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KARYA AKHIR

# MARKET ENTRY STRATEGY TO INTERNATIONAL MARKET THROUGH OPENING AN OVERSEAS OFFICE IN DUBAI, UNITED ARAB EMIRATES (UAE): A CASE STUDY OF BANK XYZ

Diajukan Oleh :

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hereby declare as follows :

1. The title of the thesis :

   **Market Entry Strategy to International Market through Opening an Overseas Office in Dubai, United Arab Emirates (UAE): A Case Study of Bank XYZ**

   Related research for this thesis is of my own effort/study/piece of work.

2. Every idea or quotation from other people's work in forms of publication or other forms in this thesis has been admitted in accordance to the standard of reference procedure in the Master of Management Program Faculty of Economics, University of Indonesia.

3. I also declare that this thesis was written by full guidance and support from my advising supervisor **Dr. Firmanzah.**

If one day there was evidence that showed academic deception done by me, then my academic degree which I have already obtained could be taken away according to the regulation of Master of Management Program, Faculty of Economics University of Indonesia.

Jakarta, 26 January 2008

**(Muslim)**

## PREFACE

Thanks to God where I finally can finalize this final paper. This paper is mainly intended to enlarge the horizon of writer and reader knowledge pertaining to the entry strategy of Bank XYZ to Dubai, United Arab Emirates as part of its strategy to enlarge its international network and to support its vision to be a regional champion bank.

In writing this paper, I received much help and supports from several parties. I would like to express my sincere appreciation to Dr.Firmanzah as my advisor in writing this paper, who allowed some of his busy time to supervise the writer with cozy consultation and advice.

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I realize that there are still many limitations and shortages in this final paper. Hence, I do really appreciate for any constructive critics and recommendation to make this final paper better. Finally, I hope this final paper can contribute mutual benefit to me, Bank XYZ and readers.

Jakarta, 26 January 2008

**Muslim**

# ABSTRACT

Bank XYZ has a plan to open an overseas office in Dubai, United Arab Emirates (UAE) in the future according to the management of Bank XYZ's explanation in national newspapers a couple months ago. This paper research purposes is trying to analyze the suitable type of market entry strategy to UAE market in terms of suitable type of office structure to be opened subject to its internal factors, external environment factors, the cost and benefit and the risk of opening the overseas office. The data used in this paper is obtained from Bank XYZ annual report year 2005 and 2006 including the audited financial statement year ended December 31, 2006 and 2005 and some other relevant sources. The result of analysis over the market entry strategy of Bank XYZ in UAE market through opening an overseas office in Dubai, UAE could be done by establishing a branch office. In addition to the establishing of a branch, Bank XYZ has found it worthwhile in terms of money as it financially feasible based on analysis over its internal factors, external environment, cost and benefit calculation and the risk embedded over the decision as well.

Keywords: Market entry strategy, internal factors, external environment factors, cost and benefit and risk analysis.

# EXECUTIVE SUMMARY


Vision of Bank XYZ to be a Regional Champion Bank is in line with the concept of Indonesian Banking Landscape (Arsitektur Perbankan Indonesia (API)) that formulated by Bank of Indonesia in terms of its operational scope of area that is to be an International bank. In order to realize that vision, Bank XYZ has designed 3 (three) phases of transformation which are classified into Phase I (2000-2004) to be Universal Bank, Phase II (2005-2009) to be a Domestic Dominant Bank and Phase III (2009 and so on) to be a Regional Champion Bank

One of the efforts to realize that vision is through enlarges its international business network by opening overseas office in Dubai, United Arab Emirates (UAE). However, there are some factors in UAE market that must be considered by Bank XYZ before opening the overseas office in Dubai such as very fierce competitive environment of UAE market, limitation of banking services in UAE market that limit all foreign bank to serve only corporate banking, cost and benefit of opening an overseas office in Dubai and selection of market entry strategy to UAE market especially selection of suitable type of office.

Upon the above conditions, this final paper tries to answer the question whether it is feasible to open an overseas office in Dubai, UAE, through analysis of relevant internal factors such as corporate objectives, internal resources, assets and capabilities, and need for control. The external environments are also considered to be analyzed such as competitive environment, market size and growth, country risk and local infrastructures in Dubai, UAE. The last and important thing are also the cost and benefit calculation analysis and the risk analysis over the opening overseas office in Dubai.. Through the analysis of those factors, this paper will suggest the suitable mode of entry strategy could be used to enter UAE market.

This final paper has four objectives, first, to provide a comprehensive picture of some alternatives of market entry strategy that could be adopted by Bank XYZ in expanding its business to international market, especially in Dubai, UAE. Second is to understand the major factors comprise internal and external factors that influence the selection of market entry strategy and its correlation with Bank XYZ objectives in international market. Third is to analyze the cost and benefit of the opening of overseas office in Dubai (UAE) and finally the risk analysis over the type of office structure selected to be established.

This final paper also suggest some recommendations in order to support the vision of Bank XYZ to be a regional champion bank such as how to minimize the risk embedded in opening of overseas office in Dubai, UAE. For instance, Bank XYZ initially can use a market entry strategy that require a low commitment such as establishing a Rep Office to consider the high competitive environment of the market then evaluate in a regular basis over the overseas office performance in order to assess whether Bank XYZ could increase their commitment in UAE market or not, by changing the status of the office become branch or subsidiary.

The analyses are only conducted over the UAE market in which the selection of the UAE market is mainly due to its strategic location and its role as a hub of business in the region of Middle East, Europe and North Africa.

This final paper analyses have revealed that Bank XYZ to open an overseas office in the form of Branch Office in Dubai, UAE is feasible. This conclusion is strongly supported by its internal factors such as corporate objectives, international experience and a high commitment of Bank XYZ to enlarge its international business network. In addition to its internal factors, the external environments factors are also favorable over the action such as the adequate market size and growth, sound local culture and sophisticated local infrastructures. Finally, in terms of cost and benefit calculation and the risk analysis, the opening of overseas office in UAE market is feasible.

