures would help to promote the production technology and achieve scale merit. The reason is that the parts and components enterprises in China are extremely widely distributed and hardly ever specialized. Thus those enterprises should be larger-scale and more centralized than complete car enterprises. Thirdly, technology import and R&D increase would be the most significant role to advance China Auto Sector (1993 China's Automotive Industry Yearbook). For instance, Motor and Vehicle Industry imported 46 projects, including advanced technology and high-level equipment in 1991-1992. In this period the central government also approved the expanding projects of two JVs (Shanghai Volkswagen and Beijing Jeep).

3.1.2. Policy reform since the WTO entry

With a series of reform on policy, Chinese Motor and Vehicle Sector became a most popular industry to absorb foreign investors. At the end of 1999, the number of Sino-foreign enterprises, relative to 20 countries, was more than 600 from the first JVs established in 1981 (2000 China's Automotive Industry Yearbook). China participated in global production networks and became one of the most important carmakers in the world. Furthermore, accession to the WTO is helpful to realize China's globalization by changing the basic game rules and the economic environment in China.

Since the open and reform, Chinese Automotive Industry has step by step abandoned some

restrictions and utilized foreign investments. The protection of local enterprises is reduced accompanying with the entry into WTO in 2001. The regulations and laws treat the foreign companies as the China's companies in 2006. The global multinational brands would not worry any more about enter into China's market and compete with domestic corporations. Because a series of changes come into force, there is more pressure on local producers. For instance, firstly, the import tariffs were cut dramatically, from 200% in 1980s to 80-100% in 1990s and then to 25% in 2006. Secondly, global carmakers would be more autonomous since the revoke of local-content ratio requirement of production in JVs. Thirdly, the new policy also abdicated the constriction of wholesaling through JVs such as vehicle wholesale, retail organizations were permitted in 2006. As well as amplifying by 20% import quota and permitting foreign non-bank financial institutions to provide financial services, those changes transmitted bullish announcement for foreign investors (Paul, 2009).

3.1.3. The spillovers of FDI inflows

As many literatures shown, the FDI transfers the capital, but also it brings the technology spillovers. Egger and Pfaffer (2001) used CES-framework to test FDI effects in Austrian manufacturing industry and concluded that in general labor-augmenting productivity will increase resulted from the real stock of capital expansion. They also investigated that the FDI-effect on potential job creation in the international production chain practices splitting. However, this effect was likely to be smaller than the spillovers. Similarly analysis towards the FDI effects on Chinese manufacturing argued that the spillover did not automatically occur but with the FDI rise. In a sum, FDI could facilitate the technology of Chinese domestic production to get a superior level. In other words, FDI is an important expanding strategy for multinational enterprises. According to the Eclectic (OLI) paradigm, a firm will engage in FDI to seek three kinds of advantages (Hwy-Chang, 2005). Firstly, the firms would like to exploit a new foreign market and improve their competitiveness as asset-augmented FDI. Secondly, domestic firms seek adequate indigenous resource such as human capital. Thirdly, smart firms will opt for FDI to reduce the transaction costs of exploiting certain resources, such as for expanding export.

In order to demonstrate that the technologies of the auto production are promoted with the growth of the foreign investment, we generally draw the changes in four factors: the rate of technical employees, the rate of energy (coal) exhausted, the rate of labor productivity and the rate of return. In the Chart 3-1 to 3-4 we compare domestic firms with JVs in these factors.

As we known that the auto industry is a technology intensified industry, the technical employees are important resource to these automobile companies. These companies emphasize the training of the skills and the educating of knowledge to the employees. More and more enterprises introduce the skilled technical employees from the foreign auto companies. They can obtain skilled workers from foreign firms though the labor turnovers. The China’s domestic auto companies realize that the personnel are not less important than the advanced product lines. From Chart 3-1 we can see that the rate of technical employees rises steadily in domestic enterprises and the trend of foreign enterprises is stationary. The gap between domestic and foreign firms is eliminating in the recent years. To some extent, Chart 3-1 indicates that the domestic enterprises experience a remarkable progress of the staff structure.

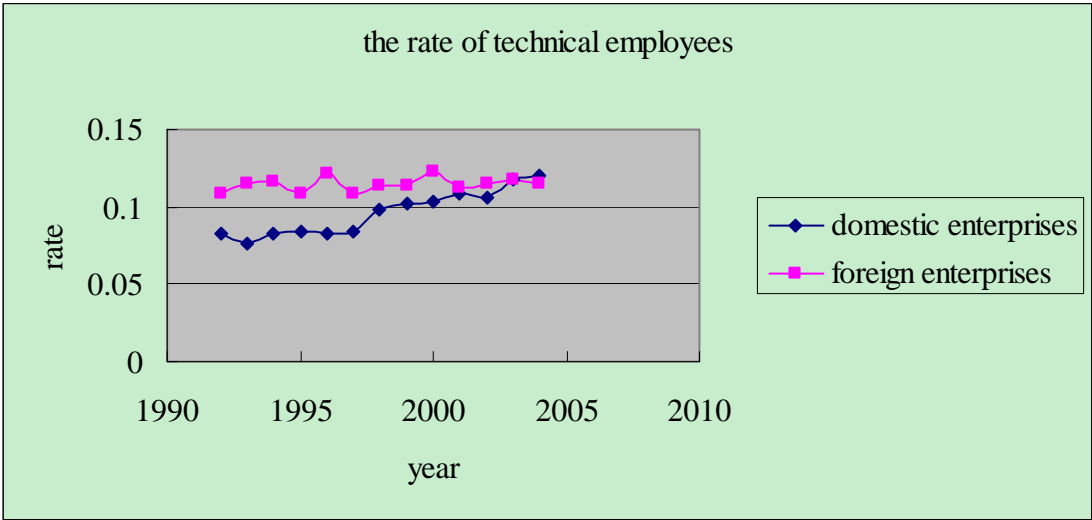


Chart 3-1 The rate of technical employees

Data resource: The Automotive Industry Yearbook from 1993-2007

As many literatures shown and we discussed above, foreign investments can benefit domestic

