

**THE FINANCIAL MARKETS IN TAIWAN --
COMPETITIVE MARKETING STRATEGY IN A GROWING MARKET**

by

HOLLY LI-CHEN YEH LIU

B.S., ECONOMICS, NATIONAL TAIWAN UNIVERSITY
(1977)

SUBMITTED TO THE
ALFRED P. SLOAN SCHOOL OF MANAGEMENT
IN PARTIAL FULFILLMENT OF THE REQUIREMENTS
FOR THE DEGREE OF

MASTER OF SCIENCE IN MANAGEMENT

at the

MASSACHUSETTS INSTITUTE OF TECHNOLOGY

June 1995

© Holly Li-Chen Yeh Liu 1995. All rights reserved.

The author hereby grants to MIT permission to reproduce and to distribute publicly paper and electronic copies of this thesis document in whole or in part.

Signature of Author: _____
Alfred P. Sloan School of Management
May 1, 1995

Certified by: _____
Barbara E. Bund
Senior Lecturer
Thesis Supervisor

Accepted by: _____
Susan K. Lowance
Director, Sloan Fellows Program

MASSACHUSETTS INSTITUTE
OF TECHNOLOGY

JUN 21 1995

LIBRARIES
ARCHIVES

**THE FINANCIAL MARKETS IN TAIWAN --
COMPETITIVE MARKETING STRATEGY IN A GROWING MARKET**

by

HOLLY LI-CHEN YEH LIU

Submitted to the Alfred P. Sloan School of Management
on May 1, 1995, in partial fulfillment of the requirements for
the Degree of Master of Science in Management

ABSTRACT

The objective of this thesis is to study and further understand the current status of the financial market in Taiwan.

With the expectation that Taiwan will establish itself as one of the premier regional financial centers in the Asian Pacific area, the government of Taiwan has incorporated into its 1991 Six-Year National Development Plan several steps for financial liberalization and internationalization. These steps create an opportunity for all the financial firms to compete in this arena. A competitive marketing strategy therefore becomes crucial for every firm that wishes to participate in this market.

Using Michael Porter's Five Forces Model as a framework, I have analyzed the financial market, considering its competitive advantages and disadvantages; then an internal scrutiny was conducted; and finally recommendations are made for a marketing plan.

With these completed, the strategy and structure for a firm capable of fulfilling customer satisfaction is developed.

Thesis Supervisor: Barbara E. Bund
Title: Senior Lecturer

TABLE OF CONTENTS

	<u>Page</u>
INTRODUCTION	5
CHAPTER 1 THE GOVERNMENT POLICY	
1.1 Introduction	7
1.2 The Role of the Central Bank of China	7
1.3 The Role of the Ministry of Finance	14
1.4 The History of Financial Deregulation and Internationalization	15
1.5 Financial Internationalization	17
CHAPTER 2 THE MACRO-ECONOMY IN TAIWAN	
2.1 Government Policies During Economic Development	18
2.2 Economic Performance	19
CHAPTER 3 THE ECONOMY OF THE BANKING INDUSTRY IN TAIWAN	
3.1 The Banking Industry in Taiwan	24
3.2 Market Competition - An Environmental Scan	28
3.3 Internal Scrutiny at the Business Level: Factors for Assessing Strengths Weaknesses	49
3.4 Offshore Banking Units	51
3.5 The Taipei Foreign Currency Call-Loan Market	53
3.6 Outlook for the Taipei Financial Center	53
CHAPTER 4 THE MARKETS	
4.1 Derivative Financial Products	55
4.2 Bond Market	56
4.3 Foreign Exchange Market and Stock Market	59
CHAPTER 5 WHO ARE THE CUSTOMERS?	
5.1 Customers' Needs	62
5.2 Findings and Analysis	72
5.3 Customer Satisfaction	76
CHAPTER 6 MARKETING STRATEGY	
6.1 Introduction	86
6.2 Identification of Opportunities and Threats	87
6.3 Recommendations for A Strong Marketing Plan	90
Bibliography	94

ACKNOWLEDGEMENTS

I wish to express my appreciation to Professor Barbara Bund, whose guidance through this thesis process and friendship throughout the year made my year in the Sloan Fellow's Program one of the most exciting experiences of my life.

Also, I am grateful to Mr. Bruce Von Cannon and Mr. Jim Vaughn, who have stood like a lighthouse in my banking career. Without them, the dream hidden in my heart for seventeen years will never come true.

I would also like to acknowledge my children, Ying-Yin, Yen-Chuen, and Shih-Dun for the achievements they have accomplished during this year. The entire year has proven to be a remarkable milestone in their lives as well.

Finally, this thesis is dedicated to my dearest husband, Yi-Tien, who sacrificed one year of his Plastic Surgeon career practice to be with me throughout this year.

INTRODUCTION

Currently, Taiwan is taking steps to establish itself as one of the premier regional financial centers in the Asian Pacific area. With this expectation in mind, Taiwan (the Republic of China) has incorporated into its 1991 Six-Year National Development Plan several steps for financial liberalization and internationalization.

Based on its fast-growing economy over the past decade, Taiwan has accumulated significant factors of both demand and supply in the financial market. In 1989, Taiwan had a Gross National Product (GNP) of US\$150.4 billion, the twentieth largest GNP in the world, with per capita income of US\$7,512, the twenty-fifth highest in the world. By the end of 1991, Taiwan's economy had become even more successful internationally, having grown to US\$178.4 billion, with per capita income of US\$8,718, enabling it to surpass other national economies that continued to struggle with recession. With Taiwanese savings rates currently averaging 30 percent of GNP,¹ Taiwan's system of financial markets must annually intermediate additional savings of US\$50 billion a year. Already, the financial system intermediates over US\$294 billion of savings held as deposits with Taiwan's financial institutions² and over US\$139 billion of savings held in securities, such as corporate equities, government and corporate bonds, and financial debentures on Taiwan's securities markets.³ [Note: The exchange rate used was US\$1 to NT\$25.7475 (New Taiwan Dollar), the interbank rate on December 31, 1991.]

¹ In 1990, Taiwan's savings rate was estimated to be 29.7%. In the 1980s, it averaged 33.54%. The savings rate hit a peak of 38.5% of GNP in 1986 and 1987. See *Taiwan Statistical Data Book, 1991*, Council for Economic Planning and Development, Taiwan, ROC, July 1991, p. 56.

² *Ibid.*, p. 29.

³ The amount of US\$139 billion, which is equivalent to NTD3.58 trillion (New Taiwan Dollars), represented the market value of these various securities at the end of 1991. Ministry of Finance, Government Finance of the Republic of China, Taipei, Taiwan, April 1991, p. 62.

Taiwan has also played a role as a capital exporter among Asian countries since the late 1980s, for two reasons. The first is Taiwan's current account trade surpluses, which have exceeded US\$10 billion annually and US\$78.6 billion cumuatively for the period 1986-1991. The second reason is increased overseas investments by some Taiwanese labor-intensive industries as a result of the appreciation of the NTD and because of rising labor costs. During this period, the financial institutions played an important role as intermediators of capital flows.

During the last two decades, the banking industry was a virtual monopoly business in Taiwan due to governmental protections. However, in 1991, due to liberalization and deregulation, traditional domestic banks began to face tremendous challenges from foreign banks. The reasons for such keen competition are not only due to an increasing number of financial institutions, but also because of the variety of products that have become available. Customers have also become more knowledgeable than ever before. Therefore, it is expected that there will be rapid growth in the Taiwan financial markets in the near future. They will move from primitive toward more mature. Hence, a competitive marketing strategy becomes a crucial factor for making a bank or a financial firm successful.

CHAPTER ONE

THE GOVERNMENT POLICY

1.1 INTRODUCTION

The financial institutions and markets of Taiwan are regulated by a framework of laws and a number of regulatory institutions. The Ministry of Finance (MOF) and the Central Bank of China are the most important and pervasive regulators. They, in turn, are controlled by the central government known as the Executive Yuan. In addition, there are some self-regulated organizations such as the Bankers Association of the Republic of China and the Taiwan Stock Exchange Corporation which prescribe rules for their members.

1.2 THE ROLE OF THE CENTRAL BANK OF CHINA

The Central Bank of China (CBC) is Taiwan's central bank. Its functions include promoting financial stability, guiding sound banking operations, and maintaining the stability of the internal and external value of Taiwan's currency.¹

The CBC is an agency of the Executive Yuan. CBC is governed by a board of directors that consists of eleven to fifteen directors who are nominated by the Executive Yuan and appointed by the president of the Republic of China.

¹ The Central Bank of China Act, promulgated by the Nationalist Government on May 23, 1935, as amended.

The CBC is divided into a number of departments, but the most significant are Banking, Foreign Exchange, and the Treasury Department.

- The Banking Department has jurisdiction over the operations of domestic financial institutions and markets, i.e., interest rate policy for loans and deposits, and the trading of government bonds, financing bonds, and short-term securities in the capital and money markets.
- The Foreign Exchange Department is responsible (in a number of foreign exchange markets) for maintaining an orderly foreign exchange; trading in foreign bills of exchange and securities; settling foreign exchange transactions; and appointing and supervising banks engaged in foreign exchange operations.
- The Treasury Department manages the treasury cash account, including the management of central government bonds and treasury notes.

Like other central banks, the CBC issues the national currency, known as New Taiwan Dollars (NTD). It is also a banker to other banks and the government, and determines and enforces monetary policy. Through the regulation of lending policy, the CBC controls the speed of credit extension in the NTD market.

The open market operations of the CBC are comprised of its buying and selling of government bonds, financial bonds issued by banks, and bills accepted or guaranteed by banks.

The reserve ratio requirement policy of the CBC is to adjust the cash reserves banks have to lend to their customers. Under a reserve requirement system, banks are compelled to deposit various ratios in either non- or low-interest bearing accounts with the CBC. These ratios can be adjusted subject to the market situations, so CBC is therefore able to directly affect the liquidity of the banking system.

In order to maintain an orderly foreign exchange market, the CBC can intervene in the foreign exchange market to adjust the demand and supply of foreign exchange. Since the early 1980s, Taiwan has actively promoted financial liberalization and internationalization in order to deal with a changing economic and financial environment in the domestic market and abroad. One of the most important measures is a significant relaxation of foreign-exchange controls.

In 1986, changes in private capital mobility began to exert an increasing effect on the NTD/\$ exchange rate and the CBC's monetary policy. The time period since then can be separated into four periods:

- (I) 1986-1987, New Taiwan Dollar Appreciation
- (II) 1988-1990, Outflow of Private Capital
- (III) 1991-June 1992, Capital Inflows
- (IV) June 1992 to the present

Each of these periods is described briefly below.

(I) 1986-1987, New Taiwan Dollar Appreciation

Taiwan's current-account surplus reached US\$16.3 billion in 1986, and US\$18 billion in 1987. During this period, the net inflow of short-term capital rose from US\$8.3 billion to US\$12.8 billion, due to growing expectations of NTD appreciation. As the supply of foreign exchange in the market reached excess proportions, those expectations were realized. The price of the U.S. dollar on foreign exchange markets declined from NT\$35.50 at the end of 1986 to NT\$28.55 at the end of 1987 (see Table 1.1 and Chart 1.1). The huge current-account surplus, as well as the inflow of capital from the private sector and authorized foreign exchange bank, also adversely affected the control of the monetary aggregates. The CBC therefore introduced a series of measures to liberalize foreign-exchange controls, and made every effort to soak up excess liquidity through sterilization operations during 1986 and 1987:

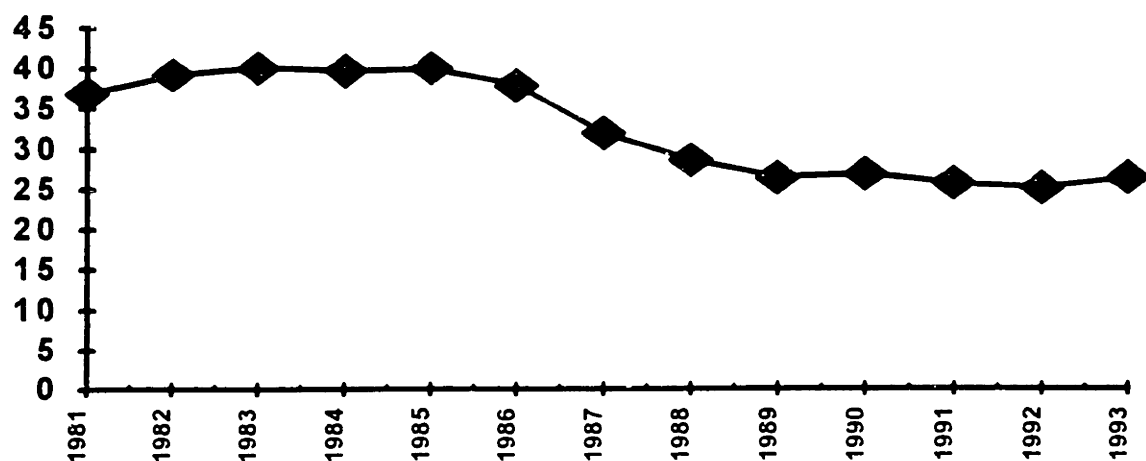
Table 1.1

US\$/NT\$ Exchange Rates

YEAR	EXCHANGE RATE
1981	36.85
1982	39.12
1983	40.07
1984	39.60
1985	39.85
1986	37.84
1987	31.85
1988	28.59
1989	26.41
1990	26.89
1991	25.70
1992	25.16
1993	26.39

Chart 1.1

US\$/NT\$ Exchange Rates



Source: The Central Bank of China

1. Portfolio investment abroad was permitted beginning in early 1986, with residents of Taiwan allowed to invest in foreign securities through the authorized foreign exchange banks. In addition, four authorized foreign exchange banks were allowed to accept foreign-currency time deposits.
2. In July 1987, a major relaxation of foreign-exchange controls was announced.
 - foreign-exchange controls related to the current account were abolished, and businessmen were allowed to hold in accounts abroad foreign exchange obtained through international trade or services, and to make free use of the deposits;
 - controls on non-trade-related capital flows were relaxed, with a company or an adult allowed to make outward remittances of up to US\$5 million per year, and inward remittances of up to US\$50,000 (the limit was raised to US\$5 million in October 1992); and

- restrictions were abolished on outward and inward remittances related to investment projects approved by the relevant authorities.
3. Open-market operations were undertaken to offset the increased inflow of reserve money stemming from the buildup of the foreign assets of the Central Bank.

(II) 1988-1990, Outflow of Private Capital

During this period, Taiwan's current-account surplus remained huge. However, due to effects of the above-mentioned relaxation in 1986 and 1987, the large net outflow of private capital almost offset the current-account surplus in the first three quarters of 1988. As a result, the foreign exchange rate remained quite stable, rising from NT\$28.55 (end of 1987) to NT\$28.93 (end of September, 1988).

The net outflow of private capital lasted until May 1990. Overall, the net private capital outflow in 1989 and 1990 exceeded the current account surplus, resulting in excess demand for foreign exchange. The CBC therefore maintained a relatively easy monetary policy during this period. It stepped up to purchases of short-term bills, expanded accommodations to financial institutions, lowered reserve/ratio requirements, and refrained from sterilizing liquidity generated by the redemption of securities issued by the Bank. By the end of 1990, these measures had resulted in substantial decreases in outstanding balances of treasury bills, savings bonds, and certificates of deposit held by banks and the public sector.