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# Chapter I

# INTRODUCTION

## 1.1. Background

The vision of Indonesian banking industry in the future as stipulated in the Indonesian Banking Landscape (API) issued by Bank of Indonesia (BI) has created a significant impact on the competition level of banking industry in Indonesia. In its blue print of Future Indonesian Banking Structure, BI has designed and classified Indonesian banking industry into 4 (four) categories consists of (1) International bank, (2) National bank, (3) Bank in certain focus of business activity and (4) Bank with limited business activity. These classifications are determined based on the total capital of a bank. This API has encouraged many domestic banks to do consolidation among them in order to meet the minimum requirement of capital balance of each category of API.

Bank XYZ, as one of the biggest banks in Indonesia and categorized as a national bank in accordance with the above categories, is really want to be the first Indonesian Bank that categorized as an International Bank and put this target as its big challenge to be realized in the future. In accordance to API, to be categorized as an international bank, Bank XYZ must have a minimum required capital of Rp 50 trillion, or more than twice of Bank XYZ current capital. In order to satisfy its target to be the first Indonesian International Bank, Bank XYZ has set target to firstly dominate the domestic market with various banking products and services before start to enter international market and reach a higher category as an International Bank with recognition as one of the prominent bank in regional area.

In order to achieve the above objective, one of Bank XYZ strategy is through opening overseas offices. Currently, Bank XYZ has 6 (six) overseas offices operated in Singapore, Hong Kong, Shanghai, Dili, Cayman Island and London. In order to speed up its international network establishment and to be recognized as one of the prominent bank in regional area, Bank XYZ considered necessary to open another overseas office in other region area of the world, such as an overseas office in Dubai United Arab Emirates (UAE) as explained by its Executive Vice President and Chief Executive Officer on Republika Newspaper on August 6, 2007.

This thesis is trying to analyze and evaluate the feasibility of Bank XYZ strategy to open an overseas office in Dubai and analyze the suitable type of office structure to be established in Dubai (UAE).

## 1.2. Identification and Limitation of the Problem

Based on the above background, problem to be identified and solved are described by several questions such as follows:

1. What type of overseas office to be established by Bank XYZ in Dubai, such as Representative Office, Branch Office, and Joint Venture with local bank or Subsidiary?
2. What are the determinant factors that must be considered in assessing the market entry strategy? What kind of limitation encountered by Bank XYZ in its effort to expand its business in overseas especially by opening its overseas office in Dubai? What kinds of effort to be conducted by Bank XYZ to overcome those limitations?
3. What cost and benefit of the opening of an overseas office in Dubai?
4. What is the risk embedded over the selection of type of office structure established in Dubai, UAE?

## 1.3. Objective of the Final Paper

The objective of this thesis, based on the above identification and limitation of the problem, are:

- To provide analyses over several alternatives of market entry strategy that could be adopted by Bank XYZ in expanding its business to International market, especially in Dubai (UAE)
- To understand the major factors including internal factors and external environment factors that relevant to the selection of market entry strategy and its correlation with Bank XYZ objectives in international market.
- To analyze the cost and benefit of the opening of an overseas office in Dubai (UAE).
- To analyze the risk embedded to the selected type of office structure to be established in Dubai, UAE.

### 1.4. Methodology of Research:

This thesis is written using a problem solving analysis in which the problem solving is concentrated on the actual problem that encountered by Bank XYZ, and support the analysis by all related and relevant data and information gathered. All data and information are then analyzed and concluded.

Information and data of this thesis consist of primary data and secondary data. The primary data will be obtained from related officer in Bank XYZ through interview. Meanwhile, secondary data will be obtained from several available sources of reference and literatures such as articles from magazine, newspapers, bulletin, internet website, and several books from library that relevant to this topic.

### 1.5. Framework of the Paper Writing

Chapter I. Describe the background, identification and limitation of the problem, objectives of the final paper, methodology of research, and framework of the final paper.

Chapter II. Describe the background of theory over international banking, motives of international banking, identification of market entry strategy, internal factors criteria for entry strategy, external environment factors criteria for entry strategy, and the strengths, weaknesses, opportunities and threats (SWOT) analysis and structure of overseas office.

Chapter III. Describe the Bank XYZ profile, its vision to be a Regional Champion Bank and its international banking performance as the object of this final paper. In addition to Bank XYZ profile, this thesis will describe the information about United Arab Emirates (UAE) and Dubai mainly the Dubai International Financial Centers (DIFC) including explanation about the rules and regulation, and the competition level in UAE banking industry.

Chapter IV. Describe the analysis of market entry strategy to international market through opening an overseas offices in Dubai by Bank XYZ.

Describe the analysis of internal factors criteria and external environment factors criteria in developing a mode of market entry strategy of Bank XYZ to UAE market and its correlation with Bank XYZ objectives in international market especially in Dubai, UAE market.

Describe the analysis of cost and benefit of the opening of an overseas office in Dubai.

Describe the risk analysis over some of office structure such as branch, rep office and subsidiary

Describe the timing of entry to UAE market

Describe the selection of mode of entry strategy

Chapter V. Describe the conclusion and recommendation of this final paper.

# Chapter II

# BACKGROUND OF THEORY

## 2.1. International Banking

International banking is a very famous in recent years. Technology advancement, mainly in telecommunication sector has caused the business activities move very fast over the countries borderlines. Movement of funds from one country to another is quite fast as fast as send a message through an electronic mail. Information about condition of economic, market and politic of other countries are easy to be accessed and obtained. These technology developments have provided investor with a lot of information that can be used in decision making such as investment decision to other countries effectively. In addition to the investor activities, international banking activities are also increase and needed to support the investors' business and become more sophisticated as well.

International banking activities generally can be classified into three categories including (Latumaerissa, 1995):

- International Trade Activities

  International Banking services are needed to support transaction of payment or collection due to international trade activities and make them well manages. The roles of international banking become wider as it could be functioned as an underwriter and provide financing for international trade.

- Investment/loan Activities

  International banking becomes sources of financial facility to investors to support their investment activity in foreign countries.

- Foreign Exchange Market Activities

  International banking could conduct a foreign exchange trading. In Indonesia, the banks that authorized to do a foreign exchange trading activity are called as Foreign Exchange Bank *(Bank Devisa)*.