enterprises via technologies spillover. For example, the local firms can learn the new technologies and advanced management skills from foreign auto companies. Moreover, JVs or wholly foreign-owned enterprises have a demonstration effect on R&D activity (Cheung and Lin, 2004). The automobile production needs much more energy, so that the cost of the energy is higher than many other industries. In order to reduce the cost of the production, many foreign auto enterprises keep researching of the methods of efficiently utilizing the energy. Many scholars presumed that domestic enterprises learn modern technology from multinational investors. Therefore they believe that the rate of energy utilization of the firms in the host country would catch up with the multinational corporations step by step. In Chart 3-2, the energy consumption rate declines sharply in domestic firms while there are a few of changes in the multinational firms. Thus Chart 3-2 can demonstrate the technical spillovers through the overseas investment from foreign companies to some extent.

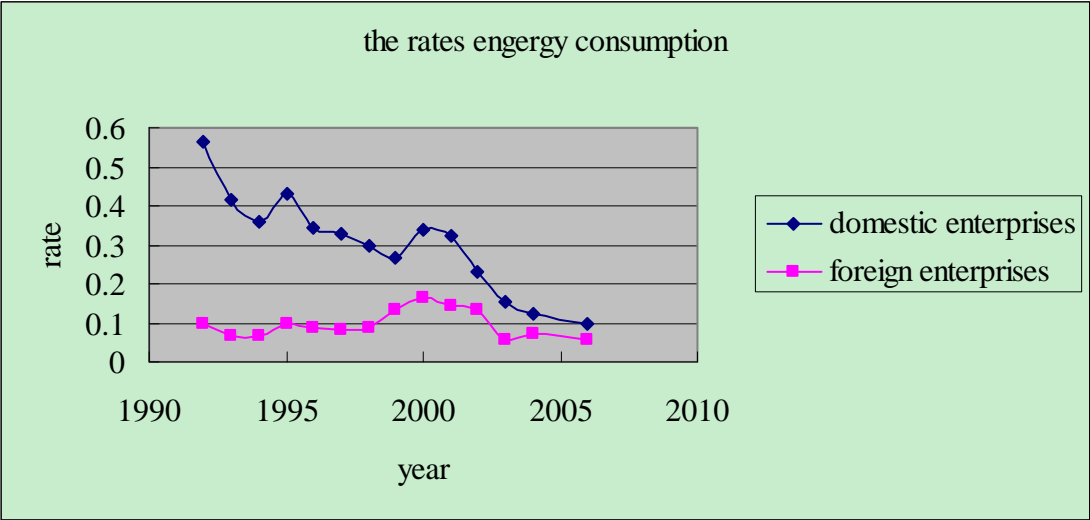


Chart 3-2 The rate of energy consumption

Data resource: The Automotive Industry Yearbook from 1993-2007

After the analysis of the staff factor (the rate of technical employees) and the cost factor (the rate of energy consumption), we need to verify the achievements of domestic firms more deeply. Because of the more advanced production lines and more skilled workers, the labor productivity increases a lot in Chinese domestic automobile firms. What’s more, we also assume the rate of return has the same trend to the labor productivity. From Chart 3-3 and

Chart 3-4, we generally accepted that the labor productivities is growing in both kinds of firms, but the rate of return keeps fluctuating during this period. Although the domestic auto firms want to diminish the gap between themselves and foreign firms through increasing the FDI, the foreign firms still have the advantages of the independent research. Thereby the labor productivity of foreign companies is much larger than the domestic auto firms in Chart 3-3. However the domestic firms can not catch up with the foreign firms now. Similarly, the trend of the rate of return in Chart 3-4 which also influenced by other economic factors, shows the gap between the domestic firms and the foreign firms still existing. Chinese automotive sector need more development.

