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FOREIGN BANK'S ACQUISITION STRATEGY AND THE BUSINESS APPROACH OF DOMESTIC BANK: A CASE OF STANDARD CHARTERED BANK

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ABSTRACT

The purpose of this study is to investigate the process of foreign bank's acquisition strategies of domestic bank by studying *Standard Chartered* bank as acquirer in Korea. The methodology of this study carries out in-depth analysis of the M&A backgrounds in bank industry, objectives and strategies of banks subject to analysis as a case study and presents performance, problems and implications for M&A strategies. Contrary to original expectation, as well as the low profitability for 10 years after its acquisition of *First Bank*, various management problems occurred, which prompted the Korean market to doubt whether the bank would indeed run a long-term and stable operation. Concerns were raised that *Standard Chartered* bank would follow the path of past investment funds which withdrew from the market after enjoying a short-term profit through business downsizing and encashment strategies such as high dividends, asset sales, and excessive commissions instead of continuous growth and reinvestment in the country. This study examines business activities of *Standard Chartered* bank in Korea for the past decade to deduce political implications useful for policymakers seeking rational policies against any other inflow of foreign capital.

Contribution/ Originality: The paper investigates the process of foreign bank's acquisition strategies of domestic bank in emerging market and provides several political implications useful for policymakers seeking rational policies against any other inflow of foreign capital in future.

1. INTRODUCTION

The gigantism of banks through mergers and acquisitions (M&A), particularly in the United States and Europe, has proliferated since the 1990s (Anthony, 2017; Banakar, Tavana, Huff, & Caprio, 2018; Hyun, 2016). Global banks such as *Citibank* and *Hong Kong and Shanghai Banking Corporation* (HSBC) have been expanding their investment avenues and acquiring banks in Asia to secure competitiveness through gigantism. In a similar event, *Standard Chartered* NEA Limited (hereinafter referred to as "*SC*") acquired *First Bank* in Korea in 2005 (Hossain & Khan, 2016; Hyun, 2016).

However, theories on effects of foreign banks' entry into the domestic banking industry have been opposed by positive and negative arguments. Kang and Kim (2005) and Levine (1996) have argued that expanding foreign ownership of banks contributes to financial stability, enhances the efficiency of bank management, and contributes to strengthening international competitiveness of the banking industry. Park and Lee (2005) and Stiglitz (1993)

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have pointed out that expanding foreign ownership of banks has a negative impact on financial development in that it increases financial instability and international capital movements. On the other hand, Tressel and Verdier (2011) have presented a neutral view that the effect of expanding foreign ownership of banks' equity might be different depending on vulnerability of the financial system to the entry country. In particular, there are positive effects of foreign banks on business performance of firms they are trading with. Fok, Chang, and Lee (2004) have analyzed the ownership structure of banks and the performance of firms using Taiwanese data during the Asian financial crisis and reported that the performance of firms is high when the proportion of foreign banks among Taiwanese firms' trading banks increases. Therefore, the aim of this study was to analyze the process of foreign bank's acquisition strategies of domestic bank by studying the case of *Standard Chartered Bank* in Korea.

The remainder of the paper is organized as follows: Section 2 provides a theoretical background and review of target bank (domestic bank) and acquirer (foreign bank). Section 3 presents acquisition strategies of *Standard Chartered Bank*, such as circumstances and issues at the time of acquisition, and localization efforts at the Initiation stage of acquisition. Section 4 provides the analysis for the acquisition strategy process including change in management of *SC First Bank* after acquisition and retreat from localization efforts. The last section summarizes and concludes the analysis results and their implications.

2. THEORETICAL BACKGROUND AND PURPOSE OF ACQUIRER'S ACQUISITION OF TARGET BANK

2.1. Theoretical Background

(Deregulation on foreign banks) The entry of foreign banks has been permitted in transition economies of Europe since the mid-1990s. Authorities of each country began to actively promote the privatization policy for domestic banking system through strategic investment of foreign banks (Mathieson & Roldòs, 2001). Beyond determining whether or not to allow entry of foreign banks, the literature shows that the regulatory environment has a more effective impact on the choice of bank FDI. Goldberg and Grosse (1994) have suggest that econometric studies analyzing the location of foreign banks in the United States are likely to establish themselves in a state where foreign banks have limited restrictions on foreign bank activity. Focarelli and Pozzolo (2005) and Barth, Caprio, and Levine (2001) have suggested that countries with less restrictive general regulatory environment for banking industry are more likely to enter foreign banks. In a recent comprehensive study of regulatory barriers to bank mergers and acquisitions, Buch and DeLong (2001) have tested samples over 2,300 commercial bank mergers and provided empirical evidence that the regulatory environment has a strong impact on the decision making of mergers by international banks.