## 2.2. Motives of International Banking

Companies around the world are mostly pursuing international markets because of the opportunities over its growth and profits. According to Philip Kottler, 1997 and other several researchers, the international banking activity are driven by some common driven factors that underlying the reason of internationalization in banking industry such as among others closeness to customers, reaction over competitor's action, market expansion, searching for cheaper capital and diversification of financial risk.

**a) Closeness to Customers**

Establish and maintain closeness relationship with customers in consistent basis is a must in current banking industry. This closeness will encourage a beneficial relationship to each other in which a bank will follow their customer wherever they go, including their expansion activity to international market to serve them in banking service activity. Banking service will be provided in the same quality to the customers both in domestic market and international market.

**b) Reaction over competitor's action**

This factor is common in order to maintain a bank image before all of its customers and represents a specific characteristics of industry in which the players is not so many and tend to make an oligopoly market. Reaction of one bank to do same action as its competitors doing in expansion activity to international market is common in banking industry. These cases are commonly happened in several countries such as Spain, French and Italy.

**c) Market Expansion**

The other reason of a bank to conduct an international market expansion is mostly due to strict monetary rules and regulation in host country which impact on reduction of bank ability to grow steadily. In addition to the above reason, other factors are quite important for bank's expansion to other country such as technology advantage over the local bank and the lower level of competition in target country. The argumentations of these phenomena are proved when the American Bank entered into market of Latin America, England, and Spain. The impacts of those bank market expansions was the level of competition in the local market become fierce. The international bank will become the agent of change in the local market due to its offer new products and service innovations.

**d) Searching for Cheaper Capital**

Globalization offer opportunity to arbitrage and access to financial resources with lowest price in every market all over the world and available every time. In the same time, the advancement of information technology has provided investor with adequate information to invest in a country that gives the highest return on investment (ROI). It quite clear that international bank has more capacity to react fast and efficiently compare to the local bank.

**e) Diversification of Risk**

Foreign exchange risk can be diversified through investment of financial resources into foreign currency. This action can be used to prevent a decline in interest income at certain point in business cycle. An international bank, due to its broad coverage area of operation in the world, has more opportunity to gain some benefit from its business compare to local bank.

## 2.3. Identification of Market Entry Strategy

Several decisions criteria will influence the choice of entry mode of firm to enter into an international market. The decision criteria can be divided into two classes of criteria consist of internal factors criteria and external environment factors criteria.

### 2.3.1 Internal Factors Criteria

Internal factors criteria are those factors that influence the entry strategy that come from the internal of Company. According to Kotabe and Helsen, 2004, the main internal factors that relevant to be considered in the market entry strategy decision are consisting of corporate objectives, cultural or psychic distance, need for control (authority level of making decision), internal resources, assets and capabilities (firm size and international experiences)

#### a) Corporate Objectives

Objectives is a complete set of long-term objectives to be achieved in business development and the set of priorities are setting on some factors such as (a) profitability, (b) customer service development, (c) country service developments. These objectives must be fully understood by all party in the company which describe in statistics, numbers and explanations through effective overall planning process.

In terms of entry modes selections, corporate objectives are key influences factor in choosing of entry modes. Firm with limited aspirations will typically prefer to an entry option that entails a minimum amount of commitment. Proactive companies with ambitious strategic objectives, on the other hand, will usually pick an entry mode that give them flexibility and control over the achievement of their objectives.

### b) Need for Control

Most firms would like to possess a certain amount of control over their overseas office operations. Control may be desirable for any element of the marketing mix plan such as positioning, pricing, advertising, the way the product is distributed and so forth. There are many of underlying reason for the level of control needed such as for instance in order to protect its proprietary know-how, the full control over the overseas office operation is required. In large degree, the level of control is strongly correlated with the amount of resource commitment, such as the smaller the commitment, the lower the control. So, most firms face a tradeoff between the degree of control over their overseas office operations and the level of resource commitment they are willing to take.

### c) Internal Resources, Assets and Capabilities

Firms with tight resources (human and financial resources) or limited assets are constrained to low-commitment entry modes such as exporting and licensing, which limited demanding to the resources. Even large companies should carefully consider how to allocate their resources between their different markets including the domestic market. In some cases, major resources commitments to a given target market might be premature given the amount of risk. On the other hand, if a firm is overly reluctant about committing resources, the firm might miss the boat by sacrificing major market opportunities. Internal competencies also influence the choice of entry strategy. When the firm, for instance, lacks of certain skill, that critical for the success of its global expansion strategy, the firm can try to fill the gap by forming a strategic alliance.

### d) Flexibility

An entry mode that looks very appealing today may not necessarily be attractive five or ten years down the road. The local environment changes constantly, new market emerge, local customer become more demanding or more price conscious, and local competitor become more sophisticated. To cope with these environmental changes, global players need a certain amount of flexibility. The flexibility offered by the different entry-mode alternatives varies a great deal. Given their very nature, contractual arrangements such as joint venture or licensing tend to provide very little flexibility. When major exit barriers exist, wholly owned subsidiaries are hard to divest and therefore offer very little flexibility compared to other entry alternatives.

### 2.3.2. External Environments Criteria

Other important aspect that must be considered in market entry strategy is the environment aspect of the target country. According to Kotabe and Helsen, 2004, the external environment factors that relevant to the market entry strategy decision are including competitive environment, government regulation, market size and growth, country risk, and local infrastructures.

#### a) Market Size and Growth

In many instances, the key determinant of entry choice decisions is the size of the market. Large markets justify major resource commitments in the form of joint ventures or wholly owned subsidiaries. Market potential can be related to the current size of the market. However, future market potential as measured through the growth rate is often even more critical, especially when the target markets is an emerging market.

#### b) Country Risk

Risk factor is another major concern when choosing an entry mode. Risks relates to the instability in the political and economic environment that may impact the company's business prospects. Generally speaking, the greater the risk factors, the less eager companies are to make major resource commitments to the country or region concerned. Evidently, the level of country risk changes over time. For instance, the peace processes in the Middle East and the abolishment of the apartheid regime in the South Africa have lured many MNCs to this region. Many companies opt to start their presence with a liaison office in the market that are high-risk but at the same time, look very appealing because of their size or growth potential.