(III) 1991 -June 1992 Capital Inflows

After the Persian Gulf War, the U.S. Federal Reserve was forced to ease its monetary policy. From 1990 to 1991, the dollar's interest rates were cut from 10% to 6.5%, a 3.5% reduction.

As a result of the widening difference between Taiwan and U.S. interest rates, substantial short-term capital inflows occurred again. To prevent the capital inflows from accelerating the growth of money stock and inflation, the CBC lowered its rediscount rate and reserve ratio requirements several times during 1991. These steps were to prevent the influx of speculative funds. However, the NTD continued to appreciate against the U.S. dollar, from NT\$27.13 at the end of 1990 to NT\$24.65 at the end of June 1992.

(IV) June 1992 to the present

During this period, the CBC continued to monitor the foreign exchange market and money supply by various instruments. By early 1993, the CBC began to find that the financial markets were increasingly unable to meet business demands for long-term funds. The inadequacy was due to the credit-tightening effect of rising expenditures as part of the Six-year National Development Plan, and a steady decline in the external sector's contribution to the growth of reserve money. The CBC decided that commencing April 1993, postal savings funds could be returned to the postal savings system up to maximum amount of NT\$10 billion monthly. This temporary measure will release a maximum of NT\$168 billion of postal savings funds and accrued interest from the CBC.

Summary

Before the relaxation of foreign-exchange controls in 1987, the current account surplus was the driving force behind NTD appreciation and the buildup of the CBC's foreign assets.

Since the relaxation of foreign-exchange controls, private capital mobility has become the main force behind movements in the NTD rate.

In recent years short-term capital flows have contributed to both fluctuations in the NTD exchange rate and to changes in monetary conditions. This shows that market expectations regarding exchange-rate movements and interest-rate differentials between the domestic and foreign markets are the major determinants of the direction of short-term capital flows.

1.3 THE ROLE OF MINISTRY OF FINANCE

The Ministry of Finance (MoF) is the primary regulator of most of Taiwan's financial markets and institutions. The MoF facilitates the Executive Yuan's administrative powers over financial institutions and markets primarily through the Bureau of Monetary Affairs, four departments, and several subordinate agencies.

The Bureau of Monetary Affairs is responsible for a number of regulatory functions, including designing, drafting, and reviewing banking and financial laws and regulations, and supervising their enforcement. The MoF, through the Bureau of Monetary Affairs, governs financial institutions subject to the Banking Law of the Republic of China. The MoF has substantial powers over these financial institutions, including designing the criteria by which banks are established, and judging and deciding upon applications to establish a bank or a branch. For example, foreign banks or financial institutions need to apply to MoF to establish offices or branches in Taiwan. Moreover, the MoF determines the scope of business of these financial institutions, the qualifications of directors, consolidation, mergers, and dissolutions. Finally, the MoF determines penalties for violators of the Banking Law.²

The four departments of MoF are the Department of National Treasury, the Department of Taxation, the Department of Customs Administration, and the Department of Insurance. The Department of the National Treasury enforces national fiscal policies to maintain a balanced budget, raises construction funds for national

² Article 134, Banking Law.

economic development, and maintains economic stability through government bond policy. The Department of Taxation and Customs Administration, as well as the Taxation and Tariff Commission, designs tax policies and a taxation system to promote economic development through investments and to improve the tax structure so as to reduce income and wealth inequalities. The Department of Insurance is responsible for regulating the insurance industry in Taiwan.

The MoF also has a number of subordinate agencies. Some of these agencies are financial institutions, which either operate in specific markets discharging the MoF's responsibilities (such as the Bank of Communication, a specialized bank supporting the industrial sector; or the Farmers Bank of China, supporting the agricultural sector) or perform specific functions (like the Central Trust of China, which not only acts as a small commercial bank, but also manages Taiwan's pension funds with a committee of government officials; or the Central Reinsurance Corporation, which is the only local reinsurance company in Taiwan).

1.4 THE HISTORY OF FINANCIAL DEREGULATION AND INTERNATIONALIZATION

The CBC and the MoF have, over the years, taken a number of steps to gradually relax, and in several cases release, restrictions on financial activities based on economic development needs. With their cooperation, Taiwan has enjoyed a great measure of success in raising the capacity utilization and improving the efficiency of financial institutions. Several deregulations have occurred in the following areas:

(1) Interest Rate Deregulation

The first major step to deregulate interest rates was to establish the money market in 1976. Beginning in 1980 the CBC gradually adopted a series of measures to relax controls on interest rates, beginning with money market interest

rates and later covering interest rates on deposits and loans. In 1989, following the implementation of the revised Banking Law, all the former controls over interest rates were completely abolished. Since then, banks have been given the freedom to set their own rates of interest and, as a result, short-term interest rates are principally determined by the supply of and demand for funds, having become much more sensitive to competition among banks and other market participants.

(2) Local Right of Establishment

The government has taken positive steps to liberalize banking operations and to relax existing restrictions on the establishment of additional financial institutions. New domestic securities companies have been given the right to establish, foreign securities house have been encouraged to enter the local market, and foreign banks with branches in Taiwan have been approved to set up at least two additional branches. The revised Banking Law of July 1989 also provides national treatment for foreign banks to set up savings and trust departments to accept savings deposits, extend medium- and long-term loans, and to apply for securities underwriting and brokerage licenses. As of the end of March 1992, there were a total of 50 foreign bank branches and 23 representative offices in Taipei.

New private commercial banks were given approval to establish in June 1991. This represented a very major development, since in the past at least 80% of loans and deposits in Taiwan have been handled by the 12 government-owned banks. Among the 15 new private banks, 12 have already opened to the public for business, and the remaining three are expected to commence operations with a few months. The easing of restrictions for new entries into the market has broken the monopoly of the banking industry, and it is therefore predicted that the pricing and qualities of banking services will become more reasonable due to keen competition.

1.5 FINANCIAL INTERNATIONALIZATION

With the expectation that Taipei will become a regional financial center, the CBC has encouraged the expansion of cross-border financial transactions among financial institution, private sectors, and governments.

Because of further relaxation of the restrictions on establishing overseas branches of domestic banks in November 1988, domestic banks have in recent years been actively establishing branches or subsidiaries in the various financial and trading centers of the world. By the end of March 1994, there are ten domestic banks expanding their branches overseas. Overall, they have established 26 branches, 14 representative offices, and 5 subsidiaries overseas, as well as several domestic banks that are in the process of applying to set up branches or subsidiaries, particularly in the United States and Europe.

CHAPTER TWO

THE MACRO-ECONOMY IN TAIWAN

2.1 GOVERNMENT POLICIES DURING ECONOMIC DEVELOPMENT

Taiwan has been separated from the Mainland China since the Communist takeover in 1949 on the Chinese mainland. Since the People's Republic of China on the mainland still claims Taiwan as one of its provinces, Taiwan has operated under a shadow for several decades. In order to protect Taiwan's diplomatic status, the government of Taiwan has pursued an aggressive program of industrialization. The goal of the program is to expand Taiwan's international relationships with other countries by using its economic strength. In the 1980s, manufacturing was the most important sector of the economy. Economic policies had been implemented through a series of multi-year plans initiated in 1953 that were designed to increase production and develop export industries. In 1991, Taiwan launched a six-year, \$300 billion public works construction program to maintain its steady economic growth. The development of Taipei as a regional financial center in Asia is one of the major targets of the National Development Plan.

Since the late 1980s, Taiwan has lost the comparative advantage it enjoyed with its manufacturing industries because of the appreciation of New Taiwan Dollars to U.S. dollars and because of increasing labor costs.

Overseas investments and capital outflows have increased each year and these contribute to the slowdown of economic growth in the country. Therefore, the government's budget deficit has ballooned in recent years because of efforts to entice

local companies to invest in Taiwan rather than overseas, and because of a concerted strategy to improve the quality of life on the island.

The People's Republic of China as adopted a more open policy toward foreign business, which has encouraged many of Taiwan's manufacturers to transfer their investments into mainland China. The Taiwan government continues to worry about this flood of investment into China, which reached record highs in 1993. The concern is both political and economic:

- a fear of excessive economic dependence on a country that three-quarters of the people of Taiwan still believe harbors hostile intentions toward the island, and
- anxiety about the potential repercussions of the wild swings in China's business cycle.

The Taiwan government continues to push its "Southern Investment Strategy", hoping to encourage Taiwan investors to invest in the development of the Subic Bay area of The Philippines which might help stem the flood of investment into China. In addition, direct foreign investment in Taiwan is encouraged by the government for projects which are considered strategic or vital to economic development. Therefore, the government of Taiwan is actively committed to a policy of financial and economic liberalization and to establishing Taipei as a regional financial center in Asia.

2.2 ECONOMIC PERFORMANCE

A. Economic Growth

Taiwan's GDP has maintained an average growth rate of over 6% for the past five years. It grew by 6.17% in 1994 and is expected to increase by 6.5% in 1995, based on fixed investment and private consumption (see Figure 2.1 and Chart 2.1).

Figure 2.1

GNP and Economic Growth

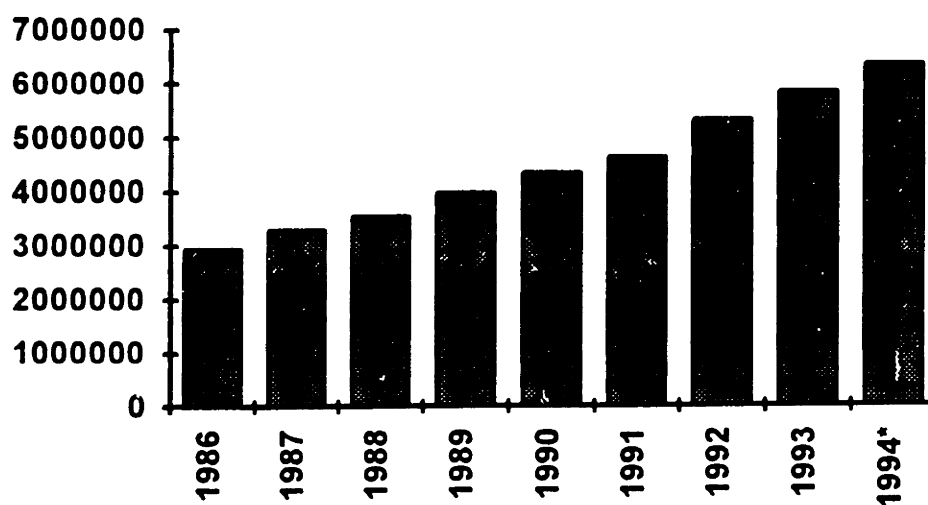
Year	GNP ¹ (current prices)	Annual Growth % ²	GNP ³ (current prices)	Exchange Rate
1986	2,925,772	12.57	77,299	37.85006
1987	3,288,973	11.87	103,200	31.86989
1988	3,535,294	7.84	125,315	28.21126
1989	3,966,975	7.33	150,283	26.3967
1990	4,326,956	5.02	160,913	26.89003
1991	4,621,233	7.24	179,753	25.70879
1992	5,301,751	6.02	210,721	25.16005
1993	5,809,285	5.87	220,129	26.39037
1994 (est.)	6,331,401	6.17	239,554	26.42995

Notes:

- 1) in NTS million
- 2) The annual growth rates are at 1986 constant prices.
- 3) in US\$ million

Source: Central Bank of China

Chart 2.1



The GDP growth was driven by the increasing portion of private consumption and fixed investment over several years (see Figure 2.2 and Chart 2.2a).

Figure 2.2
Components of Gross Domestic Product

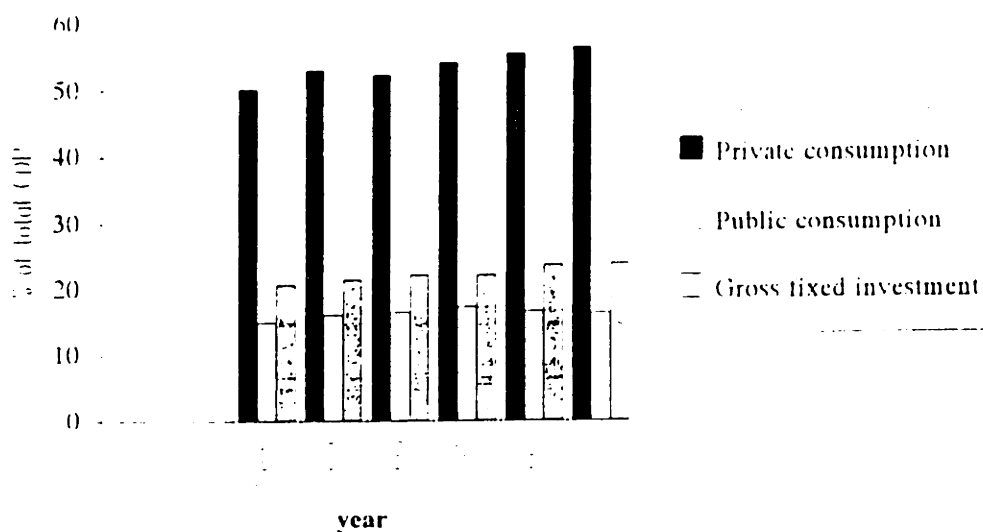
(% of total)

	1988	1989	1990	1991	1992	1993
Private Consumption	50.2	53.1	52.4	54.3	55.6	56.6
Public Consumption	15.1	16.2	16.6	17.3	16.8	16.5
Gross fixed investment	20.8	21.6	22.2	22.2	23.8	24.0
Stockbuilding	3.2	0.8	0.8			1.2
Exports of goods & services	57.1	50.3	48.8	47.7	46.5	45.2
Imports of goods & services	-46.4	-42.0	-40.8	-41.7	-42.7	-43.5
TOTAL	100	100	100	100	100	100

Source: Council for Economic Development and Planning, Industry of Free China

Chart 2.2a

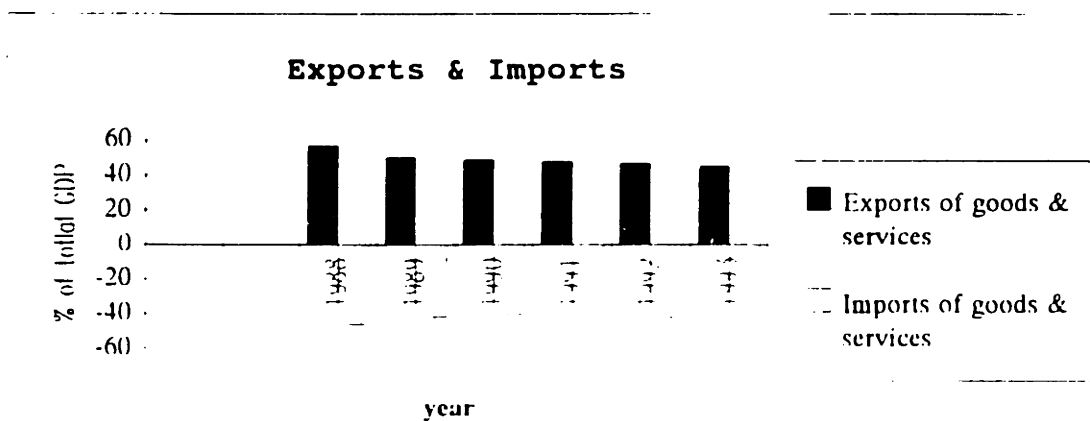
Components of GDP with increasing rate



As traditional exports decline, Taiwan's trade surplus is falling. The surplus on merchandise trade, as reported by the MoF fell to US\$7.9billion from US\$9.5billion in 1992. Many of Taiwan's traditional exports have continued to decline as a result of loss of competitiveness and consequent transfer of production to China and southeast Asia.