(Profit Opportunity) An important determinant of bank's FDI location is that the economic benefit expected from such activity will be the largest. Brealey and Kaplanis (1996); Yamori (1998) and Buch (2000) have found that there is a positive relationship between gross domestic product (GDP) and foreign direct investment (FDI). Claessens, Demirgüç-Kunt, and Huizinga (2001) have shown that foreign banks have the highest profitability, lowest tax rate, and the highest penetration rate in the period with the highest per capita income using data from 80 countries in 1988-1995. However, Wezel (2004) has suggested that per capita GDP is not an important determinant of bank FDI. Instead, if the risk of a financial crisis is lower, the likelihood of entry is higher. Thus, banks prefer a country with a stable outlook. Focarelli and Pozzolo (2005) have measured this by assuming that countries with low initial production and low inflation with more developed financial markets are most likely to grow. Their results are consistent with the view that banks will choose where to invest based on profitability criteria. However, other factors such as distance, language, and economic integration are also important.

(Information Costs) Costs associated with information are most commonly changed by geographic distance and cultural similarities such as common language, legal system, and social norms. Ball and Tschoegl (1982); Grosse and Goldberg (1991); Buch (2000) and Focarelli and Pozzolo (2005) have reported negative correlations between

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geographic distance and degree of bank FDI. These findings are from general studies on determinants of bank FDI. However, geographic and social proximity need to be investigated in detail. Buch (2005) found that streets remained a major determinant of bank FDI in all countries except the US during the period 1983-1998. While its importance is empirically obvious, the authors warn against interpreting distances as purely informational costs because they reflect other costs such as commodity shipment, given the importance of trade links found in the same research as described previously. Galindo, Micco, and Sierra (2003) have analyzes quantum bank data for a sample of 176 countries to determine the importance of various sociocultural variables on the bank's FDI selection. This includes general colonial connections, language, legal origins, bank regulatory structures and burdens, and rule of law.

(Institution Specific factors) Potential geographical diversity and efficiency improvement are two major institutional factors that can be affected by individual banks' overseas expansion. According to economic theory, bank FDI provides an opportunity to improve geographic diversity. Thus, it should improve banks' risk compensation trade-off and profitability (Berger, DeYoung, Genay, & Udell, 2000; Vander Vennet, 1996) consistent with the study of Guillèn and Tschoegl (1999). On geographical diversity, Amihud, DeLong, and Saunders (2002) have argued that the potential benefits could outweigh the potential costs faced by large and complex banks as a result. Berger et al. (2000) have noted that there are few studies on increased efficiency of cross-border banking integration and that the concentration on EMEs is still small. Altunbarş, Molyneux, and Thornton (1997) have found that the cost base of a bank is likely to increase more than the reduction after a merger. Claessens et al. (2001) have shown that foreign banks are more efficient than domestic banks in EMEs, suggesting that the relative efficiency of the banking system is greater than that of FDI-specific efficiency improvements.

(Home Market Conditions) In Europe, European fiscal consolidation and EU banking guidelines have provided a venue for substantial integration (Berger et al. (2000). Real cross-border integration has been limited so far. However, domestic integration has been broadly achieved as banks seek to scale up to gain more favorable position on possible cross-border mergers and acquisitions. The result is an increasingly saturated banking market. Results of Guillèn and Tschoegl (1999) are in line that considers Spanish banks' inroads into Latin America in the 1990s. Asset pursuit was aimed not only at taking advantage of profitable opportunities, but also at gaining larger masses which would make Spanish banks stronger in the wave of mergers and acquisitions expected to entail greater European financial integration. Guillèn and Tschoegl (1999) have performed specific case studies and provided insight into supply-side considerations leading to some major adversaries in the wave of bank FDI. Germany, Italy, and France all experienced similar levels of domestic integration, consequently experiencing market saturation. Berger et al. (2000) have argued that gradual easing of inter-bank restrictions and universal acceptance can serve as a catalyst for the rapid flow of domestic integration during that period, laying a ground-work for increased cross-border mergers.

2.2. Target Bank: First Bank (Domestic Bank)

First Bank was initially established as *Chosun Savings Bank* in July 1929. It acquired its current name in December 1958 (Ryu & Won, 2016; Seth, 2016). The business of *First Bank* focuses on banking, foreign exchange, and trust and subsidiary works related to these businesses, of which corporate finance is the strongest. Its total asset was more than that of any other commercial bank until the early 1990s. Further, management of *First Bank* was ranked first for three consecutive years starting in 1993, the first such instance in Korea. Its total deposits stood at KRW 20 trillion in April 1995, the highest in Korea at that time (Lee, Joo, & Park, 2017; Ryu & Won, 2016).