It is important to carefully assess the political power structure and mood in a country before making decisions regarding business operations. By evaluating various environmental factors, as summarized at Exhibit 1, a firm can arrive at a more thorough understanding of the likelihood of various problems or opportunities in a country.

**Exhibit 1 Country Risk Rating Criteria**

| Index Area | Criteria |
|---|---|
| Political and Economic | Stability of the political system |
| Environment | Degree of control of economic system |
| | Constitutional guarantees |
| | Effectiveness of public administration |
| | Labor relation and social peace |
| | |
| Domestic Economic | Population size |
| Conditions | Per capita income |
| | Economic growth during previous 5 years |
| | Inflation during previous 2 years |
| | Accessability of domestic capital market to foreigners |
| | Availability of high-quality local labor |
| | Possibility of giving employment to foreign nationals |
| | Legal requirements for environment |
| | Traffic system and communication channels |
| | |
| External Economic | Restrictions imposed on imports |
| Relations | Restrictions imposed on exports |
| | Restrictions imposed on foreign investments in the country |
| | Legal protection for brands and products |
| | Restrictions imposed on monetery transfers |
| | Revaluations of currency during previous 5 years |
| | Drain on foreign fund through oil or other energy imports |
| | Restrictions on the exchange of local money into foreign currencies |

Masaaki Kotabe, Kristiaan Helsen, Global Marketing Management, 3rd Ed, 2004, pg.148, adopted from E. Dichtl and H.G. Koglmayr,"Country Risk Ratings, "Management International Review 26.No.4 (1986):6.

**Moody Country Risk Formula**

Moody's formula for country risk calculation represent the average risk of sovereign risk, currency risk and banking sector risk, (bankscope.bvdep.com, 2007).

- **Sovereign risk**, measures the risk of a build-up in arrears of principal and/or interest on foreign and/or local currency debt that is the direct obligation of the sovereign or guaranteed by the sovereign. The sovereign risk informed by scores for a combination of political, policy, cyclical and structural variables.
- **Currency risk**, measures the risk of devaluation against the reference currency (usually the US dollar, occasionally the Euro) of 25% or more in nominal terms over the next 12-month period. The currency risk rating is informed by scores for a combination of political, policy, cyclical and structural variables.
- **Banking sector risk** gauges the risk of a systematic crisis whereby bank(s) holding 10% or more of total bank assets become insolvent and unable to discharge their obligations to depositors and/or creditors. Banking crises are typically associated with payment difficulties in the corporate or household sectors; bursting of asset price bubbles; currency and/or maturity mismatches. The rating can therefore serve as a proxy for the risk of systemic crisis in the private sector. The banking sector risk rating is informed by scores for a combination of political, policy, cyclical, and structural variables.
- **Political risk**, evaluate a range of political factors relating to political stability and effectiveness that could affect a country's ability and/or commitment o service its debt obligations and/or cause turbulence in the foreign-exchange market. The political risk rating informs the ratings for sovereign risk, currency risk and banking sector risk.
- **Economic structure risk** is derived from a series of macroeconomic variables of structural rather than a cyclical nature. Consequently, the rating for economic structure risk will tend to be relatively stable, evolving in line with structural changes in the

economy. The economic structure risk rating informs the ratings for sovereign risk, currency risk and banking sector risk.

- **Overall country risk** is derived by taking a simple average of the scores for sovereign risk, currency risk and banking sector risk. Ratings are derived from scores as follows: 100–89 = D; 92-79=C; 82-69=CC; 72-59=CCC; 62-49=B; 52-39=BB; 42-29=BBB; 32-19=A; 22-9=AA; 12-0=AAA.

**c) Government Regulations**

Government regulation requirements are also a major consideration in choosing of entry mode. In scores of countries, government regulations heavily constrain the set of available options. Trade barriers of all different kinds restrict the entry choice decisions.

**d) Competitive Environment**

The nature of the competitive situation (industry environment) in the local market is another driver. The five force model of competition expands the arena for competitive analysis. Historically, when studying the competitive environment, firm concentrated on companies with which they competed directly. Research suggests that different geographic markets for the same product can have considerably different competitive conditions. Another tool to assess the competitive environment is using a SWOT analysis. SWOT is stand for Strength, Weaknesses, Opportunity and Threat.

**1) Five Force Model of Porter**

A key concept in Porter's five forces model (Porter, 1979) is the view that some industries are attractive and others as less attractive. The ability to identify industry attractiveness is therefore important and Porter argues that industries can be characterized and evaluated by looking at, and analyzing the following five forces model:

- Threat of New Entrants
- Bargaining Power of Suppliers
- Bargaining Power of Buyers
- Threat of Substitute Products
- Intensity of Rivalry among Competitors

**i. Threat of New Entrants**

Identifying new entrants is important because they can threaten the market share of existing competitors. One reason new entrants pose such a threat is that they bring additional production capacity. Unless the demand for a good or service is increasing, additional capacity hold consumer's cost down, resulting in less revenue and lower returns for competing firms.

Existing competitors try to develop barriers to entry. In contrast entrants seek markets in which the entry barriers are relatively insignificant. There are several kinds of potentially significant entry barriers:

- Economies of scale
- Product differentiations
- Capital requirements
- Switching cost
- Access to distribution channel
- Government policy.

**ii. Bargaining Power of Suppliers**

Supplier power is high when:

- There are few alternative sources of supply and there are many buyers
- A particular buyers is not an important customers to the suppliers

- The product or services supplied is an important input for the buyer
- There are no substitutes for the supplied product
- The supplied product has a good brand reputation, especially when this branding is so important to the final product.

### iii. Bargaining Power of Buyers

Buyers are powerful when the following conditions are exists:

- There are few buyers who purchase in large quantities
- Buyers have low switching costs
- Buyers have choices because there are many sellers
- The product or service supplied is not an important one
- The buyer has the ability to produce the product supplied (backward integrations).

### iv. Threat of Substitute Products

Substitute products are goods or services from outside a given industry that perform similar or the same functions as a product that the industry produces. In general, product substitutes present a strong threat to a firm when customers face few, if any, switching cost and when the substitute product's price is lower or its quality and performance capabilities are equal to or greater than those of the competing product. Differentiating a product along dimensions that customer's value (such as price, quality, service after sale, and location) reduces a substitute's attractiveness.