On the other hand, exports of machinery and electrical equipment have maintained their rise, growing by 12.2% in 1993 and by 4.5% from the first quarter of 1993 to the same quarter of 1994. More capital-intensive and high-tech industries have streamed into Taiwan's economy (see Chart 2.2b)

Chart 2.2b



In spite of the fluctuations in the economy over recent years, Taiwan's GNP has continued to grow rapidly. According to government estimates, per capita income will reach US\$14,000 by 1996. By then, Taiwan will have completed most of the projects included in the Six Year National Development Plan.

CHAPTER THREE

THE ECONOMY OF THE BANKING INDUSTRY IN TAIWAN

3.1 THE BANKING INDUSTRY IN TAIWAN

Before 1991

Prior to 1991, because of various government economic plans, the banking business had been strictly regulated by the Central Bank of China and the Ministry of Finance. Customer demands had exceeded the banks' services, both in deposit-takings and loan placements in the money market. Domestic commercial banks were not only protected by local regulations but also restricted in their ability to provide a wider range of financial services. Thus, during the early years of Taiwan's domestic banking it was the foreign banks with branches in Taiwan which led the market with innovative products and services. However, the foreign banks were also controlled by government policies that regulated not only the number of branches but also the content of products and services. Accordingly, all the foreign banks who did business in Taiwan before 1991 focused more on corporate lending rather than on retail banking because of limited resources.¹

After 1991

In 1991, the market situation change dramatically due to the deregulation of financial institutions. With the expectation of becoming an international financial center similar to Hong Kong (particularly after its absorption into China in 1997), the Government of Taiwan did away with restrictions on establishing new financial firms. Very quickly, the number of domestic commercial banks increased from 24 in

1. The restrictions for foreign banks includes local currency deposit taking, lending to individual customers, export loan limitations, single branches in Taiwan, etc.

1990 to 40 in 1993. The number of foreign banks increased from 35 in 1990 to 37 in 1993 (see Exhibit 3.1). Even so, compared with Hong Kong and Singapore, Taipei is a relatively immature market for most participants (see Exhibit 3.2). Therefore, numerous small and medium-sized financial firms also joined the market at the time of deregulation.

Exhibit 3.1

Foreign Banks in Taiwan

Year	Numbers
1986	32
1989	33
1990	35
1991	36
1992	36
1993	37

Source: Central Bank of China, Taiwan

Exhibit 3.2

**Foreign Bank in the Asian Pacific Area
(as of 1991)**

Location	Numbers
Hong Kong	138
Singapore	124
Taipei	36

Source: Central Bank of China, Taiwan

Foreign exchange controls were also removed around the same time. Options and futures for both currency and commodities became legal operations. Domestic banks maintained their strategies of focusing on traditional banking services, i.e., local currency deposits and loans, while the foreign banks had no restrictions and could provide a wide range of products and services by fully utilizing their global networks. Triangle trading² and investments in mainland China also create a stream of demand within the foreign banks' network.

With this background in mind, I have analyzed the banking industry in Taiwan using Michael Porter's Five Forces Model as a framework. The outcome of the analysis is illustrated in Exhibit 3.3.

-
2. Tri-angle trading is a unique combination of technology and cheaper labor cost between Taiwan and mainland China, i.e., many Taiwanese enterprises establish their factories in mainland China to take advantage of cheaper labor cost. While they still request that foreign buyers open a line of credit to Taiwan, shipments are made from China through Hong Kong. The lines of credit are negotiated in Hong Kong instead of Taiwan to avoid the higher business taxes assessed in Taiwan.

Exhibit 3.3

Barriers to Entry (Attractive)

- Deregulation of Government's Restriction
- Demand in foreign investments increased as diversification of assets
 - Large economies of scale barrier in establishing global network
 - High demand in human resources (experienced marketing staff)
 - Market becomes product-driven, R&D experience curve effect

Bargaining Power of Suppliers

(moderate attractive)

- Number of suppliers increasing
- Differentiation of suppliers' products becomes important

INTENSITY OF RIVALRY AND COMPETITION

Bargaining Power of Buyers

(very attractive)

- Important influence of the government in the regulation of the buying process
- Buyer awareness increasing
- Buyers require high quality and sophisticated services

Threat of Substitutes (mildly attractive)

- Customers' switching cost is low, easy to accept other competitors
- "me-too" services increase rivalry
- Global network becomes a condition of competition
 - New product and technology are easy to imitate
- Very profitable industry, however declining margins
- Customer's relationship tends to be short-term and price sensitive

SUMMARY ASSESSMENT OF INDUSTRY ATTRACTIVENESS:

Attractive

3.2 MARKET COMPETITION - AN ENVIRONMENTAL SCAN

Taiwan's banking industry can be split into three groups, based on each bank's operating strategies. The three categories are:

- a. Retail banking (e.g., consumer-based transactions)
- b. Wholesale banking (e.g., corporate lending)
- c. Investment banking (e.g., currency and securities trading targeting corporations/institutional investors, and asset management targeting high net worth individuals).

With such rapid banking expansion after 1991, fueled by a economic growth and a versatile and industrious private sector, much of Taiwan's financial sector did not adapt well to the rapid changes taking place. Internally, the banking system lacked the basic financial apparatus needed to channel the high amounts of savings into much-needed investment. Externally, excessive demand created an attractive opportunity for many foreign banks to share in this market.

Most of the foreign financial firms in Taiwan are influenced by the global strategies set by their head offices. Therefore, Taiwan's overall financial atmosphere is greatly influenced by the larger worldwide environment.

What follows below is a discussion of the two components making up Taiwan's financial industry today: Foreign banks who bring with them the impact and drive of the global markets; and the domestic banks who have grown enormously in a short period of time and are finding that they must deal with every issue of the banking business both on the home front and in the larger world market.

3.2.1 Global Market

In the increasingly competitive global market, each bank must position itself by determining marketing strategies in line with its core competencies. Therefore, I have analyzed several foreign banks based on their internal strategies which illustrate this point.

Deutsche Bank

Historically, Deutsche Bank (DB) has been organized as a series of seventeen semi-autonomous regional "universal" banks based on the precepts of relationship banking and shared responsibility. Former board chairman Dr. F. Wilhelm Christians allows his local staff to carry out their business as though they were private bankers. As a result, today's DB is a confederation of autonomous regional universal banks with each bank managing its own business. The only exceptions are the areas of "Going Public" and "Mergers and Acquisitions", which are managed from central headquarters in Frankfurt.

Industry observers attributed DB's past success within Germany to its marketing power, high-quality customer services, and operating efficiencies. Nevertheless, DB's public relations manager frequently expressed uneasiness over the bank's organizational structure, particularly in light of the European economic integration in 1992. In his view, the bank would not only require new strategic plans, but also the formulation of a new corporate culture and a new way of fostering communication both within and outside the bank.

To this end, the bank hired two teams of management consultants: McKinsey and Roland Berger, to determine what adjustments in corporate organization structures would be required to facilitate the bank's broader strategic objectives. They proposed a new vertical organization structure defined by clients and products rather than geographic regions. The proposal called for the regional offices to give

up much of their autonomy and status as profit centers, and the seventeen existing head offices would be reduced to seven.

With the strong economic growth of the past decade, Germany has played an important part in the global financial market. As one of Germany's three largest banks, DB has taken advantage of the uptrend to become a successful world banking operation. Its success can be contributed to its marketing strategies, described below:

1. Government policies which strengthen the core competence of the corporation. Historically, the three big banks - Deutsche Bank, Dresdner Bank, and Commerzbank dominated the whole German financial market. In addition, in reviewing industrial development, the postwar reassertion of power by the German commercial banks is important because they occupy a special position in the organization of German industry.³ The foreign banks are somehow excluded from playing a lead manager role in the German market due to government policies.⁴ Hence, the blooming economy and national protectionism formed a perfect "greenhouse" for DB.

2. Aggressive geographic strategy to attain economies of scale. In Western Europe in recent years, DB has moved aggressively via a series of mergers and acquisitions to extend its business across all of Europe. Moreover, it has actively enhanced its services in three areas:
 - retail banking across all of Europe,
 - investment banking on a global basis, and
 - a broad array of other finance-related services both in Germany and overseas.

In the commercial banking arena, for instance, DB bought Bank of America's subsidiary in Italy in 1986 and Spain's Banco Commercial Transatlantico in 1989. Only two targets have proven difficult: Britain and France. In the

3. Shonfield, A., "Organized Private Enterprise: Germany," in *Modern Capitalism*, p. 242.

4. Deutsche Bank Group, Harvard Business School, Case 9-290-036.

securities sector, DB made acquisitions in Portugal (1987), Hoiland (1988), Canada (1988), Australia (1988), Italy (1989), and Britain (1989).⁵

In the U.S., DB has enjoyed an exemption from the Glass-Steagall Act. This has enabled the Southeastern Pennsylvania Transport Authority to lease \$56 million worth of West German buses.

In Japan, in 1987, DB became the first foreign bank in Japan to be allowed to open a securities unit.

In Eastern Europe DB will benefit from its historic and geographic relationship with East Germany. In October 1989, DB was the first German bank to be allowed by the Hungarian Ministry of Finance to open a representative office in Budapest, and DB has enjoyed a close relationship with the Soviet Union.

3. Concentration of power in the international market. As large, multi-product institutions from various multinational backgrounds begin to enter different segments of the financial services industry, the following problem may arise: the conditions of various market segments, or policies regulating the financial market may be determined to an unacceptable degree by different government policies. To cope with this possibility, DB has successfully concentrated its business power to cope with other competitors. Exhibit 3.4 shows that, among the world's large banks, DB has the highest Return on Asset (1.03%), which exceeded even the leading Japanese banks which had larger amounts of capital, and far above the second ranked, Comp. Finan. de Parib, with an ROA of 0.88%.

5. Ibid., p. 8.

Exhibit 3.4
Largest Capitalized Banks Worldwide - Selected Data

Size by Capital	Bank Name	Capital \$M	Assets		Pretax Profits \$M	Return on Assets	
			\$M	Ratio		%	Rank
1	Sumitomo Bank	13,357	373,101	3.59	2,343	0.63	478
2	Dai-Ichi Bank	12,322	408,025	3.02	1,916	0.47	588
3	Fuji Bank	11,855	366,745	3.23	1,974	.054	534
4	Crédit Agricole	11,802	241,992	4.88	1,266	0.52	547
5	Sanwa Bank	11,185	357,760	3.13	2,042	0.57	507
6	Mitsubishi Bank	10,900	364,100	2.99	1,719	0.47	584
7	Barclays Bank	10,715	204,907	5.23	1,111	0.54	528
8	Natl Westminster	9,761	186,559	5.23	649	0.35	684
9	Deutsche Bank	8,462	202,263	4.18	2,081	1.03	316
10	Indus. Bank of Japan	8,184	259,860	3.15	1,015	0.39	663
11	Union Bank of Switzerland	8,150	113,854	7.16	784	0.69	438
12	Citicorp	7,319	227,037	3.22	1,538	0.68	444
13	Comp. Finan. de Parib	6,968	138,668	5.02	1,225	0.88	362
26	Dresdner Bank	5,105	147,001	3.68	796	0.54	530
47	Commerzbank	3,803	112,825	3.37	221	0.55	523

Source: The Banker, London, July 1990.

DB's operations were fully in line with the global banking environment in terms of generating "fee" incomes. Beginning in the late 1980s, in order to limit capital risks as well as improve the ratio of "return on assets", all the leading banks emphasized the efficiency of financial operations, i.e., to increase "off-balance-sheet" incomes, and decrease "lending interest" incomes. Exhibit 3.5 shows that DB successfully sustained its interest income (by not extending credit risks), and increased its commission and fee income (non-risk incomes). The interest income fluctuated somewhat, from DM14.0 billion in 1982 to DM13.4 billion in 1988. However, the commission and fee income increased more than twice that amount, from DM1.1 billion in 1982 to DM2.5 billion in 1988.

Exhibit 3.5
Comparative Consolidated Income Accounts
(years ending December 31)

	1988	1987	1986	1985	1984	1983	1982
REVENUE							
Interest and Disc.	13.4	11.5	10.5	11.5	12.6	11.8	14.0
Investment Income	1.6	1.6	2.6	1.5	1.4	1.2	1.1
Commissions, fees	2.5	2.0	1.9	1.7	1.4	1.3	1.1
Other Income	7.2	6.4	6.0	6.4	5.5	5.3	5.0
TOTAL REVENUE	24.7	21.5	21.0	21.7	20.9	19.6	21.2
OPERATING EXPENSES							
Interest, etc.	13.3	11.8	11.1	11.9	12.8	11.8	14.2
Write-offs	0.2	0.7	0.9	0.8	1.3	1.5	1.7
Comm. fees paid	0.1	0.1	0.1	0.1	0.1	∅	0.1
Salaries & wages	3.1	2.9	2.7	2.4	2.3	2.1	1.9
Social Security & Benefits	1.0	1.0	0.8	0.8	0.8	0.7	0.6
Other Admin. Exps.	1.6	1.4	1.3	1.1	1.0	0.9	0.8
Depreciation & adjustments	1.6	1.3	1.0	0.8	0.6	0.6	0.5
Taxes	2.0	1.0	1.6	1.7	1.2	1.2	1.0
Reserves & Provisions	0.3	0.1	0.1	∅	∅	∅	∅
Other Expenses	0.3	0.5	0.4	0.4	0.1	0.1	0.1
Total Operating Expenses	23.5	20.8	20.0	20.0	20.2	18.9	20.9
NET INCOME	1.2	0.7	1.0	1.1	0.7	0.7	0.3

Source: Deutsche Bank Group

Notes:

1. Accounts maintained, prepared and reported in conformity with West German accounting principles.
2. Symbol ∅ indicates item too small for inclusion.

Bank of America

Led by its CEO, Richard Rosenberg, Bank of America (BOA) transformed itself from the national's second-largest banking company into a transcontinental giant dominating major markets across the U.S. The latest step in this transformation strategy was to buy Continental Bank Corp. of Chicago for \$1.9 billion in January 1994. What makes this move different from others is what it says about where bankers think they can make money these days.⁶

The Continental deal is shrewd, offering BOA a ready-made corporate banking franchise with roughly 2,000 industrial customers. What Rosenberg got in his first successful foray east of the Mississippi River was a profitable foothold in the Midwest. Continental earned \$258 million in 1993 on \$22.6 billion in assets - and little overlap with his own bank. Continental is active in trading loans, which BOA is not, and it has strong operations in private placements and in packaging assets like loans and mortgages as pass-through securities. Its \$5 billion private banking business, which caters to wealthy individuals, will double the size of BOA and its large trust department will allow BOA to reenter that market, as it has been struggling to do for years. Like a hungry lion, BOA has been on the prowl for a long time, building up its consumer banking operation with acquisition in ten Western U.S. states. In 1992, it topped those off with the largest bank merger in history, the \$4 billion purchase of Security Pacific, which made it the dominant bank in the West. But with California (which accounts for more than half of BOA's revenues and profits) still suffering from the effects of the recession, earnings were hurting. Adjusted to eliminate one-time accounting charges in 1992, profits for 1993 fell from the prior year's level. So the bank began to eye wholesale banking serving corporate customers. Says Vice Chairman and Chief Financial Officer Lewis Coleman: "We like the wholesale side of the business, and we think that market is to some extent undervalued." This is a view he shares with others in banking and on Wall Street. While bankers chased the consumer and ignored the corporation,

6. *Fortune*, "Go Where the Money Is," March 1994, p. 70.

wholesale banking turning into a fat, fee-based business where banks could charge for managing pension funds, placing corporate debt and equity privately with sophisticated investors, and handling an array of other tasks. To Wall street analysts, BOA is emerging as a solid, diversified company with one paw on the consumer and the other on the corporation. Says Arthur P. Soter at Morgan Stanley: "This transaction makes good strategic sense and should enhance BankAmerica's earnings and stock price."