After the 1997 foreign exchange crisis, *First Bank* which was ordered by the government in December 1997 to improve its management started experiencing difficulties. As a result, its share of 51.1% was taken over by *Newbridge Capital*, an American investment capital firm, in the same month (Cho, 2006; Lee, 2007). Similar to other

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investment capitals, *Newbridge Capital* gained the maximum short-term investment income by securing management rights and then reselling them (Cho, Lee, & Song, 2016; Seth, 2016). Thus, it sought a passive management strategy focused on organizational stability and soundness of assets instead of pursuing advanced management methods. *Newbridge Capita*l after acquiring *First Bank* whose merit was corporate finance consequently reorganized its business to focus on retail finance primarily with secured loans, contrary to the policy of *First Bank*. Thus, its residential mortgage loan accounted for 83% of its overall loans at the end of 2004. In the end of 2004, total deposits and loans of *First Bank* ranked sixth among all commercial banks.

Table 1 presents*A major incidents related to *SC*'s acquisition of *First Bank*. On January 10, 2005, *Newbridge Capital* concluded a contract for selling *First Bank* to *SC* for KRW 3,400 billion. It completed the procedure of share transfer by April 15, 2005. *SC* delisted *First Bank* on April 22, 2005 immediately after the acquisition. *First Bank* sold whole investment stocks of its subsidiary in Hong Kong (Korea First Finance Limited Hong Kong) to *SC Hong Kong Limited* on August 18, 2005 and added a profit of KRW 1 billion from the sale to capital surplus. In addition, it sold assets and debt of its London and Tokyo branches to *SC*'s London and Tokyo branches on September 9, 2005 and September 12, 2005, respectively, thus adding another KRW 1 billion of profit from the sale to capital surplus. Later, *SC First Bank* assumed assets, debt, and business of *SC*'s Seoul branch on November 28, 2005 and deducted a margin of KRW 36 billion, the difference between the price for business transfer (KRW 164 billion) and the book value of net asset (KRW 127 billion) from capital surplus (Standard Chartered NEA Limited, 2005).

In September 2005, *SC* changed its name to *SC First Bank* (Standard Chartered First Bank Korea Limited) after it had completed the acquisition of *First Bank* as its affiliated company. After establishing *Standard Chartered Korea Limited*, a financial holding company, in June 2009, *SC First Bank* once again changed its name to *Standard Chartered Bank Korea Limited* in January 2012 (Cho et al., 2016; Seth, 2016). As of the end of 2005, owing to acquisition of *First Bank*, assets in Korea comprised 25.5% of *SC*'s global whole assets and constituted its largest business portion. Unlike *Newbridge Capital* which focused on retail banking with mortgage loans, *SC* established the goal of constructing a business model by striking a balance between corporate banking and retail banking at the initial stage of acquisition.

Table-1. Major incidents related to SC's acquisition *of First Bank*.

Event Date	Incident
Nov 11, 2004	*Newbridge* Capital announced that it would conclude its MOU with *HSBC* after completing the deal for the sale of the shares of *First Bank*.
Dec 25, 2004	*HSBC* delayed announcing the acquisition of *First Bank*.*A
Jan 10, 2005	*Newbridge* Capital and *KAMCO* concluded the contract for the sale of 100% of *First Bank*'s shares to *SC**B at the price of KRW 16,511 per share.
Apr 15, 2005	The takeover of the shares by *SC* was completed.
Apr 22, 2005	The stock of *First Bank* was delisted from the Korea Stock Exchange.

Note: * are as follows; *A: Although, at first, it was known that HSBC would take over the shares of *First Bank*, *SC*, suggesting more favourable conditions, finally acquired them. *B: 48.6% shares (100,000 thousand shares) owned by *Newbridge* Capital, 48.5% shares (99,853 thousand shares) owned by *KAMCO*, and 3.0% shares (6,070 thousand shares) owned by MOFE were taken over at a price of KRW 3,400 billion.

2.3. Acquirer: SC (Foreign Bank)

SC was established in 1969 from the merger of Standard Bank of British South Africa and Chartered Bank of India, Australia, and China. These two banks were established after an approval from the British government in 1862 and 1853, respectively. They grew through intermediary trade among Europe, Asia, and Africa (Kim, 2008; Ryu & Won, 2016; Seth, 2016). *SC* continued to expand its business in conventional markets of Asia and Africa. From the early 1990s, the bank utilized its existing business network to promote franchises in these regions so that it could focus on fund management and corporate banking that were its traditional strengths (Dymski, 2016; Seth, 2016).

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Thereafter, *SC* took over the consumer banking sector from Chase Hong Kong in September 2000. After the acquisition of *Grindlays Bank* in India in August 2003, *SC* advanced into the Korean financial market backed by its high purchasing power in January 2005. It also took over *First Bank* to secure a strategic stronghold in East Asia. Following its purchase of *First Bank*, *SC* became a global bank with more than 40,000 employees (Kim, 2008) having established its business network in 57 countries in Asia, the Middle East, Africa, and the Americas. Unlike *Newbridge Capital* which acquired *First Bank* immediately after the foreign exchange crisis for the purpose of short-term profit, *SC* claimed that its motive for escalating operations into Korea was actually a market-oriented strategy to maximize long-term profit by expanding its business network in the country's financial market.