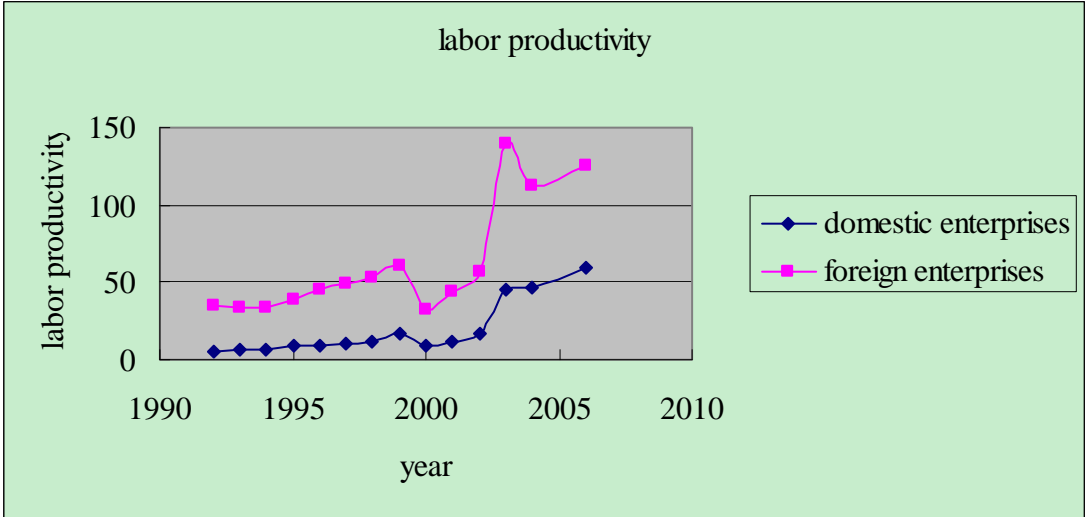


Chart 3-3 Labor productivity

Data resource: The Automotive Industry Yearbook from 1993-2007

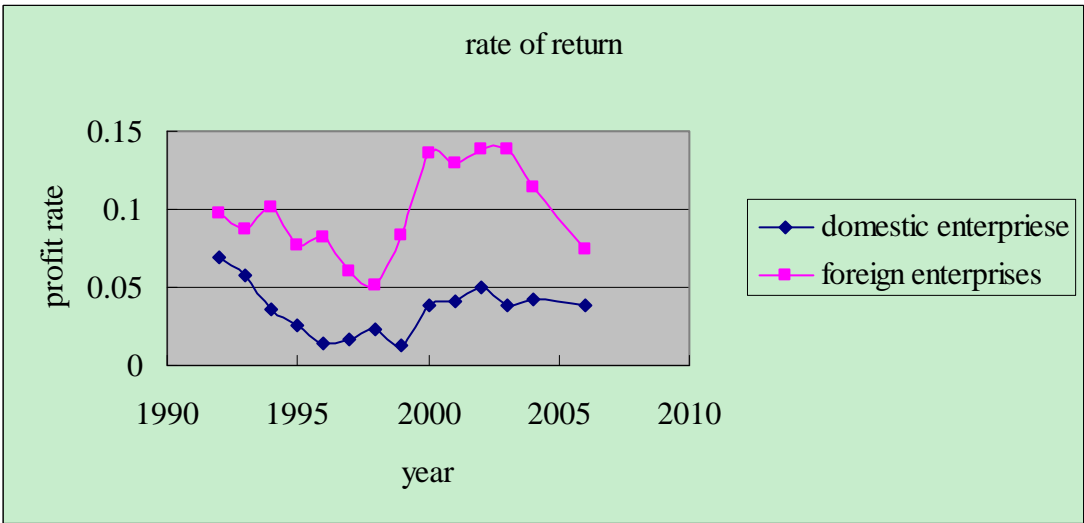


Chart 3-4 The rate of return

Data resource: The Automotive Industry Yearbook from 1993-2007

3.2 The relationship between banks and automotive sector

3.2.1. The financial services for auto sector

Nowadays, more than 70% of FDI flows into manufacturing industry. The sales revenue of complete cars boosted steadily from ¥184.85 billion in 2000 to ¥937.25 billion by the end of 2007. The growth rate is around 26% per year. Constantly market deepening has reflected a great deal of capital demand. Both international bank and international business are stimulated by the positive attitude to China's economy. Moreover, they always affect on each other to start business overseas.

On one hand, the industrial reform in China arouses the capital requirement in different sectors, especially in manufacturing industry. However, Sino-foreign companies always lost the capital advantages in China. That is to say, they are always impeded by lacking local protection to get enough bank credit. The medieval Chinese bank system could not offer unbiased procedures for the foreign firms. For example, local banks lend to multiple clients at different points in their sequence and the automotive JVs have disadvantages with following discriminatory operation (Ruhr and Ryan, 2005). As a consequence, their home banks have a motive to expand and offer overseas financial services. R.A. Brealey and E.C. Kaplanis (1996) emphasized the business expansion into another country might create the banking services abroad with following these home country customers. The international trade business of the home-country customers in the host country are preferred to be handled by international banks, because international banks and their home country customers have a closed, long-termed and reliable business relationship.

On the other hand, with the aim of creating new international business and networks and finding outlets for surplus funds, a thrust of international banking started at 1992. Since 1992, to facilitate overseas investments, Chinese government has been always sticking to the opening-up policy and creating a more harmonized investment environment for multinational

investors. These measures encourage foreign investors to trust the policy system and then they are willing to start new business in China. Despite the positive motivation theory argued that overseas investment of multinational banks resulted from their own willingness to activate in a new open market, it is hard for foreign banks to establish subsidiaries or branches in China. Because it should be noted that Chinese investment environment is not opened as other developing countries, such as India, Malaysia and so on. The government regulations play a vital role in the foreign banks expansion process. Due to a lack of knowledge about Chinese financial system and unsmooth communication with Chinese government, international banks are hardly to establish braches in China. Consequently the better choice for foreign banks to enlarge international business might be to take “following their home-country customers” as a preferential strategy in China.

The international enterprises and international banks are facing to the win-win situation. Even though the multinational bank branches or subsidiaries might be handicapped by the constraint regulations, they also can keep a loyally consolidated business relationship with their home-country customers. First, to get into a less competitive market, foreign branches can show their advantages of capital and operational efficiency. Second, overseas investment would like to make themselves more competitive by virtue of expanding business in other countries. Third, multinational banks can diversify the exchange risk in the global market. Therefore most foreign banks followed the client’s investments and start branches or representative offices in China.