Once Continental is absorbed, BOA will have assets of \$200 billion, just shy of No. 1 Citicorp's \$216 billion.

American Express Bank

American Express Bank (AEB) belongs to American Express Company.⁷ AEB operates internationally, serving wealthy entrepreneurs and their businesses as well as selected financial institutions. The Bank offers four primary services: private banking, correspondent banking, commercial banking and treasury services. Over the last few years, the Bank has focused on controlling risk, increasing profitability and growing reliable, high-quality earnings. Private Banking, while the smallest of AEB's four business lines, represents the largest growth opportunity with new products and services such as its "Worldfolio" investment program. The Capital Protection program (CPP), one of Worldfolio's most successful products, is designed to serve the needs of private banking clients who wish to safeguard their principal while earning attractive returns. Sales of CPP more than doubled in 1993, to \$913 million. Another product line, Worldfolio Mutual Funds, was launched in 1993, and the Signature series of discretionary portfolios were introduced in 1994. Paralleling these new product introductions and market expansions were a wide range of quality improvement efforts.

7. American Express Company includes Lehman Brothers (separated in 1993), Travel Related Services, American Express Bank, and IDS Financial Services.

In addition to conducting client research on a global basis to improve core services to clients, the Bank has also better equipped its employees to do their jobs through enhanced training and improved work processes.

AEB net income was \$81 million in 1993, compared with \$26 million before the accounting change in 1992 (net income of \$19 million after the accounting change) and \$60 million in 1991.

Exhibit 3.6

Net Income Summary (dollars in millions, before accounting changes)

AEB Company	1993	1992
Travel Related Services	\$895	\$243
IDS	\$358	\$297
AEB	\$ 81	\$ 26

Compared with Traveler Related Services, and IDS Financial Services, AEB is relatively small, therefore the strategy set by the corporate headquarters is sometimes not in line with the bank's actual situation, but instead with the whole American Express Company's portfolio.

For example, in 1992, the American Express Company entered into transactions involving off-balance-sheet financial instruments to manage its exposure to credit and market risks, to satisfy the financial needs of its clients and to conduct trading activities. The Company has extensive control procedures regarding the extent of its transactions with counterparties, the manner in which transactions are settled and the ongoing assessment of counterparty creditworthiness such as:

- (i) Interest Rate Products: Interest rate products, including swaps, caps and floors, options and financial futures and forwards, are used by the Company as an integral part of its interest rate risk management. Interest rate products are used, for the most part, to hedge the

Company's debt used in funding its charge card and consumer lending businesses.

- (ii) Foreign Currency Products: Foreign currency products, primarily forward contracts to purchase and sell currencies at specific rates on preestablished dates and foreign currency options, are used extensively as part of the Company's client-related trading activities and, to a lesser extent, for the Company's own account. Client-related trading positions are generally matched, resulting in minimal market exposure. In addition, foreign currency products are primarily used to hedge net monetary positions in foreign currencies, net investments in foreign entities or identifiable firm foreign currency commitments.

The following amounts, which exceed the related amount of credit risk, provide an objective measure of the Company's involvement in financial instruments with off-balance-sheet risk.

(millions)

	1993	1992
Interest Rate Products	\$15,528	\$16,012
Foreign Current Products	23,131	13,477
Options Written	1,020	296
Total Credit Exposure (dollars, in millions)		
Financial Institutions*	\$12,575	\$11,137
Individuals**	44,186	43,788
Governments and agencies***	17,977	19,465
All others	23,345	23,582
TOTAL	\$98,083	\$97,972
Composition:		
On-Balance-Sheet	78%	75%
Off-Balance-Sheet	22%	25%
Total	100%	100%

- * Financial institutions primarily include banks, broker-dealers, insurance companies and savings and loan associations.
- ** Charge Card products have no preset spending limit; therefore, the quantified credit risk includes only the Card receivables recorded in the Consolidated Balance Sheet.
- *** Government and agencies include the U.S. Government and its agencies, states and municipalities, and quasi-government agencies.

Blue Box Value. In the American Express Company, "Blue Box Values" is a credo for all the employees (see Exhibit 3.7). The corporate strategy is known as "Building the Brand: The Growth Strategies of American Express:

We finished the year (1993) with a long list of accomplishments, including achieving some of the best financial results in our history, creating a new foundation for growth with highly-motivated, reenergized employees, and rebuilding relationships with important customer groups. As with all corporations, our overriding business

objective is to create shareholder value. We believe the best way to accomplish this is to work toward making American Express the world's most respected service brand -- not out of a sense of arrogance or ambition -- but because brands have value and great brands like ours can have great value.

-- Harvey Golub, Chairman & CEO

Exhibit 3.7

American Express' Blue Box Values

All our activities and decisions must be based on, and guided by these values:

- ◆ Placing the interests of Clients and Customers first.
- ◆ A continuous Quest for Quality in everything we do.
- ◆ Treating our People with respect and dignity.
- ◆ Conduct that reflects the highest standards of integrity.
- ◆ Teamwork - from the smallest unit to the enterprise as a whole.
- ◆ Being Good Citizens in the communities in which we live and work.

To the extent we act according to these values, we believe we will provide outstanding service to our clients and customers, earn a leadership position in our business, and provide a superior return to our shareholders.

Barings Bank

Barings was one of the UK's market leaders in mergers and acquisitions and equity capital raising in 1994. Together with Dillon Read, its 40 percent-owned associate on Wall Street, Barings also ranked fourth in the world in mergers and acquisitions in 1993, advising on transactions worth an aggregate of US\$8.2 billion. Founded in 1762 and still privately owned, Barings is one of the most international of the major investment banks and has operations in 38 cities worldwide. In addition

to its mergers and acquisitions, capital raising, derivatives (with Abbey National) and buy-out businesses, it has a very strong international stockbroking business which is a leader in the emerging markets, particularly South Africa, South America, Southeast Asia and the Far East. Baring's asset management business provides investment management services, primarily to institutional investors, and has some US\$44 billion of funds under management. Baring is differentiated from other UK and U.S. investment banks by virtue of its independence, its international emphasis, and its specialized approach. This latter point is shown both in Barings' choice of the markets in which it competes and in the way it has created a team of industry specialists to service its existing clients and to help develop new relationships for the group.

However, the bank had a fatal weakness in its risk management and internal control. In early 1995, the bank faced bankruptcy and financial ruin owing to out-of-control option transactions by a Singapore dealer. Such an unfortunate occurrence proves that the most powerful way to prevail in global competition is still invisible to many companies. Within all the investment theories, risk and return go hand-in-hand. In real business practice, expansion and risk control are a crucial part of the utility curve.

Chase Manhattan Bank

The Chase Manhattan Corporation is among the world's premier global financial services institutions. Conducting business through Chase Manhattan Bank, N.A. and numerous other subsidiaries worldwide, Chase focuses its business and marketing on two types of clients -- individual consumers and wholesale clients, consisting primarily of corporations, financial institutions, and governments. Chase serves the needs of these clients through two fundamental franchises: Chase's global network, which accesses all the important world markets as clients raise, invest, move and track their financial assets; and Chase's domestic network. Together, these franchises encompass a breadth of service and depth of product that provide clients

with comprehensive financial service. Market dominance in many of Chase's businesses further characterizes its unique positioning.

Citibank

Citibank is a premier global financial services organization with a network linking over 90 countries. As world economies become increasingly interrelated and integrated, the ability to deliver service globally is clearly a competitive advantage. While many competitors have withdrawn from international markets, Citicorp continues to expand throughout both the developed and emerging economies. Citicorp has translated global presence into global success. For institutional or corporate customers, this means having the full array of Citicorp talent, skills, experience and resources, regardless of geography. For the consumer this means having the flexibility to manage their banking relationship 24-hours-a-day, seven-days-a-week.

Salomon Brothers Inc.

Founded in 1910, Salomon Brothers has developed into one of the world's preeminent investment banks with 1993 pre-tax profits of \$1.6 billion. Its parent company, Salomon Inc., had \$17 billion in total capital as of December 31, 1993, and assets of \$185 billion. Salomon Brothers' financial strength underpins an integrated global network of 28 offices on four continents, from which the firm's 6,600 employees provide clients with a wide range of services, including capital raising, strategic advice, research, securities sales and trading, and asset management. Salomon Brothers has long recognized that customer needs and market opportunities transcend national borders and require an ability to do business 24 hours a day. As a result, during the last decade, Salomon Brothers has evolved from a U.S. investment bank with an international presence into a global enterprise with a truly global culture. From its hubs in New York, London, Tokyo, and Hong Kong, Salomon

Brothers has established itself as a leader in the major markets of America, Europe and Asia.

Standard Chartered Bank

Standard Chartered was founded in 1853 to provide international finance for the burgeoning trade opportunities in the emerging markets of the world. Today, international finance remains at the heart of its business strategy. In order to meet its mission, the bank is absolutely committed to developing international managers. Standard Chartered's aim is to become the first choice bank for cross-border financial transactions between developed and emerging markets. The bank also aims to be a highly profitable and very efficient domestic bank in selected developing markets. Accordingly, the bank's largest operations are in the Asian markets, particularly India, the Asia Pacific region, and Africa. OECD countries represent a relatively small, but important part of the banking operations.

Swiss Bank Corporation

Swiss Bank Corporation (SBC), founded in Basel in 1872, has developed over the years from a conservative to a dynamic, innovative, and future-oriented Swiss bank. In Switzerland, SBC is a leading universal and asset management bank offering the full range of services to all customer segments. Internationally, it competes as a globally leading investment bank, offering a specific range of wholesale financial services to major clients. In Switzerland, SBC is one of the three big banks awarded top ratings by the three major international rating agencies. In terms of equity, SBC was ranked second in Switzerland at the end of 1993 and 23rd worldwide at the end of 1992.

It is SBC's unchanged goal to be among the world's top tier banks in terms of professionalism, profitability, and market position. Return on equity and efficient

risk management are priority concerns. To enable the bank to realize its ambitions, a few strategic thrusts have been defined:

Forward-looking organization

Structure of the New Overall Bank Organization. The success of its International & Finance Division led SBC to adopt a similar structure for its activities in Switzerland which have been regrouped into a Domestic Division. The link between the two divisions, which enjoy a large measure of autonomy, is provided by a new Corporate Center. The implementation of the new structure was completed at the end of 1994. Among the advantages of the new organization are a new and more dynamic Domestic Division, better control of future cost trends, increased accountability and responsibility for results in the Group and shorter decision paths.

Building a global compliance organization. In 1992 SBC appointed a Group Compliance officer and in 1993 it became the first of the major Swiss banks to set up a comprehensive compliance organization and to develop general compliance guidelines. These guidelines represent minimum professional and ethical standard for each employee within the bank.

Consolidating the Bank's Presence in Southeast Asia

During the year SBC strengthened its position in Southeast Asia. After acquiring equity interests in Indonesia and Singapore, it found suitable partners in Malaysia and Thailand as well. In October 1993, SBC became the first Swiss Bank to gain a seat on the Shanghai Securities Exchange.

3.2.2 Domestic Market

ABN AMRO Bank, Taipei

A Dutch bank merged with Continental Bank Taipei to become one of the largest foreign banks in Taipei. It has a strong driving force to expand its business.

With a group of young and aggressive marketing officers, ABN-AMRO Bank has efficiently penetrated the second-tier market in Taiwan.

Over the past 168 years since opening an office in Indonesia, ABN AMRO has been closely associated with Asia. By 1906, the bank had offices in Indonesia, Singapore, Malaysia, Japan, and Hong Kong. Currently the bank is established in 21 countries throughout Asia, and has more than one office in thirteen of those countries. This extensive network coupled with its Asian heritage form the cornerstones that allowed ABN AMRO to firmly establish itself as one of the few premier international banks that can call Asia home, and which offers the full range of banking products and services throughout Asia.

ABN AMRO started its business in Taipei in the early 1970s. After the merger with Continental Bank, which was known for its corporate banking, ABN AMRO became one of the largest foreign banks in Taiwan. The bank sustains its aggressive marketing strategy throughout Taiwan. Geographic expansion and increasing business volume improve the economic scale of its banking operations. That advantage enables the bank to keep its competitive pricing strategy among all the foreign banks in Taiwan.

American Express Bank Ltd., Taipei

American Express Bank (AEB) established its Taipei Branch 26 years ago. Since that time, AEB Taipei has enjoyed Taiwan's burgeoning economy in the 1980s and suffered through the recession in the 1990s. The net profit of AEB Taipei reached \$9 million in 1990, but declined since then due to the global recession and more strict credit policies required by its New York Office.

Since 1991, in compliance with AEB's global strategy focusing on controlling risk and increasing fee income, AEB Taipei has transferred its core business from

corporate lending to private banking. This transformation forced AEB Taipei to relocate all its marketing resources and retarget the local market segmentations.

The private banking group in Asia includes more than 60 professionals and is organized into geographic, product, and industry coverage groups, enabling bankers to develop expertise in particular line of business. The Hong Kong office serves as the regional office for coordination in Asia, while all the business risks evaluation is controlled in Singapore office.

All three branches work autonomously in their own region. To avoid conflict of interest among the three branches, the bank adopted a "Account Officer" systems to distribute the profit earned from customers.⁸ The core products, such as "Worldfolio" and "Capital Protection Strategic Deposits," were based on the concept of "fee income and off-balance-sheet" transactions. Because of the change in business strategy from "corporate lending" to "private banking", AEB Taipei lost its main source of interest revenue,⁹ but also had the benefit of lowering its business risks.

However, for promoting private banking services in Taiwan, AEB Taipei has created an unique competency in the local market based on two factors. First, for the past two decades, AEB Taipei has provided local industries with a wide range of financial services and established long-term relationships with Taiwan's wealthy entrepreneurs. Second, by taking advantage of the business promotion from Travel Related Services (American Express Card & Traveller Cheque), the bank enjoys a high brand recognition among all the local competitors.

8. The Account Officer System means each office has its marketing officers, and each marketing officer has to develop new accounts and takes care of his own accounts (customers). The revenue generated from these individual accounts are booked under the name of that account officer. The account officer's profits are contributed to the branch to which he reports.