However, several finance experts did not believe this announcement. They assumed that *SC* would either sell *First Bank* to another bank at a higher price or it intended to expand its size as a safeguard against any hostile M&A. According to these experts, when *SC* took over *First Bank*, the competition among international banks to augment business size through M&As was highly cutthroat. Citi Group, JP Morgan Chase, and HSBC Holdings were the top three assets holders, making them highly aggressive M&A hunters. *SC* was a major target of *HSBC Holdings* for a hostile M&A which was threatening to actually take place. Consequently, *SC* had to buy out *First Bank* in order to shield itself against an M&A attempt (Daily, 2005).

3. ACQUISITION STRATEGIES OF STANDARD CHARTERED BANK

3.1. Circumstances and Issues at the Time of Acquisition

As shown in Table 2 from the beginning of the foreign exchange crisis in September 1997 to *SC* acquisition in June 2005, the public fund input into *First Bank* was as follows: KRW 14,000 billion from the Korea Deposit Insurance Corporation (KDIC), KRW 11,781 billion from KAMCO, and KRW 892 billion from the government and others, totaling KRW 26,673 billion. Remarkably, the public fund collected during the same period was KRW 8,538 billion by KDIC, KRW 3,433 billion by KAMCO, and KRW 298 billion by the government and others, totaling KRW 12,269 billion. Accordingly, the net cost input into *First Bank* during its business normalization period was KRW 14,404 billion, the difference between those two amounts.

The after-tax profit of *SC First Bank* for the first quarter of 2005 stood at KRW 42 billion whereas that of the first half of the year dropped to KRW 27 billion, a decrease of 52% from KRW 56 billion of after-tax profit in the first half of 2004. This poor management performance during the second quarter of 2005 could be attributed to the integration cost (KRW 43 billion) for the transfer of management right along with additional allowance for bad debt (KRW 37 billion).

Table-2. Provision and collection of public fund through *SC*s acquisition of *First Bank*.

(KRW billion).

Provider	KDIC		KAMCO		Government, etc.	
Provision	Investment	5,025	Bond purchase	2,765	Investment	750
	Contribution	1,028	Bad loan purchase	9,015	Subordinated bonds purchase	142
	Asset purchase	7,948	-	-	-	-
	Total	14,000	Total	11,781	Sum	892
Collection	Shares trade	3,578*A	Repurchase cancellation	1,655	Investment withdrawal	144
	Bankruptcy dividend	27	Asset disposal	1,778	Subordinated bonds withdrawal	154
	Asset disposal	4,933	-	-	-	-
	Total	8,538	Total	3,433	Total	298

Note. *A Of the KDIC investment of KRW 5,025 billion, KRW 3,578 billion was collected through capital reduction (KRW 1,418 billion on December 30, 1999), divestment to *Newbridge Capital* (KRW 500 billion on January 20, 2000), and divestment to *SC First Bank* (KRW 1,660 billion on April 15, 2005).
Source: Ministry of Finance and Economy (2006).

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The one-time integration cost which increased from the second quarter of 2004 accounted for most of the KRW 45 billion of operating expense during the second quarter of 2005. The after-tax profit of *SC First Bank* during the third quarter of the year was KRW 27 billion, a drop of 9% compared to the third quarter of the past year. This might be attributed to large-scale investment for expanding infrastructure such as re-branding and construction of sales channels after the acquisition. Both severance payment to ex-management and integration cost resulted in an operating gain of KRW 94 billion, ordinary profit of KRW 62 billion, and after-tax profit of KRW 65 billion in 2005, representing decreases of 61%, 63%, and 46%, respectively, compared to 2004 figures.

Table 3 shows goodwill and other intangible assets of *SC* as of the end of 2005. When *SC* acquired *First Bank* in April 2005, recognized goodwill related to its business in Korea stood at USD 1,738 million. The International Financial Reporting Standards (IFRS) has enacted a provision that damage assessment should be conducted every year without allowing any depreciation after goodwill recognition. *SC* subsequently applied the projection approved by the management in the first year and the following 19 years and employed future cash flow based on the anticipated GDP growth rate along with an annual discount rate of 13.5%. Adopting these assumptions, *SC* calculated the goodwill value at the end of 2005 as USD 1,758 million for public announcement.

Table-3. Goodwill and other intangibles at the end of 2005.

(USD million)

Provider	KDIC	Goodwill	Acquired Intangibles	Software	Total
Cost	At 1 January	2,643	-	566	3,109
	Exchange translation differences	8	2	(3)	7
	Acquisitions	1,802	216	28	2,046
	Additions	-	-	88	88
	Disposals	-	-	(14)	(14)
	Amounts written off	(2)	-	(103)	(105)
	At 31 December	4,451	218	462	5,131
Provision for amortization	At 1 January	514	-	242	756
	Exchange translation differences	-	-	(2)	(2)
	Amortization for the period	-	32	125	157
	Disposals	-	-	(4)	(4)
	Amounts written off	-	-	(97)	(97)
	At 31 December	514	32	264	810
Net book value		3,937	186	198	4,321

Source: Standard Chartered First Bank Korea Limited (2006).