Since manufacturing sector is both a capital-intensive and technology-intensive industry, it becomes the biggest FDI-recipient in China. There are some key industries of manufacturing sector in China which contain Communications-electronics Industry, Power Industry, Chemical Industry, Metallurgy industry, Textile Industry, Electronically-engineering Industry and the automotive industry. The first four industries have high barriers of entrance which are controlled by the government. The textile industry is a labor-intensive industry and it likely to be in a saturated market. Hence the electronically-engineering industry and the automotive industry should be the most FDI recipient industries in China. Moreover, Auto Industry is

climbing rapidly in the ranking list of Chinese manufacturing industry in recent years. Table 3-1 simply indicates the business circumstances in Automotive Industry. We can see that the operational capacity (Total asset turnover), earning capacity (Return rate on total asset) and development competence (Total asset growth rate) are all better than the average levels of manufacturing industry. In all, the average profit rate in automotive industry occupied 167.7% in the whole manufacturing industry in 2005. Therefore, we can easily believe that Automotive Industry should be preferred by foreign investors.

The credit assessment in Automotive industry		
Index	Value (million RMB)	Compared with manufacturing industry (%)
Total asset	85946903.50	4.83
Total asset turnover	0.47	123.03
Return rate on total asset	4.26	146.86
Total asset growth rate	23.77	135.75
Average profit rate	4.01	167.70

Table 3-1 The credit assessment in Automotive industry
 Data resource: The report of the automotive industry in 2005

3.2.2. Comparison of the locations between two sectors

As the number of automotive loans in arrear increasing in China, foreign companies will look for other financial services. For instance, the rules of automotive loans turned to be more tightened in 2004 and meanwhile the vehicle manufactures could operate their own financial institutions. In the early stage of business activities, the foreign automotive firms backed up by the international banks always signed the contract with Chinese domestic vehicle enterprise. This reason is that the foreign banks can fit into manufacturing FDI better in offering loans and other business to home country clients. Goldberg and Grosse (1994), R.A. Brealey and E.C. Kaplanis (1996) found that trade and FDI activities in the locations are the determinants of their spatial distribution of multinational banks. Moreover, the trade and FDI related business always occurred in the manufacturing sector. Yamori (1998) concluded that Japanese banks would take the distributions of the FDI of the manufacturing industry into consideration when they choose the locations in the host country.

4. Empirical framework and hypotheses

4.1 Variables and hypotheses

There are several factors inducing foreign banks entering in China financial market directly.

At first, the high degree of commercial intercourse between the host country and the home country of the foreign banks is an important factor on the foreign banks' global expansion. The increase of the trade volume and investment between the host country and the home country reflects the international relation strengthened between two countries. The economists used many economic variables such as the bilateral trade volume and the direct investment from the home country to the host country to indicate this economic relation between two countries. Many previous researches showed that there is an important link between the entry of the foreign banks and the inter-country material as well as capital transactions.

As we know that some of the international trades are settled by the exchange, and then the foreign banks could provide the exchange settlement for their customers. Therefore the trade volume is bound to the amount of the transactions of the foreign banks. We prefer the total trade volume of the automobile sector in China rather than the total trade volume in China. The reason is that we choose the auto industry as the study objective to research the "follow the customers" strategy. In addition, the scale of foreign direct investment in last period would have an influence on the investment in bank sector this period. Although the effect of the foreign investment in non-bank sectors can illustrate the "follow the customers" strategy better, we can not get the precious data of the foreign investment in non-bank sectors. Then we use the foreign direct investment in previous period to indicate the degree of the integration between the two countries instead.

Variable: the total trade volume of the automobile sector in China; FDI (-1)

Hypothesis 1: The wider of the integration in China, the more foreign banks' investment was attracted to China.

In the early studies of the banks accompanying with the multinational corporations' operation from Grubel and Gray (1977), Gray (1981), Kindleberger (1983) and so on, they believed that the international banks often invest in the other countries' market following the non-financial enterprises from the home country and serve them as the main customers. Because the development of the international trade and international investment for a country can not be separated from the necessary trade financing conditions as well as adequate financial capital supporting, the relative stationary and good cooperation relationship will greatly enhance the external competitiveness of the corporations in the intense international market. Therefore, the expansion of foreign banks always followed their customers the international enterprises expansion overseas.

In this paper, we want to focus on that the development of the automobile industry affects the entry of the foreign banks. As we know that China opened this sector to the foreign enterprises at the very beginning while most of other secondary industries controlled by the government. Moreover the automobile sector is a large manufacturing industry which needs much capital to operation, thus the foreign banks can follow the auto corporations from home countries into China. The foreign banks would provide the support of the capital, the financial service and the consult of the regulations and rules to the multination enterprises.

Variable: the total asset of the auto sector

Hypothesis 2: The larger of the home customers invest in China, the more foreign banks are attracted to China.

Another factor is that the development of the host country's economy brings many profitable opportunities in the market to the foreign banks. Recently, more and more researches demonstrated that lots of the foreign banks were attracted by the host countries' good economic environment. Such as the domestic relative potentially wide developing space, comparative low the tax rate and the affluent chances for profit in the host country are the main reasons of the foreign banks expansion. Claessens, Demirgüç-Kunt and Huizinga (2001) collected and analyzed the data of more than 80 countries from 1988 to 1995, and then the

conclusion revealed the market environment of higher per capita capital and a sustainable increase expectation of the economic growth in the host country will have a greater attraction to the foreign banks.

As we know that GDP is used to measure the comprehensive level of the economic development in a country or a region, thus it is considered to be the most important indicator to evaluate the situation of the national economic development. Due to the GDP reflects the total amount of the added value from all sectors of national economy, the GDP of a country increasing rapidly is a sign of the booming economy in the country. With the growth of the national income, the consuming capacity is strengthened and the market becomes prosperous. In such situation, the central bank of the country will increase the interest rate to tighten the money supply. Therefore the good performance of the economic development and the raised interest rate will attract the foreign banks. Thereby we choose GDP of the prior period to indicate the macroeconomic environment of China for the foreign banks' entry. Another variable is the tax rate which represents the economic policies and the tax policies in the country. The level of the tax rate and the form of the tax play a key role of tax leverage in economy. Then we select the tax rate on income, profits and capital gains of revenue which affects the net profit of foreign banks. The preference of the policies to the foreign banks will determine the foreign banks' getting the maximized profit. And the more profitable opportunities in China, there are more foreign banks want to enter in China.