9. The branch's net profit drastically decreased from \$9 million in 1990 to \$7 million in 1991 and no profit in 1992.

The mission of the branch is to offer an array of products and services to all of its market segments where a customer need has been established. According to AEB's global profit analysis, almost 80% of the revenues are generated from 20% of the customers who are high net worth individuals. To follow the global marketing strategy, AEB Taipei concentrated all of its marketing strength on servicing wealthy individuals in Taiwan and their businesses. The mission statement of AEB Taipei can be stated as follows:

Mission Statement of AEB Taipei

	CURRENT	FUTURE
PRODUCT SCOPE	<ul style="list-style-type: none"> • Provide high net worth individuals and their companies and selected institutions with full range of products in asset management • Build products and services generating fee income 	<ul style="list-style-type: none"> • Deliver customized, effective, and insightful financial solutions to meet the clients' needs. • Orchestrate AEB global capacity to develop and implement personalized client services in a confidential manner • Be trusted partners of wealthy individuals in their asset management and business decisions
MARKET SCOPE	<ul style="list-style-type: none"> • Limited to high net worth individuals with potential for deposits exceeding US\$1 million or annual fee income over US\$50,000 	<ul style="list-style-type: none"> • Emphasis on wealth management, including investment counseling, fiduciary structures, and credit.
GEOGRAPHIC SCOPE	<ul style="list-style-type: none"> • Taiwan 	<ul style="list-style-type: none"> • Expand geographical boundaries of banking within Taiwan. • Provide products and services to Taiwan-based clients by global network
WAYS TO ACHIEVE COMPETITIVE LEADERSHIP	<ul style="list-style-type: none"> • Product innovation • Strong recruiting for intellectual, analytical, and customer-oriented marketing individuals 	<ul style="list-style-type: none"> • Increase product differentiation • Meet customers' needs in risk management and asset allocation for the long term

Citibank, Taipei

Citibank Taipei is known for its aggressive marketing strategy and product innovation. With its high brand recognition and strength in consumer and corporate banking, Citibank Taipei has kept its comparative advantage for more than twenty years in Taiwan. Consumer banking represents the newer business in the Citibank family in Asia.

Citibank is positioned in the region as a consumer financial services provider that is service-driven, innovative, and offers superior value to its customers. Like many foreign banks, it is restricted in the number of branches it can maintain in Taiwan. This has led the bank to focus on a largely upscale segment of the market and to develop innovative ways for distributing its products, namely, by telephone, direct mail, and at automated teller machines. With these strategies, Citibank has built thriving customer relationships with a large customer base.

Citibank has a strong portfolio of deposit products, mortgages, automobile financing programs, personal and revolving loan programs, and community banking programs. As a result of consistency and focus on positioning, strategy, and execution, Citibank enjoys a dominant market position and high brand awareness in Taiwan.

Standard Chartered Bank, Taipei

Standard Chartered Bank Taipei (SCB) is relatively young among all the foreign banks. However, its flexible pricing policy and high turnover of new products gives it leverage to capture business in the highly competitive environment. It is very active in the middle market. As SCB's global strategy aims at developing Asian countries, it gains advantage through cross-border economic scale in the Asian

region. As a result, when the manufacturing industry moved its investment from Taiwan to other developing countries such as Malaysia and Indonesia, SCB had a unique competitive advantage.

Chase Manhattan Bank, Taipei

Chase Taipei down-sized its business six years ago and changed its core business to investment banking. Its private banking business became a side product, and less competitive.

Bank of America (BOA), Taipei

BOA has been in the market as long as Citibank and American Express Bank (26 years). BOA changed its credit policy to be more conservative so that its private banking strength is difficult to measure.

Other Banks in Hong Kong and Singapore

Other banks such as Morgan Stanley, Bank of Tokyo, Swiss Bank, and Lehman Brothers, also have branches in Taiwan, although they are not as prominent as those featured above. However, it is very easy to locate their banking and associated activities in Taiwan.

3.3 INTERNAL SCRUTINY AT THE BUSINESS LEVEL: FACTORS FOR ASSESSING STRENGTHS AND WEAKNESSES

For the internal scrutiny of a bank at the business level, I have selected one bank, the American Express Bank, Taipei (AEB), as an example. Of course, the same internal scrutiny could be performed for each bank, in order to help them assess their strengths and weaknesses.

A. Portfolio Management

1. Relationship Management

Relationship Management is the process of monitoring customer satisfaction to ensure that the bank's services are meeting the customers' needs. According to bank policy, the marketing officer should visit his/her clients at least once a month. For those customers with credit facilities, quarterly financial reports must be acquired in time.

2. Portfolio Management

The American Express Bank Taipei owns and manages several investment portfolios. The branch carefully monitors the distribution of maturities in the investment portfolios to ensure that adequate funds are available to satisfy its maturing liabilities. In addition, maturities are handled based on management's assessment of interest rate trends and other factors affecting the risk involved.

3. Security Management

For private banking products, "cash-based security" is preferred. The credit facility that can be offered based on the cash deposit varies from 90% to 2,000%.

For example,

(dollars millions)	DEPOSIT	CREDIT LINE
Margin Trading Account	1	20
Currency Trading Account	1	20
Cash Borrowing (same currency)	1	1
Cash Borrowing (different currency)	1	0.9
Initial Public Offering (IPO)	1	10
Capital Protection Products	1	1

4. Credit Initiation

The process of applying for credit includes the following categories:

- (a) **Initiation:** The credit line must be requested by the customer, and initiated by his marketing officer.
- (b) **Evaluation:** The proposal must include the loan's purpose, the nature of the borrower's character, and risk coverage. Security for the loan must be properly addressed.
- (c) **Negotiation:** This includes the tenor of the loan, the terms, covenants, pricing, and sources of repayments.
- (d) **Approvals:** Credit proposals are approved at appropriate levels within the branch for the first review, then are passed to the Singapore office (Asian Credit Quarter) for final approval.

B. Marketing

The philosophy of each AEB marketing officer for finding a new customer is: "Marketing is the identification and satisfaction of customer's needs." AEB separates its marketing forces into two groups: (1) a Sales Group and (2) Product Specialists.

1. Sales Group: Acquires advice and information from the Product Specialist and then handles person-to-person contacts, account management, so as to maintain customers' relationships and expand new business.
2. Product Specialist: Monitors market movements, does research for new products, and provides new information or new products to the Sales Group.

C. Operations

The Operations Department performs the physical work of processing the bank's business transactions, audit and control, designing its computer systems, as well as managing the Bank's internal building services.

D. Credit Policy

The Credit Department is responsible for the branch's credit evaluation including individual customer's business risks, industrial risks, economic risks, and interest sensitivity risk. It works as a functional unit of the Singapore headquarters, and the New York head office.

3.4 Offshore Banking Units

In 1983, the Central Bank of China promulgated various regulations concerning offshore banking services to attract foreign capital into Taiwan's banking system. The regulations allowed banks that were located within the Taiwan's national boundaries to establish offshore banking units (OBUs) as a means of strengthening international financial activities. However, the clients of OBUs are

strengthening international financial activities. However, the clients of OBUs are restricted to non-Taiwan residences and non-Taiwan registered corporation. Between 1984 and 1989, twenty OBUs were set up.

In order to encourage development of OBUs, interest on deposits has been exempted from withholding tax. OBU income is also exempt from tax, and their transactions are free from stamp duty. In terms of tax incentives, Taiwan's OBUs are more favorable than ACUs (Asian Currency Units).

As of March 1992, a total of 32 banks had been approved to set up and operate OBUs. Sixteen of these banks were local banks and the others were foreign banks. Total assets amounted to approximately US\$23 billion. On a geographical basis, Asia was by far the largest source of funds in 1991, accounting for 82%, followed by Europe with 9%, and the U.S. with 8%. About 90% of the funds were utilized in Asia, with Europe and America accounting for some 4% each (see Exhibit 3.8).

**Exhibit 3.8
Foreign Exchange Reserves**

COUNTRY	AMOUNT (\$ billion)
Japan	\$114.2
Taiwan	92.5
Singapore	56.8
Hong Kong	43.0
China	36.5
Malaysia	30.9
Thailand	28.7
South Korea	23.5

Sources: International Monetary Fund,
Baring Securities Ltd. Central Bank of China

3.5 THE TAIPEI FOREIGN CURRENCY CALL-LOAN MARKET

The Taipei foreign currency call-loan market was established in 1989 in order to make effective use of the country's foreign exchange reserves to meet industrialists' demands for foreign exchange funds. The OBUs provided a basis for the foreign currency call-loan market.

The eligible participants and tradable currencies has expanded each. Fifty foreign exchange banks are permitted to participate in call-loan market transactions. Since August 1990, the headquarters and affiliated institutions of foreign banks with operations in Taiwan, the overseas branches of local banks, and all financial institutions in Singapore, New York, and London have been allowed to participate in the market. At present, the interest rates in the market (the Taipei Interbank Offering Rate, TIBOR) tends to parallel the LIBOR and SIBOR. The tradable foreign currencies have increased from only the U.S. Dollar to a total of 13 major currencies listed on the foreign exchange market.

The Taipei Foreign Exchange Market Development Foundation developed several linkage agreements with money brokerage houses in Singapore, Hong Kong, and Tokyo, such that Taipei will be increasingly integrated with Singapore, Hong Kong, and Tokyo as a regional financial network.

3.6 OUTLOOK FOR TAIPEI AS A FINANCIAL CENTER

The offshore banking operations and the foreign currency call-loan market have already formed the stage for Taipei to become a regional financial center. The Taiwan government is now developing the basic infrastructure, such as information systems, human resources, deregulation of strict laws, and other frameworks to reach the goal.

A number of measures will be put in place to help realize the goal, including:

- (1) allowing more financial institutions to operate in Taipei;
- (2) enlarging offshore banking operations and the Taipei Foreign Currency Call-loan Market.
- (3) promoting the money and capital markets.
- (4) establishing the Taipei International Monetary Exchange (TIMEX)

The plan to develop Taipei as a regional financial center has already been incorporated into the government's Six-Year National Development Plan. Given Taiwan's geographical location, economic strength, highly educated workforce, and significant reserves, the Taipei market will complement already established Asian centers such as Hong Kong, Singapore, and Tokyo in cross-border transactions.

CHAPTER FOUR

THE MARKETS

4.1 DERIVATIVE FINANCIAL PRODUCTS

The liberalization and internationalization of Taiwan's financial markets and institutions will, as a result, generate a demand for domestic derivative financial products so that financial institutions, companies, individuals, and governments can use the appropriate risk-management strategies when holding, dealing in, or trading the underlying cash instruments in their respective markets.

On June 19, 1992, the Legislative Yuan enacted new legislation, known as the "Foreign Futures Trading Law" (FFTL)¹ to legalize and regulate the futures industry in Taiwan. Moreover, attached to the FFTL was a separate resolution requiring the Executive Yuan to draft a domestic futures law by the end of 1992 which would open the way for the eventual introduction of domestic derivatives financial products, including a stock market index and government bond futures and options.

As for portfolio investment, the government has set up specific channels for people to invest in foreign securities, and transactions conducted through these channels are not subject to outward and inward limitations. Merrill Lynch and Shearson Lehman Brothers were granted permission to establish branches in Taipei in March 1991. As a result, the public is now allowed to trade in the securities on the stock exchanges of New York, London, and Tokyo through these two foreign-based securities firms. Foreign investors have also been allowed since May 1983 to

1. The Foreign Futures Trading Law, was introduced in the Legislative Yuan on December 5, 1990. The FFTL was enacted June 19, 1992. English translation of FFTL provided by Lee and Li, Attorneys-at-Law, Taipei, Taiwan.

invest indirectly in Taiwan stock market by purchasing shares in four "Taiwan Funds" issued abroad. This indirect investment constitutes the first phase of a three-phase plan to permit the entry of foreign capital into Taiwan securities market. Presently, Taiwan is in Phase Two of the plan, in which foreign institutional investors are being allowed to invest directly in the local market. The third and final phase will involve the total liberalization of direct investment by both foreign individuals and institutional investors.

4.2 BOND MARKET

Government Bonds

Taiwan's bond market consists of government and corporate bonds. Government bonds issued by the central, provincial, and municipal governments, dominate Taiwan's bond market, accounting for over 80% of the outstanding bonds. In the smaller corporate bond market, outstanding corporate bonds issued by government-owned enterprises account for about 11% of the total bond market, with the outstanding corporate bonds issued by private corporations amounting to only 4% of all bonds, a minuscule US\$600 million.²

The government bond market has undergone a major transformation, as new government bond issues related to the Six Year Plan have massively enlarged the government bond market. With a more modern and sophisticated institutional arrangement underlying the government bond market, which allows more complex instruments, the corporate bond market may become even livelier, allowing corporations more diverse forms of medium- and long-term finance. Both

2. Ibid. The figure \$410 billion New Taiwan Dollars (US\$600 million) is comprised of \$260.1 billion for outstanding government bonds; \$63.3 billion for provincial government bonds; \$24.1 billion for municipal government bonds, \$46.8 billion for corporate bonds issued by government enterprises; and \$15.3 billion for corporate bonds issued by private enterprises.

developments would provide domestic and foreign investors more diverse financial instruments by which to invest in Taiwan.

The bond indebtedness of Taiwan's governments is extremely modest by international comparison. At the beginning of the 1980s, the outstanding amount of central government bonds was NT\$10.9 billion; by the end of the 1980s, with large amounts of construction bonds issued to raise funds for major construction projects this amount had increased to NT\$158 billion, a relatively small amount of approximately US\$6 billion. As a percentage of GNP, the level of government indebtedness has increased in this period from 0.83 to 4.3%, with principal repayment and interest payment comprising only 5.3 percent of total government expenditures.³ In Canada and the United States, government bond indebtedness as a percentage of GNP is much higher, in the 50-60% range, with debt service and principal amortization comprising an increasingly larger amount of government expenditures.⁴

The present institutional configuration of primary and secondary markets will undergo substantial changes in the 1990s, in large part due to the Six Year National Development Plan, 1991-1997, the implementation of which began in fiscal year 1992, which started on July 1, 1991. The Six Year Plan is a bold attempt on the part of the central government to reinvent Taiwan as a competitive trading nation, and as a nation in which to live. The central government has budgeted NT\$8.2 trillion for spending on a total of 775 projects, many of which are major infrastructure projects to achieve a number of goals. In order for the primary and secondary markets to accommodate these initial and subsequent extremely large amounts of government bond issuances under the Six Year Plan, the CBC, MoF, and the government are

3. *Supra*, n.5, Government Finance of the Republic of China.

4. In the United States, the gross federal debt of \$3,113 billion (US) for fiscal year 1990 (ending September 30, 1990) was 57% of GNP. See "U.S. Federal Debt," *Globe & Mail*, October 2, 1990, p. B1.

undertaking a number of reforms to realign the current institutional configuration of bond markets. The government has revised the current Statute for Issuance of Government Bonds. The ceiling on the issuance of government bonds as a percentage of the total central government budget has been increased from 40 to 60%, starting in the fiscal year 1993. In addition, the scope of spending of these bonds has been enlarged, as bond revenue can now be applied to general construction spending, as opposed to major construction spending.

Corporate Bond

The corporate bond market in Taiwan is relatively small compared with other developed countries. Corporations that used to rely on bank financing has moved their fundraising into the bond market. Like the secondary markets for government bonds, there is a bifurcated secondary corporate bond market, with trades of listed corporate bonds on the Taiwan Stock Exchange, as well as registered bonds on the over-the-counter market that take place in the offices of bond brokers. The outstanding amount of corporate bonds on the OTC market comprises 80% of all corporate bonds, and is a somewhat more active market, where the total trading value as a percentage of the outstanding value of bonds was 42.6% in 1989, compared to only 8.8 percent in 1989 for listed bonds on the Taiwan Stock Exchange.

