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The Effect of Internationalization on Bank Performance in Republic of Korea

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Abstract

The goal of this paper is to discover the effect of internationalization on bank performance of 8 internationalized commercial banks from Republic of Korea (ROK). Resource-based view is applicated as theoretical framework. To reach the goal, this research used panel data regression by fixed effect model. The dependent variable of this research is ROA. Meanwhile the independent variables are number of foreign presences, TNI, and South Korea's macroeconomic conditions. The research using secondarily data that collected from FSS of ROK and BOK. The result reveals that internationalization gives positive effect to the performance of the commercial bank in ROK.

Keywords: Internationalization; Bank performance; Resource

Introduction

The flow of globalization has made banks an intermediary institution increasing their activities to abroad by internationalization. Historically, internationalization of a bank started by European banks (such as Germany, England, and France) by establishing various number of branch offices in Latin America due to the high demand of capital to fulfill the industrial sector needs (World Bank, 2018). Internationalization can give benefits for both customer and the bank itself. When the bank operates abroad, it will be convenient to the customer because the transaction cost would reduce. Then for the bank it will increase the flow of the fund that they collected, because it will flow not only domestically but it will flow to the other countries they operate.

From the advantages mentioned, increasing operational activities to abroad will affect the bank profitability. It is because the bank faced competition with domestic bank in the host country. Also, the bank needs lot of investment to operate internationally. For example, bank should collect the information about the host country situation, or they should adapt their product based on the customer preferences in the host country which increasing the research & development cost.

On 2020, Republic of Korea (ROK) became the second largest on export the goods and services in Asia after Japan (World Bank, 2020). One of the services that the country export is financial services through commercial bank. ROK has 8 of 12 commercial banks that has internationalized, while the rest are still fully operates domestically. From the average of ROA (return on assets) in the last 5 years, the bank that operates internationally has a better performance rather than the bank that still operates domestically.

The previous research found various result. Hejazi & Santor (2010) and Outreville (2010) found that internationalization has a positive impact to the bank performance when the bank have great competencies to operate it. On the other side, Barua et al., (2017) and Slager (2005) found the difference result that internationalization has negative influence to the bank performance due to the cost are higher than the benefits. Due to the various results on the previous research, it shows that this topic still needs further research. From the literature gap and the fact mentioned, this paper wants to discover the effect of internationalization on the bank performance of 8 commercial bank that internationalized from ROK.

Literature Review

The effect of internationalization on bank performance can be explained using resource-based view. Resource-based view (RBV) is a concept which looks at a resource that company has can be an advantage and it would make the company performance increase (Outreville, 2010). This concept illustrates that the resource has a competitive advantage. This advantage can last in the long run. Internationalization can be a way to increase the bank's performance because the bank can gain its ownership-specific and internationalization advantage (Panda & Reddy, 2016). Resources of the bank has comprised tangible assets (such as building, employee, and its assets) & intangible assets (such as age, managerial competency, and customer trust).

A bank can expand their business through internationalization. This strategy is an effort to catch the international market. The bank that implements internationalization still operates like usual. They collect and loan the funds to its customer. But internationalized banks are more likely on wholesale activities which financing a large loan to another company or government institution for supporting their productive activity (Montgomery, 2003). Internationalization of a bank can be done by building a foreign branch, representative office, local subsidiary, and correspondent bank. Internationalization gives some benefits but also gain the risk for the bank. A benefit for the bank are increasing diversification, transfer resource, liberalisation, regulatory arbitrage and innovation (Barua, Khan, & Barua, 2017; McCauley, McGuire, & Wooldridge, 2021). Also, internationalized bank faced some risk with their operation from foreign exchange, host country economy & political condition (Berger, Ghoul, Guedhami, & Roman, 2016). When the competition between the domestic and foreign bank is higher, it will be lowering the profitability for the both (World Bank, 2018). The low level of profitability will lead to excessive risk-taking act by the bank and increasing moral hazard. It is because the bank distribute the loan using foreign currency that will increase the credit risk and fluctuation of foreign currency.

When a bank wants to start internationalization, they should fulfill at least 4 general requirements (OECD, 2017). The general requirements are: (1) host & home country authorities should have an MoU for cooperation; (2) the executive board should be hired from the host country locals; (3) both host & home country should allow the trade flow; (4) the requirements for the business should be easier but keeping the prudent act. Internationalization should consider the liquidity, foreign exchange, and solvency operation (BIS, 1983). It is to keep the soundness & exposure on the appropriate level for the bank and the authorities.