Variable: GDP (-1); the tax rate of income, profits and capital gains of revenue (control variable)

Hypothesis 3: The better macroeconomic environment in China, the more opportunities for the foreign banks to expand.

The exchange rate is a significant factor for the trade volume and the preference to the currency. The increase of foreign exchange settlements leads the transactions of foreign banks adding. The foreign banks will get more revenue from the exchange payment service. In the other hand, the devaluation of the RMB would cause the extension of the export in China and

stimulate the production of the export products. The enlargement of the production needed the more capital, so the entrepreneurs would borrow money from the banks. Unfortunately, the expectation of the appreciation of the foreign currency will retard the industrialists borrowing the foreign currency loans from the foreign banks. Thus the exchange rate has a complex effect on the development of the foreign banks in host country.

We use the present exchange rate to estimate the “follow the customers” strategy for the foreign banks in China. We assume the trade volume increase will enlarge the transactions of the foreign banks, while the exchange loans will decrease with the rise of the exchange rate. But the present exchange rate will influence more efficient on the transactions than on the loans in foreign banks. However, the exchange rate is one of the main elements affect the investments from foreign banks.

Variable: the exchange rate (control variable)

Hypothesis 4: The more the present exchange rate rise, the more foreign banking asset accumulated.

4.2 Data and methodology

In order to get the coefficient of the parameters in the model, we collect data in the period of 1992-2006 from different resources and build simple multivariate regressions. According to our hypotheses we set total foreign banks asset as the dependent variable and use the value of auto trade, total foreign auto companies' asset, the exchange rate, the tax rate on income, profits and capital gains of revenue, total GDP as well as the total FDI as explanatory variables. In order to demonstrate the variables in a simple way, we change the variables' names into the following representations:

Dependent variable:

FBA= the total foreign bank assets in one year in China

Independent variable:

FDI= foreign direct investment inflows into China in one year

GDP= gross domestic product in China in a year

EXR= the average exchange rate in a year (USD/CNY)

ITR= the tax rate on income, profits and capital gains of revenue each year

AUT=the total trade (export and import) of the automobile sector each year

FAA =the total asset of the foreign automotive companies in one year in China

To be specific, we obtain the original data relating to the Auto Industry from the Automotive Industry Yearbooks. We reset “AUT” variable by adding total auto export volume to total auto import volume as a whole trade volume. The “FAA” variable denotes total foreign auto companies’ assets. Secondly, from the Almanac of China's Finance and Banking we employ three series data directly: “FBA”, “EXR” and “FDI”. Finally, the statistics of “ITR” and “GDP” variables are derived from the WDI indicators. Meanwhile, we notice that the measurement of “FAA” variable is changing in the different years. In Automotive Industry Yearbook published from 1993 to 1996, we extract the data directly from the listed index. However, since 1997 there is no direct index about it, thereby we need to sum the data of the joint venture collaborating with Hong Kong or Macao and the data of the joint venture collaborating with foreign countries.

Due to the data are time series with high autocorrelation, we firstly check the stationary of data. With the aim of checking the multicollinearity among the independent variables, we run the correlation among them. After that we use the Augmented Dickey-Fuller test to examine whether the first differences of all variables are stationary or not. Meanwhile we simply choose the Schwarz Info Criterion to do the unit root test of FBA, GDP, AUT and FAA variables include intercept and trend in equations according to their raw data graphs. We use ADF test for the residuals of the regressions to check whether the variables cointegrate.

Therefore we run the multivariate regression to see the influence power. Finally, we will examine the significant effect of the coefficients with the t-ratios and the F-statistics of the whole model. We will test the problems of heteroskedasticity (ARCH) and autocorrelation (D.W.). Those statistical tests help us to amend the model more appropriate. All results will be demonstrated in the next three regressions.

4.3 Empirical results

Before we build the model, we check the stationarity of these time series variables. We use the Augmented Dickey-Fuller test and the Schwarz Info Criterion to test the unit root in all variables. Unfortunately we can not reject that none of the variables have the unit root as the Table 4-1 shows. Therefore we transform the original data into taking the first differences of them.

		FBA	EXR	ITR	FDI	GDP	AUT	FAA
Original	Prob.	1.000	0.636	0.281	0.934	0.953	0.877	1.000
data	T-stat.	4.249	-0.073	-0.970	1.215	1.430	0.835	5.469

Table 4-1 The unit root test for of all the variables

With the aim of checking the multicollinearity, the correlations among all new variables are examined before we conduct the ordinary least squares regression. The Table 4-2 shows the correlations among the variables. We find that most independent variables are not correlated except the exchange rate and the income tax rate. However, there is no financial theory support that the exchange rate has a possible relation with the income tax rate. Due to both of them are important factors on the foreign investments according to the theories, thus we still include both of them in the models.

	d(FBA)	d(EXR)	d(ITR)	d(FDI)	d(GDP)	d(AUT)	d(FAA)
d(FBA)	1.000						
d(EXR)	-0.181	1.000					
d(ITR)	0.423	-0.877	1.000				
d(FDI)	0.001	-0.087	0.105	1.000			
d(GDP)	0.682	-0.078	0.054	-0.068	1.000		
d(AUT)	0.467	-0.121	0.032	-0.022	0.724	1.000	
d(FAA)	-0.073	-0.087	0.039	0.329	0.083	0.042	1.000