Despite the limitation of the corporate bond market as an investment vehicle for investors, the SEC has been cautiously permitting the application of foreign financial technology to diversify the types of bonds corporation can issue and in which investors can invest. Although the SEC had regulations governing the issuance of convertible bonds as early as March 1983, no convertible bonds had been issued given some substantial technical impediments that existed in the Company Law. However, sophisticated financial engineering circumvented these constraints in part when in 1988 Yuen Foong Yu Paper Manufacturing Company Limited (YFY) issued an exchangeable bond for NT\$1 billion at 3.01% per annum, under which the

bond proceeds could be converted into the shares of a company in which YFY had a substantial holding at a conversion premium of 17% two years after the issuing date. Moreover, YFY in 1988, and other companies subsequently have successfully issued convertible preferred shares to the public in Taiwan.⁵ When amendments to the convertible bond regulations were enacted in August 1989, Far Eastern Textile Ltd. issued the first domestic convertible bond for NT\$1.5 billion, with a 4.25% coupon and a conversion premium of 25% in March 1990. With the Eurobond markets recovering, a number of other Taiwanese companies have recently issued convertible bonds in the Euromarkets. Acer Serteck Inc. is the first of these, with an issue in May 1991. Given the fall of the TSE, where YFY common shares have traded for as little as 20% of their pre-crash values, these new Taiwanese companies have had to offer better incentives to foreign investors to make their issues attractive, including higher interest rates and lower conversion premiums.

4.3 FOREIGN EXCHANGE MARKET AND STOCK MARKET

Between 1949 and 1963 Taiwan had a multi-tiered exchange rate policy with graduated rates for exports, imports, and remittances. At the end of September 1963 the exchange rate was unified. The New Taiwan dollar remained pegged at NT\$40 to US\$1 from 1963 to early 1973. Since the New York "Plaza Accord" of September 1985, when the leading industrial nations agreed to let the U.S. dollar find its own level against the yen and the deutschmark, upward pressure on the NTD has been relentless. Like its fellow Asians -- South Korea, Hong Kong and Singapore -- Taiwan has been a beneficiary of the relative loss of Japanese exchange rate competitiveness. This was a major factor in a ballooning surplus in its bilateral trade with the U.S. From 1986 on, there were frequent calls from the U.S. for a

5. Supra, n. 38, p. 79. Convertible preferred shares enable the holder to exercise an option, usually after a certain period of time, or in accordance with certain conditions, preferred shares for common stock at a stipulated conversion price of share exchange ratio.

reevaluation of the NTD. The expectation of continued upward pressure contributed to an alarming inflow of speculative capital, which the government tried ineffectively to stem in March 1987. By the end of April 1990 the NTD stood at NT\$26.39 to the U.S. dollar, an appreciation of 51% since the end of 1985, but down 3.2% on the US\$=NT\$25.55 rate reached a year earlier.

The inflow of speculative capital caused tremendous changes both in economic distribution and social environment. The stock market index raised from 2,000 in 1987 to 12,000 in 1989, then dropped back to 3,000 in 1991. The price of land increased thirty times as an average within five years, such that many land owners and farmers became very wealthy without knowing what had happened. The excessive money eroded many of the Taiwanese people's virtue of diligence and hard work, with the result that sometimes Taiwan was referred to as the "Republic of Casino".

After it abolished trade-related foreign exchange control, the Central Bank relaxed controls on capital account transactions in July 1987, thus allowing local residents to freely hold and utilize foreign exchange. At present, each individual or company is allowed to outwardly or inwardly remit up to US\$3 million each year, without Central Bank approval and without restrictions on the use of the funds remitted.

As for portfolio investment, investors in Taiwan may conduct direct transactions in the global market through authorized institutions, including the domestic and foreign banks in Taiwan and other financial consulting companies. The government has set up specific channels for people to invest in foreign securities, and transactions conducted through these channels are not subject to outward and inward limitations. For example, in March 1991, Merrill Lynch and Shearson Lehman Brothers were granted permission to establish branches in Taipei. As a result, the public is now allowed to trade in securities on the stock exchanges of New York,

London, and Tokyo through these foreign-based firms. Of particular note is the US\$100 million worth of "Dragon Bonds" that were issued in Taiwan in December 1991 by the Asian Development Bank. These Dragon Bonds are the first foreign currency bonds to have been directly issued here.

Since May 1983, foreign investors have also been allowed to invest indirectly in Taiwan's stock market by purchasing shares in four "Taiwan Funds" issued abroad. This indirect investment constitutes the first phase of a three-phase plan to permit the entry of foreign capital into Taiwan's securities market. At present, Taiwan is in phase two of the plan, in which investors are being allowed to invest directly in the local market. The third and final phase will involve the total liberalization of direct investment by both foreign individuals and institutional investors.

CHAPTER FIVE

WHO ARE THE CUSTOMERS?

5.1 CUSTOMERS' NEEDS

When considering the financial services industry as a whole, and comparing Taiwan with Hong Kong, Singapore, and Tokyo, Taiwan is still a relatively primitive market. Coming from very traditional and conservative agricultural and industrial backgrounds, most investors are quite risk-averse. Therefore, the large commercial banks play an important role because they are perceived as "safe" reservoirs for more than 50% of Taiwan investors' financial assets (see Figure 5.1). However, inspired by activity in the global financial environment, some investors have taken steps to expand their risk tolerance, particularly if they have accumulated substantial personal net worth. Speculative products, such as Margin Trading, and Options and Futures were only legalized in the early 1990s. Corporate buyers have made their investments based on their business transactions plus some speculations. Individual buyers have invested based on the need for an investment portfolio and risk management.

Figure 5.1

Structure of Financial Assets in Taiwan
(1987-1992)

(in NTD 100 million)

	1988	1989	1990	1991	11/92
Cash and Bank Deposits	49,207	56,718	63,311	73,961	86,081
Cash	3,206	3,484	3,546	3,877	3,942
Demand Deposit	16,298	17,203	15,772	17,775	18,658
Time Deposit	29,703	36,031	42,993	52,309	63,481
% of total	49	40	54	54	57
Money Markets	4,809	6,012	7,208	8,622	10,523
Treasury Bills	1,970	340	180	1,160	830
Commercial Paper	858	1,347	2,820	2,944	3,843
Bankers Acceptance	434	570	650	501	483
Negotiable C/D	1,536	3,545	2,969	3,060	4,427
Corp.	11	210	589	957	940
Bills					
% of total	5	4	6	6	7
Capital Market	2,621	2,981	2,752	4,521	6,778
Gov't bonds	1,856	2,229	1,888	3,475	5,530
Corp. bonds	521	454	516	640	638
Others	244	298	348	406	610
% of total	3	2	2	3	4
Other Financial Assets	43,397	75,422	43,852	49,857	48,794
Stocks	33,832	61,741	26,819	31,840	27,273
Trust Funds & Insurance Reserves	4,818	6,077	7,824	9,718	9,292
Capital A/C of Financial Firms	6	1,400	3,029	2,756	5,038
Gov't Deposits	4,741	6,204	6,180	5,543	7,191
% of total	43	53	38	36	32
Total Financial Assets	100,034	141,133	116,123	136,961	152,176
Growth Rates (%)	35	29	-22	15	11

As discussed in Chapter Three, in order to fully utilize their core competencies, the banks have reallocated their resources to target three different segments:

1. Retail Banking:
 - Focus on consumer-based transactions
 - Emphasize on geographic extension

2. Wholesale Banking (Commercial lending)
 - Very sensitive in pricing
 - Focus on each bank's expertise
 - Emphasize on credit control

3. Investment Banking (corporate and institutional investors, or high net worth individuals)
 - Product innovations create differentiation
 - Reliance on relationships between bankers and customers
 - Heavy investment in information technology, such as Reuters, Telerate, etc. to provide intensive service network.

Some of the banks concentrate in only one field, while some cover more than one field. In order to properly position itself in the market, each bank has to strengthen its marketing power by targeting different segments. These kinds of deviation in banking functions also apply in Taiwan's market.

Due to historical development in geographic extension and a massive base of clients, most of the domestic banks such as Chang Hwa Commercial Bank, Hua Nan Commercial Bank, Bank of Taiwan, and other newly established local banks can be categorized in Retail Banking. Foreign banks in Taiwan are rarely interested in this market segment because of heavy office equipment and human resources cost.

Citibank is the exception, and by utilizing aggressive promotion and advertising strategies, it performs pretty well at this segment.

The banks with strong equity capability and more aggressive lending policies select "Whole Banking" as their core business. The local banks such as China Trust, Chiao Tung Bank, Chung Hwa Trust & Development Corp, and other foreign banks such as Credit Lyonnaise, Banque National de Paris, Standard Charter Bank, ABN AMRO Bank, etc. are good at the segment of commercial lending.

The banks that are highly efficient in the global network and which intend to use fewer human resources in the Taiwan market, are more interested in the segment called "Investment Banking", which is contracted in the derivative products and financial consulting services, such as Swiss Bank, American Express Bank, Bankers Trust, Citibank, Standard Chartered Bank, ABN AMRO Bank, etc.

Some banks function within more than one category, such as Citibank, which covers both "Retail Banking" and "Investment Banking". Standard Chartered Bank and ABN AMRO Bank cover both the "Commercial Banking" and "Investment Banking" fields.

A survey was conducted in the Taiwan market concentrating on Investment Bank, which is believed to be the mainstream for the near future because of Taiwan's financial liberalization and internationalization. The survey was undertaken as a way of better identifying customers' needs. Below are excerpts from interviews with customers in Taiwan.

**Questionnaire for
Customers' Needs and Satisfaction Survey**

1. What kind of services do you think a bank or a financial services company can offer you?
2. What is your criterion for choosing a bank or a financial service company? Have you ever changed or increased your banker or financial services company before? Why?
3. How important to you is the reputation of the financial institutions?
4. How do you feel about your present banker? Do they meet all your requirements?
5. What kind of bank products do you use frequently in your current financial management?
6. What do you need when you choose financial products?
7. What kind of problems would you have if you did not use those financial vehicles?
8. What do you think about risk control in your financial management?
9. Until now, what kind of risk management tools are you aware of? Have you ever used derivative products in your financial management? If not, will you use them as part of your financial management program in the future?
10. How do you evaluate the performance of account officers? What do you feel about the reliability of the account officers? What do you think about the reputation of account officers?
11. From your perspective, which is the most significant element in choosing a financial product/service?
 - a. Provide efficient market information
 - b. Opportunity of learning new product
 - c. How comfortable you feel about the account officer
 - d. Reputation of the institution
 - e. Products of the institution
 - f. Delivery of the products and after-sales service (i.e., buying a stock and getting good feedback on its progress and reliable month-end statements and return data -- system related)
 - g. Pricing

CASE 1:

- Customer Profile: Privately owned motor company, joint venture with Fuji Heavy Industry of Japan. capital size: US\$70 million. Annual sales US\$210 million. Demand for Japanese ¥5 billion annually for import parts.
- Person Contacted: CEO of the company
- Existing Banks: 3 major local banks, no foreign banks
- Results: The company chooses their banks based on previous long-term relationships. In 1988, the three major local banks absorbed their venture capital as deposits by offering favorable interest rates when the market was filled with excessive money supply. The three banks also provide working capital to the company at current low lending interest rates. They had a negative experience with an American bank two years ago where transactions were restricted to "Currency Hedging." The relationship was terminated because the bank's manager left the bank. Since then, the company has never dealt with another foreign bank. They need financial advice for controlling currency risks, but the CEO is very careful about choosing the bank officer who will be in charge. The reputation of the bank and the officer are considered the most important elements, while pricing is listed as a less important consideration.

CASE 2

- Customer Profile: Government-owned steel company, sustains strong profitability for more than a decade. Not only the leader of the steel industry in Taiwan, but also the flagship of all government-owned business.

Person Contacted: Financial controller, the assigned speaker of the company

Existing Banks: At least 40 banks (both local and foreign banks) currently, more are on a waiting list to service this customer.

Results: The company selects its banks based on the government's policies. Its existing service banks are mostly local banks that are selected by the bank board. Leading foreign financial firms are also selected as financial consultants. The company has its own dealing room with 40 staff members; pricing is a typical issue when they use foreign firm's facilities.

CASE 3

Customer Profile: Motorcycle company with an ROA that rank it fifth among Taiwan's Top 500 companies in 1993. The company is profitable even though the motorcycle industry has been in a down-trend for years, because it took over the major market share from all the competitors . The company has diversified its investments and assets to China and other Asian countries.

Person Contacted: CEO of the company.

Existing Banks: Deal with most of the local banks and four foreign banks.

Results: This customer's financial decisions are fully delegated to the financial manager. The department operates autonomously, therefore, pricing and product quality are the most important elements. The financial manager has great latitude to choose the company's banks.

CASE 4

- Customer Profile: Wire and cable company with annual sales of US\$1.2 billion. This company is the flagship of a group of companies that includes a commercial bank.
- Person Contacted: Chief Financial Officer.
- Existing Banks: Deals with all the local banks and foreign banks.
- Results: The company is good at leveraging its assets and liabilities portfolio. They raise funds easily from the capital market by issuing commercial papers or bankers acceptances such that they can earn the interest differential between different banks. They do not reject any bank's credit facilities as long as the prices are competitive. Product and market information are a second important element. The profit generated from the capital and derivative markets brings in an exceptional income for the company.

CASE 5

- Customer Profile: A five-star international hotel, owned by a conservative family. The business group includes a hotel, trading company, and a famous baseball team.
- Person Contacted: Chief Financial Officer.
- Existing Banks: Most major local banks except one, no foreign banks.
- Results: The financial operations are very simple, usually only deposits, seldom any borrowing. The company rejected business dealings with one local bank because the bank withdrew the company's credit line when the company experienced some financial difficulties. That record has prevented them from:

banking with the particular local bank. They do not place deposits with foreign banks because the interest rates are not favorable.

CASE 6

- Customer Profile: A high net worth individual with diversified global investments. He has a moderate risk tolerance. He expects a return of 10% per annum with maximum loss on all the investments. Portfolio size: US\$20 million.
- Person Contact: The individual himself.
- Existing Banks: Several local banks, security companies, and two major foreign banks.
- Result: The character and quality of the account officer is the primary factor in choosing a bank for reasons of confidentiality and security. The bank's reputation is a second factor. Pricing is less important.

CASE 7

- Customer Profile: High net worth individual, Chairman of a commercial bank. Risk tolerance moderate, capital protection strategy is preferable because he is too busy to check his personal investments. Typical target for all the investment banks, he really relies on the account officer to be his personal consultant.
- Person Contacted: The individual himself.
- Existing Bank: His own bank and one American bank

Results: Trustworthiness of the account officer is the primary factor, and the reputation of the bank is second. Pricing is less important.

CASE 8

Customer Profile: President of a medium-sized industrial company. Like many other Taiwanese entrepreneurs, he has a personal interest in learning about new financial products. He maintains an aggressive strategy in investment, is very speculative.

Person Contacted: The individual himself.

Existing Banks: Several local banks and one American bank

Result: Factors for consideration, in order of importance are: the character of the account officer, products offered by the bank, the bank's reputation, and pricing.

CASE 9

Customer Profile: Owner of a trading company, quite risk-averse, emphasizes capital protection, does not like speculation.

Person Contacted: The individual himself.

Existing Banks: Many local banks and one American bank.

Results: Very strict standards when choosing an account officer owing to reasons of confidentiality. The reputation of the firm is of next importance, while pricing is never considered.