3.2. Localization Efforts at the Initiation Stage of Acquisition

SC First Bank made various localization efforts at the initiation stage of acquisition. *SC*, which took over *First Bank*, adopted the strategy of respecting the Korean corporate culture to receive a favorable evaluation from mass media and financial institutions. Moreover, it announced its management goal (vision) to interested parties, such as customers, employees, communities, investors, and its supervising agencies, of transforming *First Bank*, which was ranked sixth among commercial banks in Korea at the time of acquisition, into a leading bank in the financial industry.

After the foreign exchange crisis in 1997 and the acquisition of *Newbridge Capital*, the priority of corporate banking, which was the conventional merit of *First Bank*, gradually diminished while retail banking expanded. Consequently, at the early stage of acquisition, *SC* devised a strategy to widen its profit sources by developing a balanced project model between the two sectors. In August 2007, the revised Financial Holding Company Act

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allowed foreign financial institutions to manage domestic financial holding companies. Consequently, Korea SC Financial Holding Company became the first financial holding company approved by the Financial Services Commission (FSC) in June 2009.

In particular, after establishing the financial holding company, *SC* strived to sell various trade loan products instead of working capital loan, based on its traditional strength in that kind of finance. Further, *SC* was allowed the use of the Advanced Internal Rating Method, a meliorated company risk evaluation model, which it used in the UK, to assess the BIS equity capital ratio. This development was significantly meaningful from the viewpoint of the advancement of the Korean financial industry. The approaches for assessing BIS equity capital ratio include the Standard Method, the Basic Internal Rating Method, and the Advanced Internal Rating Method. All other domestic banks applied the first or the second method, whereas *SC First Bank* initially employed the Advanced Internal Rating Method in Korea, a more sophisticated management approach, like most banks in Hong Kong and Britain.

European multinational corporations seek localization by managing their affiliated companies overseas, wherein the managers dispatched from the headquarters emphasize on maintaining a close relationship instead of applying formal and systematic control (Kim, 2008).

After the acquisition, *SC* aggressively guaranteed autonomous management of *First Bank* and delegated all authorities and responsibilities to the president to maintain Korean values as well as global standards. In particular, *SC* actively responded to the requests from financial authorities and tax authorities in Korea for their positive localization, and, according to the request from FSC, it appointed four Korean executives, composing half of board members, a first among foreign banks in Korea. Moreover, SC refrained from excessive competition for residential mortgage loans with low interest, and, unlike other commercial banks, reported the withholding tax on the yen depo swap trades according to the request from the National Tax Service (NTS).

SC changed the name of *First Bank* to "*SC First Bank*" based on a survey of employees and customers after the acquisition. Such combination of "*SC*" and the name of the acquired bank ("*First Bank*" in this case) was a first in the history of SC, which was acknowledged as its will to exert tremendous effort for localized management in Korea. With regard to the corporate philanthropic activities, *SC First Bank*, instead of merely making monetary contributions, boosted its efforts for localization through various contribution programs such as "Program for Eyesight Recovery of the Blind," in which customers actively participated. Moreover, to improve labor relationship, *SC* increased its employee strength by 9.5%, 3.9%, and 2.5% in 2005, 2006, and 2007, respectively, indicating that no artificial manpower restructuring occurred before and after the acquisition.

At the time of its acquisition of *First Bank*, *SC*'s Seoul branch had approximately 290 employees and *First Bank* had around 5,000; thus, the nature of the acquisition was virtually a merger of *SC* into *First Bank*. *SC* adjusted the ranks of the employees of both companies to proceed with real integration without conflict. The ranks of employees in *SC*'s Seoul branch were lowered, whereas those of *First Bank* were raised, a reflection of *SC*'s highly aggressive approach. *SC* could complete the integration without any conflict through persistent negotiations with the labor union while taking over *First Bank*. After the acquisition, *SC* actively embraced the existing employees with various cultural events, and agreed that it would not employ anyone from outside without permission of the labor union. Moreover, Korean was also designated as the official language of *SC First Bank*.