### v. Intensity of Rivalry among Competitors

In many industries, firms actively compete against one another, therefore action taken by one company usually invite competitive responses. Competitive rivalry intensifies when a firm is challenged by a competitor's actions or when a company recognizes an opportunity to improve its market positions. Firms within industries are rarely homogenous; they differ in resources and capabilities and seek to differentiate themselves from competitors. Visible dimensions on which rivalry is based include price, quality and innovations.

### 2) SWOT Analysis

One particularly useful technique in analyzing a firm's competitive position relative to its competitors is referred to as SWOT (Strengths, Weaknesses, Opportunities and Threats) analysis. According to Kotabe and Helsen, 2004, a SWOT analysis divides the information into two main categories (internal and external factors) and then further into positive aspects (strengths and opportunities) and negative aspects (weaknesses and threats). The internal factors that may be viewed as strengths or weaknesses depend on their impact on the firm's positions, that is, they may represents a strength for one firm but a weakness in relative terms, for another. They include all of the marketing mix (product, price, promotion and distribution strategy), as well as personnel and finance. The external factors, which again may be threats to one firm and opportunities to another, include technological changes, legislation, socio-cultural changes and changes in the market place or competitive position.

SWOT is one aid to categorization, and is not the only technique. One drawback of SWOT is that it tends to persuade companies to compile lists rather than think about what is really important to their business. It also presents the resulting lists uncritically, without clear prioritization, so that, for example, weak opportunities may appear to balance strong threat. Furthermore, using the company's strengths against its competitor's weaknesses may work once or twice but not over several dynamic strategic interactions, as its approach becomes predictable and the competitors may begin to learn and outsmart it.

### e) Local Infrastructure

The physical infrastructure of a market refers to the countries distribution system, transportation network and communication system. In general, the poorer the local infrastructure, the more reluctant the company is to commit major resources. The local infrastructure is a vital aspect for any company that will expand its business to foreign countries.

## 2.4. Structure of Overseas Office

Once a bank has made a decision to establish an overseas operation, the next decision is how to structure it. According to Hughes and McDonald, 2002, a variety of organizational unit's structures are possible to be established in overseas market. The types of structure of the overseas structure are much depends on the strategy and commitment of the firm. The types of office structure could be as follows:

### a) Correspondent banking

The lowest possible level of exposure to the foreign market may be achieved through a correspondent banking relationships. Correspondent banking involves using a bank native to the foreign market to provide services for the foreign bank. Correspondents provide a range of services to banks located in other countries that do not have local offices, or whose local offices are prohibited from engaging in certain type of activities. This relationship allows the foreign bank to provide trade-related and foreign exchange services for its multinational customers in the foreign market without having to establish its own physical presence in the foreign market.

### b) Representative Office

The next level of exposure is a representative office (also referred as a rep office), in which the bank establishes a physical presence in the foreign market that has very limited functions. A rep office cannot provide traditional banking services. Its officers troll for business opportunities in the foreign market, but the office cannot accept deposits or lend fund on its own book. The rep office essentially serves as liaison and marketing function for the parent bank, which is not legally present in the host country with regard to legal or tax liability. Rep office are low budget and can easily closed down, making them useful vehicles for exploring a new, high risk market or it can be used in countries where authorities do not permit foreign bank to set up full services branches or subsidiaries.

### c) Branch Office

Opening up a branch usually indicates a higher level of commitment to the foreign market than the rep office. A branch is an integral part of the parent bank and it acts as a legal and functional arm of the head office. Branches may perform all banking functions that are permitted by the host country, including accepting deposits and extending loans (unlike a rep office). Indeed, the predominant activity of foreign bank branches is extending credit, usually on a wholesale rather than retail basis. The branch is not a separate legal or financial entity from the parent, implying that the "full faith and credit" of the parent stands behind its branches everywhere in the world. Branches are usually not separately capitalized from the parent.

### d) Agency

Like a branch, an agency is also an integral part of the parent bank. Agencies fall somewhere in between the branch and the rep office. They may perform more functions than a rep office, but they cannot perform all the functions of a branch. Agencies are used primarily for wholesale international commercial banking.

**e) Subsidiary**

A subsidiary is separate legally from the parent bank, organized under the laws and regulated by the authorities of the host country. It may engage in full banking activities as permitted by host country regulations. Banking subsidiaries may be established as a new organization, or through acquisition of an existing bank. The advantages of subsidiaries are it eliminates the major disadvantage of branch or agency-namely, potentially putting the entire capital of the parent bank on the line. The second advantage of subsidiary over branch is that it may offer a wider range of services. The primary disadvantage of a subsidiary is that it must be separately capitalized from the parent. This often requires a greater start-up investment than a branch, which relies on the parent's capital and borrowing power.

**f) Consortium Bank**

Bank may also join forces in entering new markets, in order to reduce the capital requirements and risks involved in new ventures. So-called consortium, which are nothing more than a group of banks forming a joint alliance to enter a new market were popular in the 1970s but have since fallen into disfavor. The parent institutions found it difficult to share power and clients in the joint venture, and most of consortiums have dissolved.

# Chapter III

# PROFILE of BANK XYZ and DUBAI (UAE)

This chapter will explain the profile of Bank XYZ as the main subject of this paper and Dubai, United Arab Emirates (UAE) as the target market. Bank XYZ profiles to be explained are especially comprises the brief history of its establishment, its vision to be a regional champion bank and its current international banking performance. Meanwhile, Dubai profiles are mainly concerned on its free zone area Dubai International Financial Centers (DIFC) where all foreign banks are domiciled and operated in UAE financial service market.

## 3.1. Bank XYZ

Bank XYZ is the biggest bank in Indonesia in terms of assets, credits and third party fund. Bank XYZ as one of national bank has a plan to enlarge its business network not only in domestic market but also in international market. In line with its vision to be a regional champion bank and play a major role in international market in the future, Bank XYZ has a plan to open an overseas office in Dubai, UAE as explained in one national newspaper in August 2007. Bank XYZ plan to open an overseas office in Dubai, UAE is very interesting due to Dubai, UAE aspect of demography, markets, economy, social and politic, country risk and its strategic location as a hub to other region such as Europe, North Africa and Middle East.