Table 4-2 The correlation coefficient of all the variables

We estimate the following regression at first:

The first OLS regression:

$$d(FBA) = \alpha_0 + \beta_1 d(EXR) + \beta_2 d(ITR) + \beta_3 d(FDI) + \beta_4 d(GDP) + \beta_5 d(AUT) + \beta_6 d(FAA) + \varepsilon$$

Subsequently, we see the results of the OLS regression of the first model in Table 4-3. This

model includes all of the variables we want to analysis. We find that in this model, some of the independent variables which can be considered as the control variables (d(EXR) and d(ITR)) are significant. Variable d(EXR) has a positive effect on the foreign banks' assets as we assume, however, the coefficient of d(ITR) appears a positive value unexpectedly. And we reject the elements of d(FDI), d(AUT) and d(FAA) from the results of the regression. Furthermore, the strange result is that d(AUT) has a negative determinate influence on d(FBA). Those opposite results have suggested some problems existing in our model. The D.W. value is closed to 2, which means the regression has no first order autocorrelation. The result of ARCH obviously can not reject the null hypothesis that the absence of ARCH components. So we can say there is no heteroscedasticity in the model.

	Coefficient	t-Statistic	Prob.
C	-2102.036	-2.002	0.085
d(ITR)	426.396	3.152	0.016
d(EXR)	2881.980	2.307	0.054
d(FDI)	0.027	0.508	0.627
d(GDP)	0.306	2.770	0.028
d(AUT)	-2.254	-0.943	0.377
d(FAA)	0.679	0.468	0.654
Adjusted R ²	0.690	Durbin-Watson stat	1.955
F-statistic	5.824	Prob(F-statistic)	0.018
ADF stat of residual	-3.526	prob.(ADF)	0.002
Heteroskedasticity: ARCH	0.349	Prob. F(1,11)	0.567
Ramsey RESET Test	50.129	Prob. F(1,6)	0.000

Table 4-3 Regression results with all variables; dependent variable: d(FBA)

Due to the time series data might present unit roots problem, we test the unit roots of the first differences of all the variables and find that the first differences of GDP and FAA are not stationary while the AUT is a marginal significance for the stationary. We think the reasons of leading the spurious regression and the strange errors in the model are that d(GDP) and d(FAA) are not the stationary variables. Furthermore, the Ramsey test has been rejected which means the model is misspecification. As a result we at first delete the GDP variable.

		FBA	EXR	ITR	FDI	GDP	AUT	FAA
The first	Prob.	0.025	0.000	0.002	0.003	0.968	0.083	0.999
difference	T-stat.	-4.298	-28.961	-3.575	-3.278	-0.418	-3.519	1.474

Table 4-4 The unit root test for the first difference of all the variables

Therefore, the regression model will be changed into:

The second OLS regression

$$d(FBA) = \alpha_0 + \beta_1 d(EXR) + \beta_2 d(ITR) + \beta_3 d(FDI) + \beta_4 d(AUT) + \beta_5 d(FAA) + \varepsilon$$

From Table 4-5 we observe that the adjusted R^2 of the OLS regression turns less than the first one that is to say that the capability of the explanatory variables is decreasing. Fortunately the coefficient of $d(AUT)$ becomes a positive one as we expected. All of the coefficients of the independent variables turn to a better behavior except the $d(FDI)$ variable. We carry out the Ramsey test, and then we find that the result can not reject the null hypothesis. Hence the model is not misspecified. From the ADF statistic we remind that there is still a non-stationary variable in the model. According to the unit root test in table 4-4, the variable $d(FAA)$ is also a non-stationary variable. Even though $d(FAA)$ is one of the important independent variable we would like to analysis, we can not modify it well enough. In order to build a better model, we have to drop $d(FAA)$.

	Coefficient	t-Statistic	Prob.
C	144.898	0.160	0.877
d(ITR)	529.563	3.006	0.017
d(EXR)	3910.123	2.421	0.042
d(FDI)	0.015	0.203	0.844
d(AUT)	2.933	1.804	0.109
d(FAA)	1.738	0.673	0.520
Adjusted R^2	0.432	Durbin-Watson stat	2.385
F-statistic	2.974	Prob(F-statistic)	0.083
ADF stat of residual	-4.455	prob.(ADF)	0.000
Heteroskedasticity: ARCH	0.000	Prob. F(1,11)	0.996
Ramsey RESET Test	0.505	Prob. F(1,7)	0.500

Table 4-5 Regression results without $d(GDP)$; dependent variable: $d(FBA)$

The third OLS regression is

$$d(FBA) = \alpha_0 + \beta_1 d(EXR) + \beta_2 d(ITR) + \beta_3 d(FDI) + \beta_4 d(AUT) + \varepsilon$$

In order to investigate the exact effects of the $d(FDI)$ and $d(AUT)$, we remove $d(FAA)$. The results of the new model in Table 4-6 are better because of the increase of the adjusted R^2 . From the t-statistics of variables excluding the $d(FDI)$ we can say all of them are statistically significant at the test size of 5%. Unfortunately the variable $d(FDI)$ still is not statistically

significant. We try to correct its coefficient through modifying the models, but we fail. At last we examine the original data resource, and we recognize the inaccuracy of FDI. We should use the non-bank sectors' FDI rather than the total FDI in China. However, we can not get the exact non-bank sectors' FDI data. Thereby this is a flaw in our model. Additionally with the decrease of the number of the explanatory variables, the adjusted R^2 of the OLS regression is not large. The Ramsey test shows that the model is not misspecified also. In all, most of the results in table 4-6 are all coherent with our assumptions. The $d(ITR)$ is opposite to our expectation which might be caused by the inaccurate data.