4. ANALYSIS FOR THE ACQUISITION STRATEGY PROCESS

4.1. Change in Management of SC First Bank after Acquisition

Over time, *SC* adopted a regressive manner of conducting business activities, on lines of other domestic banks, which was quite different from its various advanced financing techniques adopted immediately after the acquisition (Cho et al., 2016). In particular, *SC* delisted *First Bank* from the stock market in the course of takeover; thus, it could change its business activities relatively freely and adopted a passive approach just to observe regulations. The most surprising incident, although not included in the series of negative incidents after the acquisition, was the error in

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public announcement of *SC*'s net income. The bank issued the financial statements for the 2008 fiscal year, where the reported net income was KRW 308 billion. However, presuming that more than KRW 100 billion of net income had been underreported, FSC investigated *SC*'s accounting data and observed that the data differed from the one presented by its headquarters. Consequently, it was suspected that foreign financial institutions, after the acquisition of domestic firms, abused the IFRS provisions to transfer the non-performing assets or costs of their headquarters. *SC First Bank* explained that the incident was caused by a computing error, which was triggered by the difference from the accounting standards of its headquarters. Thereafter, *SC First Bank* announced the corrected management performance for the fourth quarter of 2008, converting net loss of KRW 41 billion into net income of KRW 58 billion, thus reflecting the underreported net income of KRW 99 billion. The bank also converted the net income for the first quarter of 2009 to KRW 112 billion from KRW 211 billion, explaining that the error in settlement date, i.e., the difference of two days, which was made on December 31, 2008, was carried over to the next year, exerting conflicting effects on the net incomes of both quarters in a row. Later, FSC concluded that the significant accounting mistake of *SC First Bank* caused by its system error was not an accounting fraud but a technical problem; it also reprimanded the bank's CFO.

(Poor Profitability) Despite various efforts after the acquisition of *First Bank, SC* failed to boost its profitability and establish a stable business foundation in Korea. The loan size of SC First Bank decreased from KRW 34,200 billion at the end of 2005 to KRW 31,800 billion at the end of 2006, while its total assets decreased from KRW 57,400 billion to KRW 56,800 billion during the same period. Although much time has passed since then, its loan size and total assets at the end of 2017, KRW 39,985 billion and KRW 60,739 billion respectively, were not much higher than its initial accomplishments enough. In addition, the percentage of total assets among commercial banks steadily decreased to 3.5% and 2.7% in 2012 and 2017, respectively, from 4.0% in 2004, and the percentage of deposits and loans substantially declined to 2.9% and 2.2%, respectively in 2012, and to 2.5% and 2.2%, respectively in 2017, from approximately 5% in 2004 Seth (2016). Furthermore, despite government encouragement for supporting small-and-mid sized firms, *SC First Bank* turned its back on corporate loans, failing to get out of its business style that focused on retail banking. In particular, after the financial crisis in 2008, its household loans increased significantly; the ratio of household loans in the overall loans reached 65% at the end of June 2009, which still kept as high as 65% at the end of June 2017, from 61% at the end of December 2008. Consequently, the *SC* headquarters curtailed the value of goodwill in Korea by USD 1 billion in 2013 from USD 1.7 billion in 2005 after it concluded that the goodwill was impaired by deteriorated business environments in Korea. Thus, reflecting the general economic recession, the return on equity (ROE) of *SC First Bank* plummeted to 4% in 2013 from 18% in 2005. SC insisted that the deteriorated business environments were attributed to such plummeted profitability as well as complicated regulatory policies and rapid growth of loan losses caused by individual rehabilitation policies. However, a criticism was raised regarding the reason behind the continuous decline of *SC First Bank*'s profitability. The deteriorated business environments were attributed to low interest rates as well as the pursuit of excessively stable profitability and the reduced business size in Korea. Major business policies of SC First Bank have rarely changed since then, and, although improved a little, its ROE still stayed at 8% in 2017.

(High Dividend) After paying a dividend of KRW 8 billion before the acquisition in 1996, *SC First Bank* never paid any dividend until 2008. However, as like Table 4 it paid KRW 850 billion from 2009 to 2012, and KRW 855 billion from 2014 to 2018 to SC Financial Holdings Company, its parent company, raising criticism that the dividend payout ratio was excessively higher than that of any other commercial bank. SC Financial Holdings Company paid almost all of the dividends received from *SC First Bank* to *SC*'s headquarters, which also raised questions about *SC*'s will for long-term and stable re-investment in the Korean market. However, *SC* termed this as a minor issue, saying that the dividend paid to headquarters was significantly smaller than the KRW 3,400 billion invested while taking over *First Bank* from *Newbridge Capital*. Moreover, the dividend payout ratio of *SC First Bank* in 2017 and 2018 is 45.7% and 51%, respectively, which is significantly higher than the industry average of 8% and

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11%. While the banking industry average has fallen from 20% to 8%~10% since 2012, *SC First Bank* has more than six times the industry average payout-ratio. In particular, the *SC First Bank*'s payout-ratio is 2-3 times higher than other foreign banks. Therefore, this suggests that the high dividend increases the FDI return of SC to Korea.

Table-4. Dividend payment and payout-ratio by year.