### 3.1.1. The Brief History of Bank XYZ

Bank XYZ was established on 2 October 1998 as part of bank restructurings program of Indonesian government. In July 1999, 4 (four) state-owned banks were amalgamated into Bank XYZ. On 14 July 2003, Government of Republic of Indonesia divested 20% of its shareholdings in Bank XYZ through an Initial Public Offering (IPO).

In April 2003, Bank XYZ issued a five-year USD 300 million of Medium Term Notes (MTN) listed on the Singapore Stock Exchange. On 11 March 2004, Government of Republic of Indonesia divested additional 10% if its shareholding in Bank XYZ through a secondary offering. This laid the foundation to the next phase of its transformation to become a regional champion bank.

Bank XYZ is the biggest bank in Indonesia in terms of assets, credit and third party fund. Bank XYZ total assets as of 31 December 2006 amounted to Rp 268 trillion (USD 29.8 billion) with market shares about 16.64% of total Indonesia banks assets (Rp 1,610.5 trillion). Total third parties fund in Bank XYZ amounting to Rp 213.8 (2005: Rp 213.1) trillion or represent 15.5% of total third party fund in Indonesia (Rp 1,379.5 trillion).

Capital Adequacy Ratio (CAR) of Bank XYZ are 25.3% and 23.65% at the end of year 2006 and 2005 respectively for CAR with credit risk and 24.62% and 23.21% at the end of year 2006 and 2005 respectively for CAR with credit risk and market risk which are far above 8% of Bank Indonesia minimum requirements.

### 3.1.2. Vision of Bank XYZ

Vision of Bank XYZ to be a Regional Champion Bank is in line with the concept of Indonesian Banking Landscape (Arsitektur Perbankan Indonesia (API)) that formulated by Bank of Indonesia that is as an International bank. In order to realize that vision, Bank XYZ has designed 3 (three) phases of transformation which are classified in to Phase I (2000-2004) to be Universal Bank, Phase II (2005-2009) to be a Domestic Dominant Bank and Phase III (2009 and so on) to be a Regional Champion Bank as summarized in Exhibit 2.

**Exhibit 2 Transformation phase to be a Regional Champion Bank**

**Transformation Phases to Achieve the Vision of Regional Champion Bank**

| | |
|---|---|
| **2009 – and so on**<br>**Transformation - Phase III**<br>**Regional Champion Bank** | **Domination on Domestic Market**<br>**Strong Capital**<br>**Wide Regional Network** |
| **2005 - 2009**<br>**Transformation - Phase II**<br>**Domestic Dominant Bank** | **Market Leader in Consumer & Commercial Banking Market**<br>**Market Capitalization Rp 100 Trillion**<br>**Implementation of Basel II**<br>**Reach the level of International Bank in accordance to Indonesia Banking Landscape (API)** |
| **2000 – 2004**<br>**Transformation - Phase I**<br>**Universal Bank** | **Build a strong base of Universal Bank**<br>**Integration & Implementation of New IT System**<br>**Go Public** |
| **1998 – 1999**<br>**Merger & Consolidation** | **Establishment of Bank Mandiri**<br>**Transfer of Non Performing Loan**<br>**Legal Merger &**<br>**Recapitalization**<br>**Reorganization**<br>**Strengthen the Risk Management** |

Source: Bank XYZ Annual Report 2006

Starting year 2005, Bank XYZ committed to a 5-year transformation plan that would result in realization of Bank XYZ's target as a Dominant Multi-Specialist Bank in year 2010. This transformation is divided into 3 stages:

- Back on track – focus on fixing the platform for growth.
- Building growth momentum – driving significant growth in all segments of focus.
- Shaping the end game – when the bank will play an active role in the consolidation of the Indonesian banking sector.

This strategy will be implemented across four themes:

- Building a winning organization and performance culture
- Delivering tailored propositions for priority segments
- Building internal and external alliances
- Strengthening it risk management and operations.

### 3.1.3. International Banking Performance

Year 2006 was an important milestone for Bank XYZ in its quest to create a performance driven organization using a Strategic Business Unit (SBU) based organization in June 2006. The Bank XYZ formally reorganized its directorates into 6 SBUs (Corporate Banking, Commercial Banking, Consumer Finance, Micro & Retail Banking, Treasury and International Banking and Special Assets Management), 3 corporate centers directorates (Risk Management, Compliances & Human Capital and Finance & Strategy) and a shared services directorate (Technology & Operations). On the basis of current contribution margins, Bank XYZ has classified the 5 business-generating SBUs into 3 (three) stages of development: cash generators, emerging business and future growth engine.

Treasury & International Banking, with Rp 948 billion in contributing margin in 2006, is a critical element of Bank XYZ Corporate Strategy. The collaboration between Treasury of Head Office and Corporate SBUs will be integral not only in expanding future fee based income, but also in further cementing relationship with corporate client and improving the profitability of corporate customers.

In 2006, Bank XYZ maintained reciprocal relationship with 1,117 correspondent banks in 102 countries as well as 35 nostro accounts, which supported to generate a 28.2 % increase in business including trade finance and remittance as well as risk-sharing and bilateral financing agreement.

In trade services, Bank XYZ market shares of correspondent bank export transactions is rose by 5.6%, while import transactions from correspondent banks declined by 38.7% from 2005. In remittance services, total international remittance volume in 2006 rose 20.6% compared with 2005. Indonesian Overseas Labor (TKI)-sourced remittance volume was 56.4% higher in 2006, while the associated fee-based income rose 25.3%. In all, the fee-based income arising from trade services, including Bank Guarantee issuance and remittances, increased by 12% compared with 2005.

## 3.2. United Arab Emirates (UAE)

Business in the UAE is complicated by the distinct character of each emirate. The commercial aspirations of Dubai Emirate mean that in most quarters there is a definite will to conduct business at a Western-style pace. This does not mean that traditional courtesies are waived. Business visitors will find that in Abu Dhabi, where there are fewer commercial pressures, the pace is more measured and the atmosphere more traditional. In the smaller emirates, except Sharjah, the pace of business is altogether more traditional. Sharjah, with its rapidly growing industrial sector, to a great extent follows the Dubai mode. So lessons learned in one emirate are not necessarily applicable in another.