	Coefficient	t-Statistic	Prob.
C	368.368	0.453	0.662
$d(ITR)$	508.525	3.027	0.014
$d(EXR)$	3686.006	2.407	0.040
$d(FDI)$	0.033	0.498	0.631
$d(AUT)$	3.568	2.777	0.022
Adjusted R^2	0.466	Durbin-Watson stat	1.991
F-statistic	3.837	Prob(F-statistic)	0.044
ADF stat of residual	-3.656	prob.(ADF)	0.002
Heteroskedasticity: ARCH	0.014	Prob. F(1,11)	0.909
Ramsey RESET Test	1.015	Prob. F(1,8)	0.343

Table 4-6 Regression results without $d(GDP)$ and $d(FAA)$; dependent variables: $d(FBA)$

4.4 Location distributions comparison

According to the previous analysis above, we consequently draw a table of distribution for all the subsidiaries of foreign banks (Appe. Table 4-(1)). Subsequently we draw the distribution table of foreign automotive branches with an aim to compare the choices of the different major cities for different country multinational banks (Appe. Table 4-(2)).

From the table below we can see that the foreign banks always choose the similar area as foreign auto companies from home countries. Beijing, Shanghai, Tianjin municipalities and Guangzhou province are their main choices, since these areas have much more economic freedom. In all, the location distributions comparison between foreign banks and foreign auto corporations approximately demonstrated the “follow the clients” strategy. The similar location choice of the same home country is an additional remark to the analysis of the “follow the customers” strategy.

	Japan		Korean		Germany		France		Sweden		US		UK	
	B	A	B	A	B	A	B	A	B	A	B	A	B	A
Beijing	2	2	5	2	4	2	4		2	1	1	2	1	
Shanghai	3	3	5	2	4	2	6		2	1	1	1	1	
Tianjin	1	1	4				2				1	1	1	
Guangzhou	3	3	2	1	2		3	2			1			
Liaoning	3		3			1					1	1		
Jilin		2	1			1								
Heilongjiang			1											
Sichuan	2	2					1	1			1			
Jiangsu	2		1	1									2	1
Jiangxi		2										2		
Shandong	1		3	1								1	1	
Fujian	1	1				1								
Hainan		1												
Hubei							1	3						

Table 4-6 The number of foreign banks and foreign auto companies located on different areas

Note: B represents foreign banks branches and representative offices and A represents automotive branches.

More specifically, from Table 4-(1) we can see that the biggest Japanese carmakers in China,

Honda and Toyota, focus on Guangzhou and Tianjin. What's more, the other strategic options for Japanese automobile manufactures is distributing extensively, such as Changchun, Jiangxi and Henan. We can easily notice that three of five Japan banks lie in Guangzhou and two banks locate in Tianjin from Table 4-(1). Some of the banks will choose a closed place to their customers. For instance, the foreign automotive corporations locate in Jiangxi province adjoining to Fujian and Zhejiang provinces. Thus the foreign banks choose target locations in Xiamen and Hangzhou, which are belong to Fujian and Zhejiang province separately. Thus there is a similar location relation between Japanese foreign banks and Japanese auto enterprises.

In addition we can see that most Korean banks concentrated Beijing in Table 4-(1). This is because the biggest Korean car manufacture, Hyundai, is cooperated with Beijing automotive carmakers. Moreover, the following auto customers' strategy is not obviously for auto sector, since there are other important customers in other industries, such as Samsung electronics. By the way, Samsung electronics lies in Tianjing also attracted many Korean branches.

Both the biggest car components and parts manufacture and the biggest carmaker from German, Bosch and Volkswagen, site in Shanghai which is demonstrated by Table 4-(2). From Table 4-(1), we notice that the coherent location choice of Germany banks is also mainly in Shanghai. Another representative example is Volvo from Sweden. We find that the branches of Sweden banks locate in Shanghai and Beijing from Table 4-(1) and the Volvo choose Shanghai and Beijing as well. To some extent, those can generally signify the international banks follow their home country automotive clients.

Despite the Peugeot and Renault are famous car brand in the world, the quantity is not big in China. In addition, Citroen carmakers in China almost stop the manufacturing factories in Xiangfan (Hubei) and Wuhan (Hubei), and only focus on the bigger business factory in Guangzhou. We can get the conclusion that the French banks choose Guangzhou, Sichuan and Hubei provinces as following their car customers. In addition, the rich city such as Beijing, Shanghai and Tianjin are also their target location.

We can obtain that the distribution of French banks is mainly situated in Beijing, Shanghai, Tianjin and Guangdong from Table 4-(1). The similar result occurs in American and British banks. Because that those foreign banks entry into China since the early stage, they consequently have a widely business networks in China. To some extent, they might verify the 'defensive expansion' theory of multinational banks. Stephen (1988) argued the home country risks may push the investment abroad and then examined some risk factors in home countries affect on outward FDI in US. He concluded that the foreign banks would go abroad and then extend business in the host country relying on some comparative advantages. Those multinational banks have experienced a lot in China and are getting to be more familiar with Chinese market. Therefore they prefer to using “defensive expensive” strategy rather than “follow the customers” strategy.

5. Conclusion

In this paper we construct some models to examine whether the foreign banks take the “follow the customers” strategy in China. The macroeconomic environment and the regulations in China are not very apparently open to the foreign banks which would like to enter into Chinese market. Therefore the foreign banks prefer to start business in China’s financial market by following their existing customers’ overseas expansion from their home countries. This is the major adopted strategy in the initial stage of the foreign banks’ expansion. Furthermore we put our focus on the effect of the development of automobile sector on the foreign banks. Thus we find the results of the OLS regression models can explain the “follow the customers” to some extent. From table of the location comparison, we discover the multinational banks from some countries indeed choose their automotive customers in their following strategy.