		FY2005	FY2006	FY2007	FY2008	FY2009	FY2010	FY2011
SC First Bank	Dividend payment	-	-	-	-	250*	200	200
	Dividend payout ratio	-	-	-	-	58%	62%	78%
Commercial banks (average)	Dividend payment	162	395	301	14	171	231	454
	Dividend payout ratio	15%	34%	22%	2%	28%	30%	33%
		FY2012	FY2013	FY2014	FY2015	FY2016	FY2017	FY2018
SC First Bank	Dividend payment	200	-	150	500	80	125	142
	Dividend payout ratio	103%	-	(net loss)	(let loss)	36%	46%	51%
Commercial banks (average)	Dividend payment	192	161	213	230	227	283	251
	Dividend payout ratio	23%	5%	7%	8%	8%	11%	10%

Note: * SC First Bank had paid the first dividend in 13 years since 1997 to its parent company Korea SC Financial Holdings.
Source: Financial Supervisory Service (2019).

(Continuous Sales of Assets) To secure the funds required for establishing the holding company and fulfilling its core business strategy, *SC First Bank* sold out several buildings belonging to its branches to real estate trust companies, and then rented these buildings (sale and leaseback). A total of 26 buildings were found to be sold out in this manner from 2008 to 2010, with the total selling price reaching KRW 248 billion. Moreover, some of these buildings were suspected to have been chaffered away. Before these sales took place, 94 out of 367 branches had their own buildings, while the others had leased office buildings. However, among the owned buildings, *SC First Bank* sold its *Gaepodong* branch building in Seoul in September 2009 at a price of just KRW 9,500 million, which was less than half of the appraised value of KRW 20,000 million. Further, it granted a loan of KRW 7,500 million to the buyer on security of the purchased building itself. Again, in November 2009, *SC First Bank* sold its *Duncheondong* branch building in Seoul to the same buyer at a price of KRW 6,800 million, which was excessively lower than the market value of more than KRW 10,000 million. Moreover, when *SC First Bank* closed 27 branches in 2011, it sold some buildings of those branches. Furthermore, it announced in 2013 that it was going to close another 100 branches to confront the changing business environment, and actually 112 branches were close from 2011 to 2015.

In 2011, a National Assembly inspection for the government revealed that all the buildings *SC First Bank* sold out after the acquisition were worth KRW 438 billion. *SC* stated that KRW 350 billion out of this amount had been spent on the modernization of computer systems. However, considering that most financial institutions spent approximately KRW 20 billion on modernization of their computer systems, the bank's statement was hardly persuasive. According to another criticism, *SC First Bank* sold out these real estates to pay out excessive dividends to its headquarters. It was also suspected that the proceeds from the sale of these real estates were used as a source

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of dividends, and not corporate loans. In particular, a consistent controversy had revolved around the bank's passive effort for corporate philanthropic activities in addition to payment of excessive dividends to close its business in Korea. With respect to this controversy, Reuters reported on May 26, 2011 that *SC First Bank* might be sold to Korean financial companies, such as Hana Financial Group Inc. and KDB Financial Group Inc. Speculation was also rife about the closure of *SC First Bank*'s branches. However, the bank clarified that it had been endeavoring for accompanied growth with customers in the Korean market into which it had invested heavily; thus, the rumor of acquisition was proved to be baseless.

(Payment of Excessive Commission) More than KRW 100 billion was paid annually by *SC First Bank* to its headquarters in the United Kingdom in the name of commission for business consulting. The fees for branding raised a tax issue and attracted criticism of excessive payment. Most foreign banks paid the value-added tax (VAT) for supplied services from their headquarters through the reverse charge, whereas *SC First Bank* paid no VAT at all in this regard (Kim, 2008). Although *SC First Bank* claimed that the service received from the headquarters was exempt from VAT based on its own legal consulting, it was highly likely to bear the burden of the VAT because such service is clearly taxable under the current tax laws.

4.2. Retreat from Localization Efforts

The name of *SC First Bank* was changed to Korea *SC Bank* on January 11, 2011. SC explained that the change of name was in line with the global strategy of its headquarters to reinforce the integrated image of the bank (Financial Supervisory Service, 2019). As only *SC First Bank*, among the five affiliated companies belonging to Korea SC Financial Holdings, used "First" in its name, it impeded the overall integration effect. However, *SC* was blamed for the name change, and censured for damaging the historic value of *First Bank* and generating an unnecessary menu cost. *SC First Bank* was blamed for neglecting student loans with a low profitability, ranking last among commercial banks, and thus turning away from the public interest. Although most foreign banks were passive about student loans, in which profit margin is mostly very low, *SC First Bank* showed the poorest performance. The bank's aloofness from public interest can also be judged by the poor performance of loans for small-and-mid sized firms and poor people (Montgomery & Takahashi, 2018). As foreign banks, including *SC First Bank*, focused on short-term profitability, reflecting the emphasis on stockholder interest and the preference for risk-free assets, it was known that they had persistently reduced loans with a high default rate. Furthermore, although commercial banks promised to offer credit loans of up to KRW 20 million to poor people with low credit grades, by concluding the "Spore for Hope" loan agreement with FSC in 2009, foreign banks, including *SC First Bank*, demonstrated the worst performance. Moreover, although *SC First Bank* launched a new "Hopeful Dream Loan" worth KRW 13 billion in 2009 for the poor, no actual loan was granted. Likewise, unlike other commercial banks, *SC First Bank* could not show any loan performance with the micro credit project by FSC, and in the financial crisis in 2008, it rather broke the agreement with the government by curtailing the loans to small-and-mid sized firms, and was therefore blamed for belittling the public role of financing.