CASE 10

- Customer Profile: A typical second generation Taiwanese entrepreneur. Young, aggressive and confident in the investment market.
- Person Contacted: I spoke to one individual; however, this profile is representative of a class of investors.
- Existing Banks: Many local banks, three foreign bank, and two foreign financial firms.
- Results: Factors that are considered, in order of importance, are: pricing, product, account officer, and the reputation of the firm.

5.2 FINDINGS AND ANALYSIS

1. Based upon the above interviews, by observing the process of buying decisions, customers can be categorized into two types for the purpose of analysis:
 - a. Corporate buyers (Institution buyers)

Buying decisions are made by the management of the company. Decisions are made by a group of people, or a designated person reporting to the top management. Most of the transactions are based on commercial demands, or for the purpose of risk control. Some transactions could be speculative but subject to management's approvals. They are more price-sensitive because of internal cost reporting systems. From the perspective of the banks, they tend to be

like transaction buyers¹ because of the low switching costs.

Compared with individual buyers, they are more willing to change their bankers as long as lower price offerings exist.

b. Individual buyers (Private investors)

Buying decisions are made by the customers individually and they are private investors. The transactions could be made due to the needs of asset allocation or speculations. They are more concerned with their personal relationships with the marketing officers of the banks. They are more like relationship buyers² because of concern about confidentiality and quality of the services rather than the prices.

2. According to the above, to be successful Relationship Marketing needs to make excellent offerings available for today's customers. The banks need to develop a stream of product offerings over time and give customers a variety of options for growth to build up customer's confidence.³ By using talented marketing officers, banks can allay customers' fears about their dependence on financial advice or advisors.
3. To be successful, "Transaction Buyers" need to have the best combination of inducements immediately available for a sufficient number of customers every

1. "Transaction Buyer" vs. "Relationship Buyer": Transaction buyers are more short-term relationship, price-sensitive; buying decision is made in every single transaction independently.

Relationship buyers are more long-term relationship, quality-oriented; buying decision is made in connection with previous experiences or future perspective.

In the buying behaviors, customers may locate themselves anywhere in the spectrum between these two types. (Adapted from the Class Notes of Prof. B. Bund, MIT, Fall 1994.)

2. Ibid.

3. Adapted from the Class Notes of Prof. B. Bund, MIT, Fall 1994.

day. In most instances, banks strive to make every transaction profitable because the next transaction may not come to your bank.

Therefore, choosing the right level of services and the right products that will generate satisfied customers and bring long-term profits to both the bank and the customer is a difficult and demanding management challenge. As a result, an understanding of customer satisfaction is vital for creating a successful marketing strategy. The topic of customers' satisfaction will be further discussed in Section 5.3.

4. As discussed in Chapter 4, the need for local derivative financial products markets is apparent in many areas. For example, Taiwan ranked fifteenth globally in trading, with a total trade volume of US\$122 billion in 1990.⁴ It reached fourteenth in 1991. However, in terms of products available, Taiwan does not do as well in market development. For instance, through November 1991, Taiwanese exporters and importers were unable to hedge against foreign exchange risks in pricing imports from and exports to the United States. Furthermore, until 1994, individual investors were not able to hedge the currency risk against their foreign investment portfolio. Thus foreign investments are exposed to the danger of a New Taiwan Dollar appreciation at any time.⁵

Without stock indexes and stock index futures and options, risk-averse investors are unable to hedge investments in this volatile market.⁶ The

4. "The ROC Rounded Out the First Dozen," *Business Taiwan*, April 8-14, 1991, p. 14.

5. New Taiwan Dollars were the fifth-ranked hard currency worldwide at the time of this writing (March, 1995).

6. A stock index is the value of a weighted number of shares on a stock exchange. Because the index has no connection with any physical entity and is connected only to the price of the underlying shares, physical delivery of share certificates is neither contemplated nor possible. A stock index future is an agreement to pay or receive cash reflecting the difference between the price of the stock index at a future time and the price of the stock index at the time of the

absence of these products increases the volatility of the market in two ways. First, institutional investors (who are longer-term investors) are absent from the market because without the indexes they cannot hedge their investments inexpensively and must resort to very costly active trading to continually achieve the appropriate Taiwan Security Exchange portfolio. Second, without indexes, individual long-term investors retreat from the market, awaiting more stable conditions, thereby leaving continuing active short-term trading to the remaining individual investors. As a result volatility cannot properly be hedged, so the Taiwan Security Exchange will be a less attractive place to make long-term investments, compromising the timing and ability of listed companies to issue securities in the primary market.

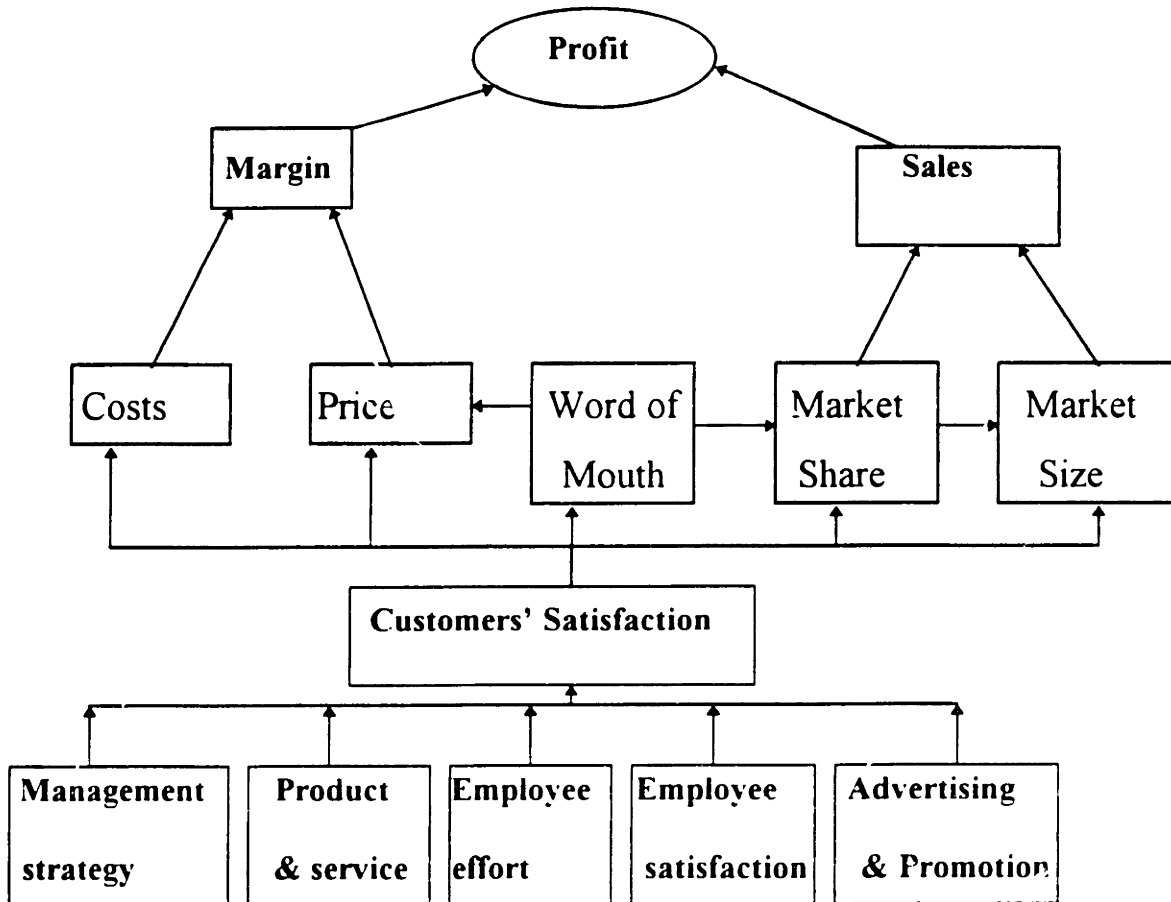
The Legislative Yuan and other related regulatory authorities are now exploring the appropriate market and legal frameworks for more sophisticated markets and products. It is the government's expectation that by the completion of the Six-Year National Development Plan, Taiwan will achieve the status of a regionally important financial center.

5. In handling individual private accounts, the market would be much more like a "push" market rather than a "pull market". Most of the investors are not as aware of modern investment vehicles; therefore, the efforts of a marketing manager and the relationships between the bank staff members and clients become very crucial to the business. It seems apparent that an educational function could be considered as one needed marketing tool.

5.3 CUSTOMER SATISFACTION

The satisfaction of all its customers is an important factor in a corporation's profits. How to measure customer satisfaction is illustrated in the following model (see Exhibit 5.1):

Exhibit 5.1



Source: Hauser, March 1995.

The model is based on the following premises:

1. Customer satisfaction is a multi-year issue - a firm (or its employees) takes actions today that affect purchasing behavior in the future.
2. Customer satisfaction is a competitive weapon (dissatisfied customers are more likely to purchase from competitors).
3. Customer satisfaction measures indicate future profit potential (more satisfied customers will buy more, buy more often, but at a higher price, and/or communicate to others).

Therefore, to build a profitable business, firms must satisfy customers better than the competition satisfies them. And in a bank, the customer's satisfaction is built on five pillars:

- Managerial Strategy,
- Product and Service Design,
- Employee Effort, and
- Employee Satisfaction.
- Advertising Promotion Distribution

1. Managerial Strategy

This is concerns the business extension (marketing), internal control (risk management), and human resource management. How should short-term incentives (sales) incentives and long-term incentives (satisfaction) be balanced? Incentive systems which tie promotions, compensation, and other rewards to either quality or customer satisfaction are being embraced by many firms in a variety of industries, including banking.

In a highly competitive market, a firm could be led into bankruptcy if risk management is not carefully controlled, such as the case of Barings Bank which happened in March 1995.

Changes in banking industry are continuous, and this concept is already known to every international bank. However, the idea is relatively new to local Taiwanese banks due to government protection over the last two decades. And like a block of marble from which the chisel has only half begun to show the statue, the future form of banking in Taiwan is only now beginning to reveal itself.

A review of four major factors that should be part of a bank's managerial strategies are discussed as follows.

- The first is changing the bank's production methods due to the extremely rapid evolution and application of new technologies to most areas of finance. Of all the underlying reasons causing the transformation of the banking universe, this factor looms largest, carrying with it the most far-reaching changes and affecting the entire provision of banking services. Banks with the ability and the means to adapt will be tomorrow's winners.

- The second factor concerns competition. Developments in technology are critical, but they will not alone shape the destiny of banks for the rest of the century. Even before its spectacular intensification, technology had transformed the traditional domain of banking by adding the private individuals' banking business to the great historical market of intermediation and by modifying the traditional relationships of banks with sovereign borrowers. The nature and intensity of competition has become at least as important as technical progress in shaping the loan business, the corporate banking market, the private

individual banking business, and the securities and money market businesses. Moreover, competition and technology are linked, because it is virtually impossible to compete effectively in any of the sectors mentioned above without access to sophisticated technology.

- Deregulation, the third factor, marks the end of an age when banks were kept under close surveillance by public authorities purely because they managed and had the power to create currency. This historical situation explains the distinctions between several types of banks as well as the separation of banks and financial institutions. Deregulation has a lot more to do with technological advances than with ideology. Certainly, new products can be created today which could not have been created yesterday. But there are two sides to this coin, and the other side contains the additional responsibilities banks have acquired -- which in time generate their own regulations -- and new controls, on a global dimension, arising from the new risks of internationalization.

- The fourth factor is the difficult question of human adaptation to the acceleration of technical, commercial, and regulatory changes. Techniques may change but people remain much more bound to their origins, their training, and their history. Technical changes might be introduced fairly easily, with firms adapting gradually to cope with technical progress; but no organization, however well managed, will be able to reorient human behavior and mentalities so quickly, or so smoothly. Barriers of age, training, methods of activity, and remuneration can weaken capacity to act and seize opportunities. High mobility becomes a norm in the banking industry including Taiwan. Aggressive staff members will make themselves more attractive to the external market instead of showing loyalty to the internal firm.

Human resource management has therefore become at least as crucial as that of technology. The two are in fact intimately linked. The efficiency of tomorrow's bank will depend on its capacity to mobilize and unite the complex groups of people required by the development of technical, commercial and institutional constraints. These people must therefore be given a plan, that is, a strategy.

2. Product & Service Design

Differentiation enables a bank to respond to strategic constraints over time by being able to offer a range of products which lends the bank earnings stability. Global banks tend to monopolize a growing share of activities in the markets where they operate. The advantage of larger economies of scale and network lead them to play the role of world operators. These operations, so-called "off-balance-sheet" transactions, are in the process of being partly reintegrated into the capitalization ratio by the central banks of the major financial centers - and they are critically dependent on highly reliable advanced technology. And in personal banking, individual needs for financial products and related items (leisure activities, insurance) will become even more extended worldwide over the next ten years. Hence, the two principal market segments (large corporate accounts and individuals) and products (such as credit cards, swaps, etc.) are growing at an exponential rate around the world. Banks need a highly specialized internal information-gathering and processing system.

Technology, as we have seen, both modifies existing product costs and also helps create new products. Not only has it modified the cost of handling private individuals, but it has changed the very nature of these costs. The need for a bank manager to assess a customer's creditworthiness individually has been replaced by systems which contain all the relevant information required to reach a credit decision,

via a process which is largely statistical. In this way the information/technology duplex fundamentally calls into question branch networks and the ways in which they function.

The principal banking products revolutionized by technology are the money-market products. To create an arbitrage, a trader who trades between these products has real-time price feeds, a knowledge of what is happening throughout the world, and is able to benefit from minute market price differences by analyzing the prices and other information using on-line systems.

Depending on the technological choices made, two categories of large network banks will come to coexist :

- those having made the right choices, will attract the consumers and companies to whom they will offer products and services at competitive prices, owing to the economies of scale and consequently with lower processing and marketing costs;
- those that have backed away from the transformation in structures and in people, the high investment costs, and the complexity inherent in highly sophisticated integrated systems.

As a result, the banking system characterized by this dual structure will undergo further concentration as the weak are eventually bought out by the strong.

3. Employee Effort

As analyzed in the customer interview section, the atmosphere in the Taiwan financial market is much more like a "push market" rather than a "pull market" due to the awareness and attitudes of customers toward new financial vehicles. Language

barriers and lack of experience are major obstacles preventing both corporate and individual investors from getting into the foreign markets. Ongoing effort and personal patience will make the new marketing approaches more successful than other channels of distribution.

Choosing the right level of service and the right product for long-term profits is a difficult and demanding management challenge. Saying "no" to the customer who does not need a particular product requires a level of wisdom and political grace which every marketing manager should learn. But employees, even managerial employees, are more short-term oriented than the firm would like. Individuals, to a much greater extent than the firm, tend to discount the future. In fact, a short-term view makes sense for managers and employees because there are no guarantees that they will be around long enough to collect long-term rewards. To overcome this short-term perspective, a firm can reward its employee today for benefits that the firm will reap tomorrow -- the reward is based on customer satisfaction. However, for such rewards to work, the satisfaction measures must indicate future sales potential and must depend upon actions taken by managers or employees. The firm is most profitable when it balances rewards for satisfaction with rewards for sales. The employees' efforts would be maximized only if the benchmarks of the rewards are clearly guided.

4. Employee Satisfaction

Interviews were conducted with ten employees employed by local banks,⁷ and the results of those interviews found that almost all the employees defined banking as their life-long careers. Traditionally, jobs in banks were relatively attractive to young people in developing countries such as Taiwan ten years ago.

