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Internationalization of Korean banks during crises: The network view of learning and commitment

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ABSTRACT

This study addresses the effect of crisis on bank internationalization from the perspective of network theory. Employing the internationalization process (IP) model, we particularly examine the role of learning and commitment in overseas expansion for banking services under stable and critical periods. Following the IP model and business network approach, the study develops a theoretical view for analysis of international banks from South Korea. South Korean banks are selected as they experienced two global crises, one in 1998 and the other in 2008. Findings show that while the first crisis in 1998 stopped internationalization, the 2008 crisis stimulated firms to find new markets, especially in developing countries. Different from the studies showing that commitment increases in stable periods and decreases in crisis, this study contributes to the finding that experiencing earlier crises enhances learning and increases commitment needed for expansion and strengthening of the business network.

1. Introduction

Although service firms were relatively slow to globalize (Drogendijk & Hadjikhani, 2009), the recent growth of foreign investments in the service sector has been remarkable. Banks are one type of service firm actively going global. Establishing banks in foreign markets has often been regarded as a management strategy to increase flexibility during a crisis and is understood in the context of financial liberalization (Lee & Makhija, 2009). Others argue that internationalization is a strategic challenge for international financial service firms (IFSFs) (Grant & Venzin, 2009).

There are several unique aspects to the process of internationalization of financial service firms. Unlike manufacturing firms that deal in physical and tangible goods, service firms rely on intangible and firm-specific resources tailored to the needs of individual customers. In addition, service firms are distinguished from manufacturing firms in that they integrate production and consumption simultaneously. In the process of internationalization, therefore, service firms prefer the wholly owned subsidiary entry mode, which offers a high level of control and allows IFSFs to replicate the entire value chain in host markets (Bouquet, Hebert, & Delios, 2004). These facts differentiate the foreign expansion of financial firms from that of manufacturing firms, making the former an interesting research topic in its own right (Engwall, 1992, 1994).

Banking services are intangible, and transactions are tailored to each customer (Bouquet et al., 2004; Ford, 1990). Although many banking services now exist only online, the fundamental banking services—lending and borrowing—still require interaction between a bank and a customer. Further, banks always cooperate with domestic and international regulatory or non-regulatory units such as credit rating institutions. Although the banking industry is liberalized in many countries, many aspects of its activities are monitored and regulated by agencies. The ways in which various socio-political environments influence the conduct of business have long been a topic of scholarly attention (Keilor, Wilkinson, & Owens, 2005; Streeck, 1992). However, as Hadjikhani et al. (2008); Hadjikhani et al. (2008, 2013) point out, this topic has rarely been considered in the context of marketing or business networks. Furthermore, this line of research has done little to elucidate the behaviour of multinational enterprises (MNEs) in foreign markets.

Given the background, the effects of changes in the international business environment regarding the internationalization of financial service firms constitute interesting issues (Hadjikhani, Hadjikhani, & Thilenius, 2014). The internationalization process (IP) model, mainly developed by Johanson and Vahlne (1977),

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explains internationalization as a function of learning and commitment, which are defined, respectively, as experience-driven knowledge acquisition and as the consequence of the size of an investment and its degree of inflexibility (Forsgren, 2002; Johanson & Vahlne, 2009). Learning may be both general and specific. Commitment may decline or even cease depending upon performance and prospects.

Studies employing the IP model have explained internationalization behaviour with the general assumption of "stable" market conditions (Bouquet et al., 2004; Eriksson, Johanson, Majkgård, & Sharma, 1997). In contrast, relatively few studies have attempted to understand internationalization behaviour in unstable market conditions (Hadjikhani et al., 2014; Van Heerde, Helsen, & Dekimpe, 2007). Because a crisis substantially affects transaction costs, it may discourage internationalization, rendering a firm risk-averse. Alternatively, it may drive further internationalization in an effort to diversify risks. Thus, the relationship between crisis and internationalization is generally unclear, and it raises the following question for this study: What have been the roles of learning and commitment in the relationship between crisis and bank internationalization? Our study contributes to the understanding of the IP model, especially with regard to international expansion under turbulent conditions. There were two crises that changed Korean banks' plans for internationalization: the Asian financial crisis in 1998 and the global financial crisis in 2008. In order to answer the question posed above, we approached the issue from a network perspective and conducted an aggregate analysis as well as firm-level case studies.