When *SC* took over *First Bank*, neither a particular conflict between SC and the labor union nor any large-scale de-hiring occurred. However, in 2008, *SC First Bank* carried out a major reorganization to reduce departments at the head office from 133 to 95, removing 572 positions (First Bank, 2009). Those to lose their position were to be moved to branches or sales positions depending on their performance at a two-week training. *SC First Bank* also carried out voluntary resignations without any agreement with the labor union, following which the labor union appealed for an injunction from the court, asking it to suspend the resignations. Moreover, objecting to such moves, the labor union hindered the training of those to be assigned to branches and occupied the office of vice-president to finally cause a physical confrontation. The conflict between labor and management worsened when it was alleged that *SC First Bank* had forced some employees to resign voluntarily with individual interviews and the bank planned to inflict the voluntary resignation system adversely on its employees (Standard Chartered First Bank Korea

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Limited, 2009).

SC executed another major reorganization in 2011 by assigning many of its employees at the head office to SC Financial Holdings, during which the disagreement over the adoption of the performance-based annual pay system instead of the existing salary step system caused disruption and sit-ins, and eventually led to a total strike. After the strike, the labor union negotiated with the president more than 10 times, but failed to reach any agreement, increasing the inconvenience of customers who visited the branches. Taking a note of these incidents, *Moody's* changed its credit rating from "stable" to "negative" (Yi, Jung, & Park, 2005). The strike ended on August 19, 2011, and 20 executives and 813 employees (13% of total employees) left the bank through voluntary resignation by the end of 2011. As per the request of some employees, performance-based annual pay system was partially employed; the system has been completely adopted since 2012 (Standard Chartered NEA Limited., 2013).

5. CONCLUSIONS

Contrary to this expectation, as well as the low profitability for 10 years after its acquisition of *First Bank*, various management problems occurred, which prompted the Korean market to doubt whether the bank would indeed run a long-term and stable operation. Concerns were raised that *SC* would follow the path of past investment funds which withdrew from the Korean market after enjoying a short-term profit through business downsizing and encashment strategies such as high dividends, asset sales, and excessive commissions instead of continuous growth and reinvestment in the country. *SC First Bank* is blamed in the following two perspectives such as corporate social responsibility activities and relation with labor union.

First, *SC First Bank* had been extremely stingy with corporate philanthropic activities compared with other smaller commercial banks, and was criticized for not doing enough to fulfill its corporate social responsibility (Hossain & Khan, 2016). For instance, other commercial banks spent 1.2% of their net profit on corporate philanthropic activities, whereas *SC First Bank* spent only 0.4%. The amount of KRW 1,400 million spent by *SC First Bank* on philanthropic activities from 2004 to 2007 was only 2.9% of the total KRW 47,500 million spent by 12 commercial banks during the same period.

Second, the performance-based annual pay system is based on a five-grade evaluation of employees. Although, under the system, most employees started earning better, wages for employees to be evaluated as the lowest for two years in a row were curtailed by up to 45%. The labor union was extremely concerned and fiercely objected to the system. However, the strike ended almost fruitlessly, and the system was adopted fully as the management wished, with most employees returning to work. Another conflict between labor and management took place with regard to the career switch program adopted for employees reassigned to branches in order to streamline the head office. The labor union expressed its strong objection for the absence of prior consultation and the ambiguous selection criteria. In short, *SC First Bank* served the first notice as late as November 17, 2011 to selected 160 employees from the departments of corporate banking, retail banking, and personnel at the head office, and stated that they would be trained to be assigned to other affiliated companies of SC Financial Holdings by the end of December.

Both *SC* and the Korean government seemed to be responsible for this dramatically worsened business position. Having an unreasonable optimism about the potential of the Korean market, *SC* managed its business without secure preparation; meanwhile, the Korean government was not equipped with the solutions for various problems that might occur along with the inflow of foreign capital into the domestic market. This study, which highlights the obvious contrasts in the business approach of *SC* after advancing into the Korean market, is expected to offer implications that are useful to policymakers who seek rational policies against any other inflow of foreign capital in the future. However, its policy implications should not be generalized to be applied to individual business case about foreign capital to make inroads in emerging markets, and it is highly desirable to carefully recognize the limitation of this study – the feature of in depth but broadly analyzed case study, which is to be complemented by relevant future studies.

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