Method

This research using quantitative approach. To reach the goal, this research using panel data regression using fixed effect model. Panel data combine both cross-section (population that consist of 8 ROK's commercial bank that internationalized) & time series (half year data from December 2015 to December 2021). The data collected secondarily from ROK's Financial Supervisory Services (FSS) and Bank of Korea. The dependent variable of this research is bank performance using ROA as an indicator. Meanwhile, internationalization become the independent variable. The indicator of internationalization using total amount of foreign presence (foreign branch, representative office, and local subsidiary) and transnationality index (TNI). These indicators became the value added of this research, because no similar research has been found using these two indicators simultaneously. Macroeconomics by using output gap as an indicator becomes the control variable of this research. The equation of this research:

$$Y_{it} = \beta_0 + \beta_1 X1_{it} + \beta_2 X2_{it} + \beta_3 X3_{it} + \varepsilon_{it}$$

Information:
Y_{it} = Return on asset (ROA)
$X1_{it}$ = Number/amount of foreign presence in host country
$X2_{it}$ = Transnationality index (TNI)
$X3_{it}$ = ROK's output gap
ε_{it} = error term

ROA can be an indicator that represent the performance of a company. It shows the efficiency of a company when they generate the profit (ECB, 2010). To count the ROA can be dividing between the total assets and the total income (Silalahi, 2020). The higher value makes the company more resilient from a shock. Number of foreign presences can be an indicator to capture the degree of internationalization of a company (Barua, Khan, & Barua, 2017). The form of foreign presence that a bank can do such as foreign branch, representative office, and local subsidiary. Another indicator that used in this research is TNI. TNI is an index that range from 0 to 100. The higher value of TNI represent a company has a strong competitiveness internationally (UNCTAD, 2007). To capture the macroeconomic conditions of South Korea, this research using output gap as an indicator. The output gap is a difference of actual output and the potential output (Indonesia's Financial Ministry, 2014).

Discussion

Table 1. Multicollinearity Test

	X1	*X2*	*X3*
X1	**1**	0,778787	0,002618
X2	0,778787	**1**	-0,04157
X3	0,002618	-0,041567	**1**

The result shows that there is no multicollinearity on the model (due to the value are below 0.8).

Table 2. Heteroscedasticity Test

Variable	Prob.
X1	0,3427
X2	0,9550
X3	0,3339

The result shows that there is no heteroscedasticity on the model (due to the value are above 0,05).

Table 1. Regression Result using Fixed Effect

Variable	Coefficient	t-*Statistic*	Prob.
X1	0.018032*	1,676092	0,0971
X2	0.010753***	2,864449	0,0052
X3	0.022124**	2,508080	0,0139
Constant	0,210252	1,482044	0,1417
R-squared	0,302410		
F-statistic	4,031619		
Prob. (*F-statistic*)	0,000131		

(***) significant on α=1%

(**) significant on α=5%

(*) significant on α=10%

The result shows that internationalization through physical presence (X1) has a positive and significant effect on the performance of 8 ROK's commercial banks. When the bank added 1 physical presence in abroad, it would increase their performance 0.018032%. From RBV perspective it shows the resource that the bank owned it would improve the bank performance. From the result it can be explain that the establishment of foreign branch, representative office, or local subsidiary in other countries can be an effort for bank to distribute their products and services through physical presence, so it will gain their income which improve the bank performance.

The positive and significant effect of internationalization on bank performance is found on TNI indicators. When the transnationality index of a bank increasing 1, their operation would 0.010753% more efficient. From the result it can be explained, when the bank increased their usage of resources in abroad, it gained the number of products being sold. Then it will increase the foreign sales and foreign profit. When the bank calculates aggregately it will improve the performance of bank.

Lastly, ROK's macroeconomic as a control variable also has a positive and significant effect to the performance of 8 commercial banks that internationalized. When ROK's output gap increasing 1 billion Won, it would gain the bank performance 0.210252%. ROK is currently on the list of advanced economies country. From the result it can be explained, when the economy is in the good condition, it will increase the amount of investment. Commercial bank can take a part as an institution by distribute their product and services to another company and community to support the financing for the productive activities. Thus, it will increase the income level which make the people can pay or save the money to the bank, so the revenue of the bank will increase, and the bank can run efficiently.

Conclusion

The result found that internationalization has a positive effect on the performance of 8 commercial banks from ROK (from both indicators which are foreign physical presences and transnationality index). When the bank increasing the tangible assets through establishing foreign branch, representative office, or local subsidiary it will gain its performance. Also, internationalization can increase the amount of transaction and the flow of loan (represented by the increasing number of foreign sales) which can gain the ROA and improved the profitability of the bank. Lastly, ROK's macroeconomic condition be the external factor for the bank which has a positive influence for the profitability of ROK's commercial bank.

From the observation it found that nowadays Bank of Korea (as a central bank of ROK) did a lot of agreement related to currencies swap with another country. The agreement can make the flow of investment and trade easier. Some countries that cooperate are the host country of commercial bank from ROK. The agreement between central bank can be an opportunity for ROK's commercial bank to gain its profitability by operates internationally.

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