This paper is structured as follows: in the next section, we provide an overview of the theoretical ideas underpinning our study. Then, we discuss our methodology, including the research setting, analytical approach, and data collection. We end with our findings and conclusions.

2. Relevant theories

2.1. The internationalization process model and international financial service firms

The Uppsala internationalization process (IP) model is based on learning and commitment and the relation between them (Johanson & Vahlne, 1977, 2006). As seen in Fig. 1, the central question that this model addresses is how the learning and commitment of an internationalizing firm affect its overseas expansion, including sequential entry, establishment form, or functional management in the host market. The model is founded on the causal relation between learning (or knowledge), commitment, commitment building, and the current activities of foreign expansion (Forsgren, 2002).

The IP model assumes that foreign expansions are developed gradually as MNEs overcome uncertainties. The model also addresses uncertainties and risks, but it is concerned primarily with expansion strategies and path-dependence, usually as presented under stable market conditions (Blomstermo, Eriksson, & Sharma, 2002; Engwall & Johanson, 1990; Eriksson et al., 1997; Johanson & Vahlne, 1977). Attempts to overcome uncertainties in a turbulent environment or in a crisis have rarely been investigated, except by a handful of studies, such as those by Van Heerde et al. (2007) and Hadjikhani et al. (2014).

Depending on the level of perceived risk from crisis management in bank services, the outcomes of the internationalization process appear to vary. In terms of timing, for instance, one can observe either the sequential establishment of overseas operations or concurrent establishment. MNEs acquire knowledge and if the knowledge acquisition is low, they postpone the next investment decision until knowledge accumulation is high enough to make the perceived risks low. If MNEs are not strongly committed to the host market, they would not run the risk of handling investment decisions simultaneously.

Regarding the form of overseas businesses, transaction-cost economics explains that as firms have more knowledge (and thus face less uncertainty), MNEs are likely to choose greenfield investments over acquisitions. Making greenfield investments represents a stronger commitment to the host market, given that it becomes necessary for foreign entrants to justify more resource inputs.

Compared to the timing and the form of overseas expansion, the issue of functional balance has received less attention. Functional balance is defined as a contribution to the host country relatively equal on the value chain. If MNEs have asymmetric learning or partial commitments, they will only develop in areas that they know or where they are committed. In fact, functional balance is often desired by the host government. Many developing countries are concerned with the possibility that MNEs exploit the large domestic market but do not effectively transfer knowledge to the host countries (Prahalad & Lieberthal, 2003). Lee, Abosag, and Kwak (2012) found that, in the case of the Chinese automobile industry, the Chinese government tended to favour foreign automobile manufacturers that not only procured local supplies, but also established R&D facilities. In the banking industry, given its sectorial characteristics, the functional balance may appear in the form of positions between lending and borrowing, between corporate and individual customers, or between host and home customers.

Perceived risk is primarily a function of an MNE's level of knowledge and commitment in a foreign market (Forsgren, 2002). The risk arises from unknown local regulations, unfamiliar local consumers, or disconnected local business actors, all of which constitute entry barriers for foreign firms. Specifically, the banking

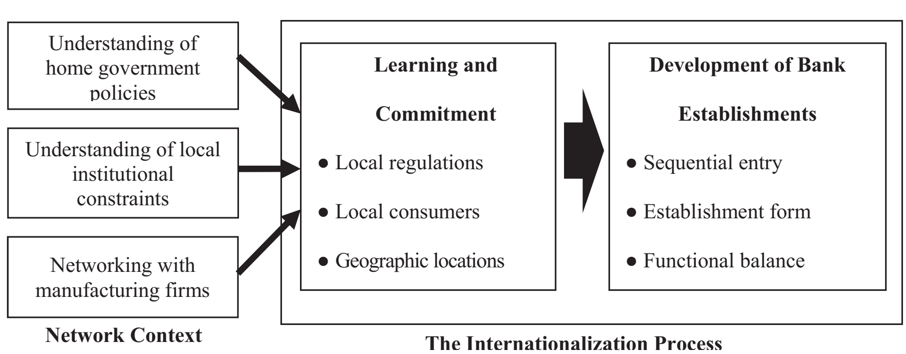

Fig. 1. A conceptual model.