The application of uniform federal standards and regulations, which started in the 1980s, has increased in speed in the first half of the 1990s. But discrepancies and procedural differences still persist.

### 3.2.1. UAE Business with Indonesia

There is no officially published information on the balance of payment in relation to the UAE business with Indonesia. There are some information in Bank XYZ with regard to the business transaction with UAE market mainly in trade finance and remittance services as summarized in Exhibit 11. Comparison of year 2005 and 2006 transactions result, noted that there are increases trend over the volume and value of the transactions and it looks that the business activity between Indonesia and UAE is very prospective in the future.

### 3.2.2. Economic Aspects

The economy of United Arab Emirates (UAE) are largely dependent on oil and gas production (about 33% of GDP) and hence has been booming for last few years (especially from 2003 onwards) due to rise in global oil prices and increase in OPEC quotas. Although the UAE is dependent on oil, the success of the diversification process and the scale of the country's surpluses leave the economy structurally robust. The economy of the UAE continues to perform very strongly. Despite continuing progress toward economic diversification, the oil and gas sector concentrated in Abu Dhabi remain the driver of the UAE economy thus exposing it to the volatility of international oil prices.

UAE has the fourth highest GDP per capita in the world. Out of the seven Emirates constituting UAE, two of them i.e. Dubai and Abu-Dhabi are account for 80% of the total GDP. The GDP growth rate was 9.7% in 2004 and 8.5% in 2005. It is estimated that the growth can reach 11.5% in 2006. UAE GDP per capita amounted to USD 32,208 in 2005 and approaching USD 36,411 in 2006 and it is among the highest in Middle East together with Saudi Arabia and Iran. Population growth of UAE is also low that is below 6% per year during year 2005 – 2007. See Exhibit 3 of the Economic and Demographic statistics.

**Exhibit 3 Economic and Demographic of UAE**

| No. | Economic & Demographic | Unit | 2005 | 2006 F | 2007 F |
|---|---|---|---|---|---|
| 1 | Gross Domestic Bruto (GDP) | USD Billion | 105.30 | 132.20 | 157.60 |
| 2 | Gross Domestic Bruto (GDP) per Capita | USD | 32,208.00 | 36,411.00 | 38,159.00 |
| 3 | Population | Million | 4.10 | 4.33 | 4.57 |
| 4 | Inflation Rate | % | 6.10 | 6.00 | 5.80 |
| 5 | Foreign Reserve | USD Billion | 20 | 20-25 | 25-30 |
| 6 | External Debt | USD Billion | 40-50 | 50-60 | 60-70 |

Sources: Moody's Website 2007

### 3.2.3. Politic and Social Aspects

Despite being a loose federation of seven individual emirates, the UAE has enjoyed a stable domestic political environment since its creation in 1971. Relations among the emirates remain strong. The smaller emirates are still dependent on Abu Dhabi for economic support. Dubai is more independent fiscally but benefit hugely from inflows of private capital from Abu Dhabi.

Generally, there is a high level of economic integration and cooperation among the individual emirates although there is an evitable degree of rivalry between the two largest emirates Abu Dhabi and Dubai. Politically, the ruling families of the individual emirates are well represented at the federal level. See Exhibit 4, for detail political and social aspect of UAE.

**Exhibit 4 Political and Social Aspects**

| Political & Social Aspects | Descriptions |
|---|---|
| Government Type | Federation |
| Administrative Division | 7 Emirates ( Abu Dhabi, 'Ajman, Dubai, Ra's Al Kaymah, Ummal Qaywayn, Al Fujayrah, Sharjah) |
| Legal System | Federal Court, Secular Court, Islamic Court |
| Executive Branch | Chief of State : President and Head of Government: Prime Minister / Vice President |
| Legislative Branch | Unicameral Federal National Council |
| Judicial Branch | Union Supreme Court |
| Ethnic Groups | Emirates (19%), Other Arab and Iranian (23%), South Asian (50%), Other Expatriates (8%). |

Sources: Moody's Website 2007

### 3.2.4. Banking Industry Laws and Regulations

UAE has enforced strictly its laws and regulations to be complied by all banks established and operated in UAE market. Those laws and regulation include the law applied to foreign banks established and operated in DIFC area. DIFC will be governed by its own regulations, administered by an independent capital market authority. DIFC licensees will not be subject to the relevant financial and banking laws of the United Arab Emirates or of Dubai. The notable exception to this is that anti-money laundering regulations imposed within the UAE will also be applied by the DIFC. The related banking laws applied in UAE are summarized in Exhibit 5 as follows.

**Exhibit 5. Banking Law**

| No. | Banking Law | |
|---|---|---|
| 1 | Applicable Banking Laws | DIFC Regulation (in case of DIFC) |
| | | Union Law No.10 of 1980, that ruled the establishment of the UAE Central Bank |
| | | |
| 2 | Banking Supervisory Body | UAE Central Bank (UAE Jurisdictions) |
| | | Dubai Financial Services Authority/DFSA (DIFC Jurisdictions) |
| | | |
| 3 | Regulation - Others | Local bank sectors have been saturated, therefore no new licence to open a new bank. |
| | | For regional purposes, Government of UAE form DIFC as financial center of Middle East, South Asia and North Africa |

Sources: Internet – UAE Official Website

### 3.2.5. International Trade – Export

In terms of export, UAE main commodities of export are crude oil and natural gas. In 2005 oil and gas directly accounted for around 35% of GDP and 80% of consolidated government revenue and 90% of exports (excluding re-export and free zone export). The UAE holds the fifth largest proven oil reserves in the world and this would last for over 100 years at current rate productions.

Despite the predominant role played by oil and gas, the numerous free trade zones established in the country are also contributing enormously to the value of exports and the UAE has become the third most important re-export center in the world (after Hong Kong and Singapore). In fact re-export trade provides a substantial one-third of the entire trading sector in the UAE. In Dubai, where a large part of the re-export trade is concentrated, it forms an even greater proportion of that emirate's total income. Although Iran and India feature prominently as destination countries there is a fairly even spread of re-exports across at least 35 countries. Currently, the main partner countries for exports are Japan and South Korea (See Exhibit 6).

