THE ROLE OF LOCATION-RELATED FACTORS IN U.S. BANKING INVOLVEMENT ABROAD: AN EMPIRICAL EXAMINATION

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Abstract. This study examines the role of major location-specific advantages in the international branch banking involvement of U.S. banks. Using pooled time-series (1976-82), cross-sectional (thirty countries) regression analysis, this study finds that the U.S. business presence in a foreign country has a strong positive effect on U.S. branch banking activity in that country. In contrast, the local market opportunity appears to have no significant effect. These results hold for the entire set of countries, as well as each of five subsets (developed, less developed, European, Latin American, and Asian countries). The openness of the host country to the establishment of new foreign bank branches does affect U.S. branch banking involvement. This effect is most pronounced in the less developed countries, particularly those in Asia.

The question of why banks headquartered in a particular country set up branches or subsidiaries in foreign countries has been the subject of investigation in many international banking studies. Several factors are suggested as major motivating forces for foreign banking presence; namely,

- to optimize economic rents emanating from a bank’s possession of comparative advantages in producing certain banking products;
- to avoid or exploit various externalities in both home and foreign banking markets caused by either government-imposed restrictions, structural imperfections, and/or market failures;
- to exploit local banking opportunities in foreign markets;
- to serve the international banking needs of the bank’s home country clients in foreign countries in a more efficient and cost-effective manner.

Very little empirical analysis has been conducted in investigating the validity of the hypotheses mentioned above. The purpose of this study is

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Received: October 1985; Revised: February 1986; Accepted: April 1986.
to empirically test the effect of some of the above forces on U.S. branch banking involvement in foreign countries.

**Major Motivations for Foreign Banking Presence**

It is widely believed that banks with unique capabilities to produce certain banking products more efficiently than their competitors (local as well as foreign) are more likely to go overseas to expand their client base in order to exploit their competitive advantages more economically. Such competitive advantages are found to arise from the bank's possession of unique banking techniques, extensive banking experience, skilled personnel, organization skills, and a large domestic capital and deposit base (Lees 1974, Aliber 1976, Cho 1983 and 1985).

Banks are also found to be attracted to foreign markets to exploit favorable (or less restrictive) foreign banking environments (Brimmer and Dahl 1975, Aliber 1976, Kelly 1977, Fieleke 1977, Goldberg and Saunders 1980, Rugman 1981) and/or to take advantage of local banking opportunities in foreign countries (Fieleke 1977, Terrell 1979, Khoury 1979 and 1980, Goldberg and Saunders 1981, Cho 1983 and 1985). A substantial foreign banking presence in various offshore banking markets and some onshore banking markets of developed and developing countries seems to suggest the significance of such motivation.

Finally, banks tend to establish their presence in foreign countries to serve the banking needs of their home country client firms there. These banks can do this more competitively than other banks (both local and foreign) due to their pre-established relationship with and better access to information on their clients at home (Pringle 1966, Dahl 1967, Brimmer and Dahl 1975, Grubel 1977, Fieleke 1977, Metais 1979, Terrell 1979, Khoury 1979 and 1980, Gray and Gray 1981, Ball and Tschoegl 1982, Goldberg and Saunders 1980, 1981 and 1982, Vastrup 1983). Furthermore, these banks may need to accompany their clients abroad in order to ensure a continuing business relationship with the home parent of the foreign subsidiaries. Failure to do so would force foreign subsidiaries to turn to foreign banks or domestic rivals with offices there and eventually such growing commercial relationships might expand to where domestic business is overtaken by those domestic or foreign banking competitors.

However, the validity of these major motivations has not been satisfactorily established due to the modest attention given to their empirical verification. Some studies are only conceptual in nature (Pringle 1966, Dahl 1967, Lees 1974, Brimmer and Dahl 1975, Aliber 1976, Grubel 1977, Kelly 1977, Gray and Gray 1981, Rugman 1981, Vastrup 1983). Other studies that are more empirical in nature have used a limited sample of countries and time periods in their investigation of foreign branch banking involvement. For example, Terrell (1979), Khoury (1979 and 1980) Goldberg and Saunders (1980 and 1982), and Ball and Tschoegl (1982) investigated the involvement of banks from a particular country (e.g., United States, Japan, or Canada) in one foreign country (e.g., United Kingdom, United States, or Japan).