On the other side, the foreign banks have their advantages in the overseas expansion. The foreign banks have the strong capability of seizing the opportunities in China’s market. They adjust their own positions fast to provide various and flexible products and services to satisfy the local customers’ demands. Because after China joined in WTO the government permits the foreign banks handle the RMB transactions in recent years, which are indicating the financial market has been more open to the foreign banks, more and more foreign banks start to set up the branches to operate a comprehensive business in China. In future, with the aim of gaining more profit from the growth of China’s economy, the foreign banks will directly develop the offshore business by using the “defensive expansion” strategy and so on.

However, our regression could not exactly indicate the comprehensive relationship between foreign banks and foreign automotive companies. The reason is that the foreign auto enterprises cooperate with the local automobile companies through various methods and get the service from the foreign banks in different ways. It is very hard to distinguish the exact indicators from the complex data to show the “follow the customers” strategy. What’s more, the time period is so short that our model might not have enough explanatory power. In order to improve our data to examine our hypotheses, separating different foreign banks and auto

firms from different countries as a panel data might be more appropriate. The further investigation will need more specific data to explain the “follow the customers” strategy in auto sector clearly.

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Appendix

Table 4-(1) The location of the foreign banks Branches and Reprehensive Offices

Data resources: The homepage from each foreign bank

The location of the foreign banks Branches and Reprehensive Offices		
Name	Branch	Representative Offices
Japan	Mizuho Corporate Bank	Nanjing, Xiamen
	Bank of Tokyo-Mitsubishi UFJ	Shanghai, Beijing, Dalian, Tianjin, Shenzhen, Wuxi, Guangzhou
	Sumitomo Mitsui Banking	Shanghai, Tianjin, Guangzhou, Hangzhou, Beijing
	Sumitomo Trust and Banking Yamaguchi Bank	Shanghai, Guangzhou Dalian, Qingdao
Korean	The Korea Development Bank	Beijing, Shanghai, Guangzhou
	Woori Bank	Beijing-China, Beijing, Shanghai, Shenzhen, Suzhou, Tianjin
	Hana Bank	Beijing-China, Beijing, Shanghai, Shenyang, Changchun, Qingdao, Yantai, Haerbin
	Korea Exchange Bank	Shanghai, Beijing, Tianjin, Dalian
	Standard Life New York Life	Beijing, Shanghai, Tianjin, Qingdao, Chengyang(Qingdao), Wuxi
	Industrial Bank of Korea	Tianjin, Qingdao, Yantai, Shenyang
Germany	Bayerische Landes Bank	Shanghai
	Norddeutsche Landesbank	Shanghai
	Girozentrale	
	Dresdner Bank	
	Aktiengesellschaft	Beijing, Shanghai
	Deutsche Bank Aktiengesellschaft	Beijing-China, Beijing, Shanghai, Guangzhou

	HSH Nordbank AG Commerzbank AG West deutscheLandes bank	Shanghai Shanghai Shanghai	Beijing Beijing
France	BNP Paribas Banque Indosuez société générale	Shanghai-China, Beijing, Guangzhou, Tianjin Shenzhen, Shanghai, Guangzhou Guangzhou, Shanghai, Beijing, Tianjin, Wuhan	Chengdu, Suzhou
Sweden	Svenska Handelsbanken Skandinaviska Enskilda Banken(SEB)	Shanghai Shanghai	Beijing Beijing
America	National City Bank of New York	Beijing, Tianjin, Dalian, Shanghai, Guangzhou, Hangzhou, Chengdu, Shenzhen	
Britain	Standard Chartered Bank	Beijing, Tianjin, Qingdao, Shanghai, Nanjing, Nanchang, Suzhou, Hangzhou, Shenzhen, Guangzhou, Zhuhai, Xiamen, Chongqing, Chengdu	

Table 4-(2) The location of foreign vehicle corporations

Data resources: The homepage from each Sino-foreign automotive firms

The location of foreign vehicle corporations			
Name	Manufacture	Other	
Japan	Honda	Guangzhou	Hubei, Guangzhou, Fujian, Sichuan
	Toyota	Tianjin, Guangzhou, Sichuan(Chengdu), Changchun	Shanghai
	Nissan	Guangzhou, Zhenzhou (Henan)	Beijing, Shanghai
	Mazda	Changchun, Chongqing, Hainan	Shanghai, Beijing, Nanjing
	Suzuki	Changhe (Jiangxi)	
	Isuzu	Jianglin (Jiangxi)	
Korean	Hyundai	Beijing	Qingdao, Shanghai, Guangzhou
	Kia	Yancheng (Jangsu)	Beijing, Shanghai
	Daewoo	Guilin (Guangxi)	
Germany	Volkswagen	Shanghai, Changchun	Beijing
	Mercedes-Benz	Beijing	Fujian
	BMW	Shenyang	
	Bosch	Shanghai	
France	Peugeot	Guangzhou, Chongqing	Wuhan, Xiangfan(Hubei)
	Citroen	Wuhan, Xiangfan (Hubei), Guangzhou	
	Renault	Xiaogan (Hubei)	Beijing
Sweden	Volvo	Shanghai, Xi'an(shanxi)	Beijing
America	Ford	Jiangxi, Chongqing, Nanjing	Beijing, Tianjin
	GM	Shanghai, Yantai, Liuzhou(Guangzhou)	Shenyang
	Chrysler	Beijing	
Britain	MG-rover	Nanjing	
	Lotus	Jinhua(Zhejiang)	