7. The local banks included Hua Nan Commercial Bank, First Commercial Bank, Chang Hwa Commercial Bank, Bank of Taiwan, Cooperative Bank of Taiwan, and China Trust in Taipei.

The promotion and evaluation system are based on seniority and error-free judgments. Performance was not necessarily a factor to be considered. Basically, these employees have worked in a very stable and ethical environment. Therefore, it was not as important for them to have a forward vision for the next ten years because their jobs were fixed and secured.

Salaries and positions are determined by the bank no matter how different an employee is. Policies of no lay-offs, as well as no individual incentives, were the norm for most local banks over the past decade. In 1991, when new local banks began operating, some senior managers left their old banks to take positions with the new banks. However, their careers are still long-term based.

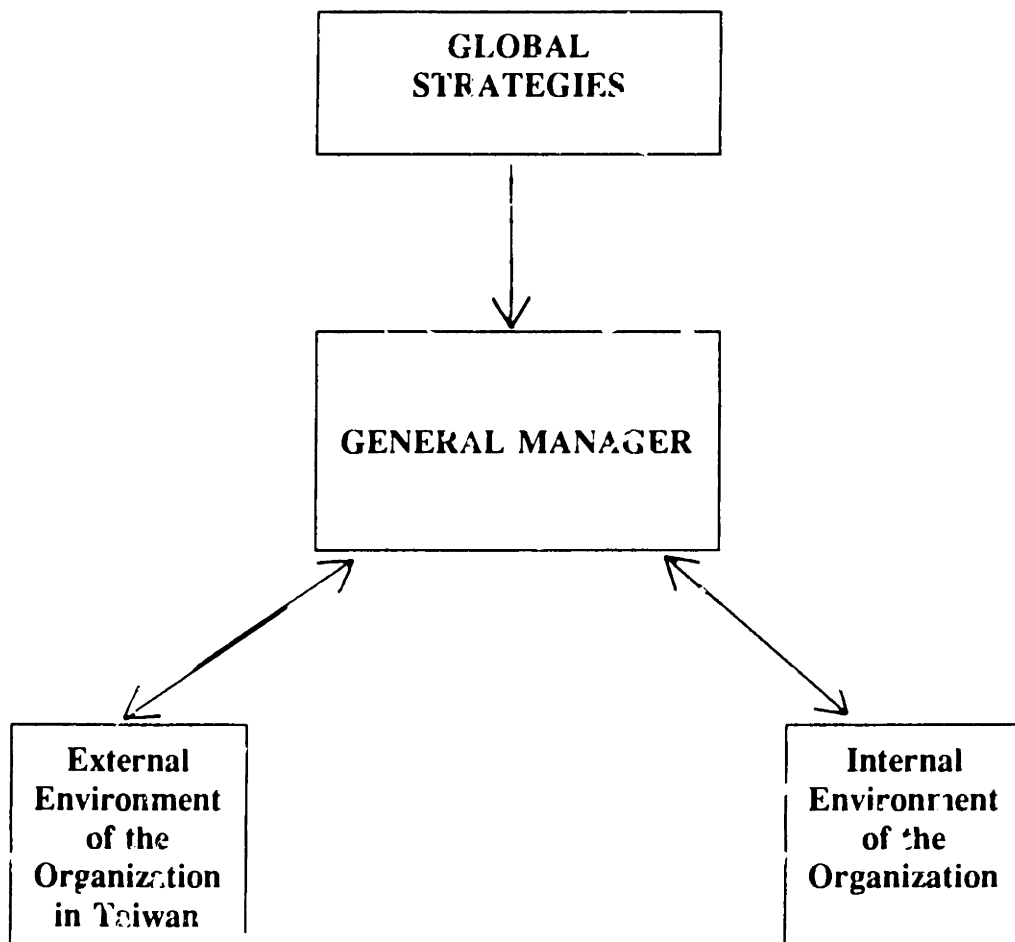
However, for those who work for foreign banks in Taiwan, the standards are totally different. In the global banking environment, change is the only constant. Hence, employees' jobs are not assured. Seniority is not the only scale for promotion; instead salary is fully based on individual performance, and loyalty alone is not measured as a performance factor. This tense competitive environment forces employees to keep alert to internal organizational developments and the external manpower market.

In such a highly competitive market the role of opportunism and the imposition on companies of short-term financial horizons have already been noted. These effects reinforce the effects of competitive managerial markets in ways adverse to innovation. Short-term financial horizons make it difficult for most companies to offer credible life-time employment to managers. Thus the manager's strategy is to make himself attractive to the external market. In particular, Marketing managers will be more focused on their solid customer base and managers are less willing to work in companies where their professional identity is blurred, instead preferring companies with clear occupational differentiations. They will also have less

incentive to invest personal resources in teamwork, or in acquiring a holistic viewpoint of the company, since these are company-specific skills.

The "principal-agent"⁸ problem is exposed more often than ever before because of the degree of market competition. It becomes a challenge for general managers of firms. The challenge for them is to meet employee satisfaction first which then brings greater customer satisfaction, and generates further profits.

Figure 5.2
General Manager's Functions or Roles in Taiwan



-
8. The "principal-agent" problem is an emotional conflict that exists between the Country Managers and local managers. The Country Manager assigned by the Head Office of foreign firms. He is the general manager responsible for all the marketing and operating affairs. His instructions are based on the corporate strategy from the Head Office. However, local managers sometimes want to manage their business their own way because they feel they are more familiar with the local market. The conflict varies depending on the degree of decentralization.

5. Advertising Promotion Distribution

Banks may utilize different marketing methods to target different market segments. In the retail banking area, where customers are already aware of the products, a bank may use the channel of advertising. However, in Corporate Banking and Individual Private Banking, where the pricing and long-term relationships are more focused, personal selling would be more effective.

CHAPTER SIX

MARKETING STRATEGY

6.1 INTRODUCTION

In this chapter, I will discuss the marketing strategy of a Strategic Business Unit (SBU) in the banking industry in Taiwan. The SBU is defined as having an external marketing and competitors' orientation; therefore, there is a clear congruency between the focus of attention of business and marketing strategies. The marketing strategy includes three functions of bank activities (Porter, 1985):

1. Outbound Logistics - Distributing the finished products. In the banking industry, the products are highly sensitive to distribution timing because the financial market situations and opportunities are always changeable and unpredictable. Efficiency in distributing newly developed products may diminish other competitors' threats to some extent.
2. Marketing and Sales - Induce and facilitate buyers to purchase the products (e.g., advertising, sales force, price quotes, channel selection, channel relations, and pricing).
3. Services - Maintain or enhance the value of the product after a sale (e.g., customer's education, customer's routine contacts, and provide market information). Service will directly influence the customer's satisfaction today, and influence the customer's buying decision tomorrow. Only a satisfied customer will be a profitable customer.

6.2 IDENTIFICATION OF OPPORTUNITIES AND THREATS

Internal Scrutiny at the Business Level

The internal scrutiny of an individual bank's business in Taiwan can be characterized by the following major strengths and weaknesses.

KEY OPPORTUNITIES

Economic Overview

- Stable growth of foreign investment in infrastructure
 - High growth of Taiwan economy for past years accumulated significant amount of private savings
 - Low interest rate policy in Taiwan decreased the interest gap between New Taiwan Dollars and foreign currencies
 - Continuous growth of other Asian countries created more attractive investment opportunities
 - Slower growth of Taiwan economy because many industries became mature and offshore investments began to look more attractive than domestic investments
-

Primary Industrial Sectors:

- Increase of financial firms leads to increase customers' awareness about investment vehicles
- Deregulation of banking laws encouraged a more dynamic market

Technological Trends:

- Increasing need for value-added banking services
- Development of derivative markets worldwide
- Development of information system within the network

Supply of Human Resources:

- Increasing supply of knowledgeable people

Political Factors:

- Strong demand for foreign investments to diversify personal assets
- Triangle trading moved Taiwan's capital to mainland China. Hedging and risk management became crucial for Taiwan manufacturers

Social Factors:

- Increasing risk tolerance in Taiwan society due to accumulation of personal wealth
 - Increasing concern for global environment
-

KEY THREATS

- Economic Overview:
- Slowdown of Taiwan's economic growth
 - High appreciation of New Taiwan Dollars could erode the performance of foreign investment
 - High fluctuation of international market increase the risk and uncertainty for investments
-

- Primary Industrial Sector:
- More competitors joined the market and a price war could ensue
 - Customers became more like transaction buyers rather than relationship buyers
 - Profit margin became very thin
 - Very difficult to sustain competencies
-

- Technological Trends
- Easy to copy another company's new product
 - Difficult to sustain differentiation between products and services
 - Lower cost for improvements in information systems decreased the entry barriers for new financial firms
-

- Supply of Human Resources:
- Low loyalty among all marketing staff due to increasingly available number of employers
 - Higher turnover rate in employees
-

6.3 RECOMMENDATIONS FOR A STRONG MARKETING PLAN

The financial services industry can be seen both as a single market for rather similar products and services, and as a number of relatively autonomous sectors each with a specific history, products, institutions, and official regulation. Developments in the 1980s have significantly narrowed earlier differences in product and institutional structures, and various financial services have become much closer substitutes for each other. Financial institutions have become exposed to new forms of competition as traditional lines of demarcation have become increasingly blurred.

Given this broader scope for competition, it has become particularly important for banks to re-assess their overall business strategies to be able to meet the shifting demands of their clients and to seek new profitable business opportunities. Below are some specific recommendations for a marketing strategy for today's competitive banking industry.

1. Long-term relationships instead of short-term transaction based relationships

To sustain its position in the coming competitive market, a bank needs to maintain long-term partnerships with its clients. The key to a long-term partnership lies in the level of trust shared by all parties involved. Some foreign banks already have a reputation for withdrawing their credit facilities when a customer experiences some financial difficulty. Such actions have hurt the reputation of those banks but have also revealed great opportunities for new banks. A bank's commitment to maintaining its relationships should be stronger than ever before.

2. Quality combined with sophisticated product innovation

The growing complexities of today's global markets pose increasing challenges for professional financial management. To be a "Market Maker" will create a competitive advantage for international banks in competing with other financial institutions. The bank's global approach to financial management, commitment to financial innovation, and strict adherence to the highest standards of quality are very important.

3. Continue geographical expansion through mergers and acquisitions to attain economies of scale

For newly established local banks, where it is more difficult to compete with international banks, geographical expansion through mergers and acquisitions may be easier for helping them to find a niche. The narrowing spread between deposits and loans in the traditional banking business has become a trend which can erode much of the banks' profit. Management costs, marketing, and product innovation have to be reduced either by economies of scale or by internal controls. The rationale behind such strategies is that as banking investment and insurance businesses focus on a common clientele, providers of such services can profitably share the advantages of integrated marketing and distribution networks and the natural complementarities between different services.

4. Use appropriate pricing strategy to select customers

Maintaining long-term relationships with customers requires quality management and time from the banks. Different pricing strategies may be applied for different purposes, for example:

- a. *A High Pricing Strategy* to skim market segments:
Taiwan's market was characterized by predominantly family-owned, highly leveraged, entrepreneurial, middle market business operating in various industries. Based upon customers' credit standings and profitability to the banks, we may divide the market into three tiers: first, second, and the third. The first tier customers represent either sound financial credit standing or high profitability to the bank. They are the typical targets of the banks. For the second- and third-tier customers in the industry, a strategy of walking away was formed. A high pricing strategy should be taken to skim this market segment, to increase return, and to accelerate phasing out the weakest accounts.
- b. *A Low Pricing Strategy* to penetrate new market segments:
Markets can be segmented by locations, industries, and risk tolerances. To approach new customers, the banks may adopt the low pricing strategy to decrease threats from other competitors during the beginning of phase of building relationships. The low pricing strategy can be applied to take major market shares so as to establish high brand recognition.

The above two strategies may be applied to the same customer in different products so that the mix of the strategies could blur the customer's attention when he is trying to compare price of all the competitors in the market. For example, the bank may use high pricing in foreign exchange transactions, but use low pricing in offering loans.

5. Select talented professional people to handle classified accounts and provide them with adequate motivation and reward

The classification of a customer's credit, profitability, and potential is designed to highlight problem credits and profit returns for attention and action at all appropriate levels and to ensure corrective measures to reduce the bank's risk and increase its profit. In view of the increasing competition in the Taiwan market and the high fluctuation in the global financial market, the more experienced or self-motivated people should be assigned to handle the targeted customers. To cope with their heavy workload and severe pressure, appropriate motivation and reward systems should be in place to meet employee satisfaction. The satisfied employee will provide quality services to meet customer's satisfaction.

BIBLIOGRAPHY

Bund, B.E., Class Notes for "Marketing Strategy" Course, Fall 1994, Sloan School of Management, MIT.

Business, Taiwan, "The ROC Rounded Out the First Dozen," April 8-14, 1991

Central Bank of China Act, promulgated by the Nationalist Government on May 23, 1935, as amended.

Deutsche Bank Group", Harvard Business School, Case Study
No. 9-290-036, April 1991.

Financial Market Trend Journal, Winter 1994.

Fortune, "Go Where the Money " March 1994.

Globe & Mail, "U.S. Federal Debt," October 2, 1990.

Goodpaster, K.E., "Some Avenues for Ethical Analysis in General Management,"
Harvard Business School, No. 383-007, Harvard University, Cambridge, 1982.

Hauser, J., "Are Customer Satisfaction Programs Profitable?," ICRMOT Working
paper, MIT, Cambridge, February 1995.

Hax, A.C., and Majluf, N., *The Strategy Concept and Process - A Pragmatic
Approach*. Englewood Cliffs, NJ: Prentice-Hall, 1991.

Hax, A.C., "A New Competitive Weapon: The Human Resources Strategy," *Training
and Development Journal*, Vol. 39, No. 5, May 1985, pp. 76-82.

Lin, C.S., "The Development of Banking Industry in Taiwan," *Industry of Free
China*, March 1993.

MBA Career Guide (The), Spring 1995.

Ministry of Finance, Government Finance of the Republic of China, Taipei, Taiwan,
April 1991, p. 62.

OECD, "Financial Market Trend," December 1993.

Porter, M.E. *Competitive Advantage: Creating and Sustaining Superior
Performance*. New York: The Free Press, 1985.

- Redman, T.C., "Opinion: Improve Data Quality for Competitive Advantage," *Sloan Management Review*, Winter 1995.
- Semkow, B.W., "Taiwan's Financial Markets and Institutions, The Legal and Financial Issues of Deregulation and Internationalization", 1993.
- Shieh, S.C., "Financial Liberalization and Internationalization : The Development of Taipei as a Regional Financial Center in Asia," *Industry of Free China*, June 1992 .
- Shieh, S.C., "Capital Mobility and Exchange-Rate Movements, and Their Effects on the Conduct of Monetary Policy - Taiwan's Experience (1986-July 1993)," *Industry of Free China*, November, 1993.
- Shonfield. A., "Organized Private Enterprise: Germany," in *Modern Capitalism*, p. 242.
- Simester, D.I., and Wernerfelt, B., "Customer Satisfaction-Based Incentive Systems," ICRMOT Working paper, MIT, Cambridge, February 1994.
- Taiwan Statistical Data Book, 1991*, Council for Economic Planning and Development, Taiwan, ROC, July 1991, p. 56.
- Taiwan Banking Law, Article 134.