**Exhibit 6 Export – Main Commodities and Countries**

| | |
|---|---|
| Main Commodities | Crude Oil (45%), Natural Gas, and Dried Fish |
| Main Partner Countries | Japan(24.4%), South Korea (9.7%), Thailand (5.5%) and India (4.3%) |

Sources: The World Fact Book 2007, US Central Intelligence Agency

### 3.2.6. International Trade – Import

Because of the population increase in the UAE, a higher demand for imports to meet re-export requirements and an increasing level of individual expenditure, there have also been risen in both the value of and volume of imports into the UAE. Low commodity prices caused by fierce competition among Asian countries, eager to maintain external markets have also had an upward effect on volume.

In terms of import, UAE mainly import capital goods such as machineries and transport equipment, and raw material for production and food. UAE main imports are coming from UK, China, USA and India (see Exhibit 7).

**Exhibit 7. Import-Main Commodities and Countries**

| | |
|---|---|
| Main Commodities | Machinery & Transport Equipment, Chemicals, and Foods |
| Main Partner Countries | UK (10%), China (9.7%), USA (9.4%), India (9.2%), Germany (5.9%), Japan (5.4%), France (4.7%) and Singapore (4.1%) |

Sources: The World Fact Book 2007, US Central Intelligence Agency

### 3.2.7. Export and Import of UAE among Middle East Countries 2006

The UAE market is very open and competitive. UAE as one of the member of Gulf Cooperation Council (GCC), play an important role in business activity in Middle East area. The top three export partners of UAE are including Japan, India and Iran. The exported commodities are mainly mineral fuels & oils, pearls & precious stones, electric & electronic equipment, and vehicles. The top three import partners are including India, China and Japan. UAE major imports are including pearls & precious stones, machinery, electric & electronic equipment, and vehicles.

UAE export and import activity in terms of value is among the highest among in the Middle East Countries. Even in import activity, UAE has the highest import value amounted to USD 88.89 billion, meanwhile UAE export activity; represent the second highest at USD 137.1 billion after Saudi Arabia (See Exhibit 8 below).

**Exhibit 8 Position of Export and Import of UAE Among Middle East Countries**

| Countries | Export Value | Import Value |
|---|---|---|
| Uni Arab Emirates | USD 137.10 Billion | USD 88.89 Billion |
| Saudi Arabia | USD 204.50 Billion | USD 64.16 Billion |
| Iran | USD 63.18 Billion | USD 45.48 Billion |

Sources: The World Fact Book 2007, US Central Intelligence Agency

### 3.2.8. Ratio Export and Import to GDP 2006

The United Arab Emirates has been a center of trade since ancient times, copper, pearls and oil being some of its most precious commercial commodities. Today, trade is still a central cornerstone of the economy, oil and gas exports remaining an important component as far as exports are concerned.

From the ratio of export and import activities, we can see the level of activities incurred in UAE market. These ratios indicate that export and import activity of UAE is quite high as UAE export and import conducted not only to fulfill its domestic market but also international market and this also indicate UAE as one of the most active international trade center.

**Exhibit 9 Ratio Export and Import to GDP**

| Countries | Ratio Export to GDP | Ratio Import/GDP |
|---|---|---|
| Uni Arab Emirates | USD 123.96 Billion | USD 80.37 Billion |
| Qatar | USD 108.09 Billion | USD 40.16 Billion |
| Bahrain | USD 104.13 Billion | USD 74.55 Billion |
| Jordan | USD 38.94 Billion | USD 84.58 Billion |

Sources: The World Fact Book 2007, US Central Intelligence Agency

### 3.2.9. UAE Financial Services

The UAE has a large number of banks. To serve a population of less than 4 million and an economy with annual GDP of some US$ 105 billion, the UAE has 21 local banks, 25 foreign banks, two specialized banks and around 51 representative offices of other foreign banks. The UAE is under pressure from the World Trade Organization (WTO) to open up its banking sector to foreign bank.

UAE banks maintained their robust performance with continued profit growth during 2006. Within the sector, there are five leading local banks in terms of assets value that are consist of the National Bank of Abu Dhabi, the National Bank of Dubai, Abu Dhabi Commercial Bank, Emirates Bank International and the Mashreq Bank, which control about 65% of overall assets. In addition to leading local banks, there are five leading foreign banks in terms of assets value in UAE market that are consist of BNP Paribas SA, ABN Amro Bank NV, Citibank NA, Lloyd TSB Bank Plc and Calyon.

The highly competitive environment of the UAE banking sector market has been conducive to the development of a high degree of diversification and differentiation in bank products and services. Accordingly, the banking industry in the UAE provides a comprehensive range of products and services, and employs the latest in banking technology and delivery channels for this purpose.

Wholesale banking products and services offered by the UAE banks have been a function of the rapid growth and diversification of the UAE economy and its main sectors, including wholesale and retail trade, industry, services, real estate and construction. These products and services cover small and medium scale of companies, large corporate, the growing number of multinationals operating in the country, and government and semi-government institutions.

### 3.3. Dubai

Dubai can either refer to one of the seven emirates that constitute United Arab Emirates (UAE) in the eastern Arabian Peninsula, or that emirate's main city, sometimes called "Dubai city" to distinguish it from the emirate.

Dubai is making great strides in opening up new avenues for economic growth and positioning itself on the world map as the regional hub for international business. Among its bold and pioneering initiatives is the creation of the Dubai International Financial Centre (DIFC).

In order to realize its goal of harnessing regional capital and investment, Dubai has established the DIFC, a wholesale financial services centre. By adding another growth industry to Dubai's diverse economic base, the DIFC is expected to make a strong contribution to the GDP growth of Dubai, as well as that of the United Arab Emirates and the region as a whole.

The vision of the Dubai International Financial Centre (DIFC) is to shape tomorrow's financial map as a global gateway for capital and investment. The mission of the DIFC is to be a catalyst for regional economic growth, development and diversification by positioning the DIFC as a globally recognized financial centre

The DIFC is an "onshore" financial centre, offering a platform of choice for leading financial institutions and service providers looking to do business in the region. It has been established as part of the goal to position Dubai as a recognized hub for institutional finance, and as the regional gateway for capital and investment.

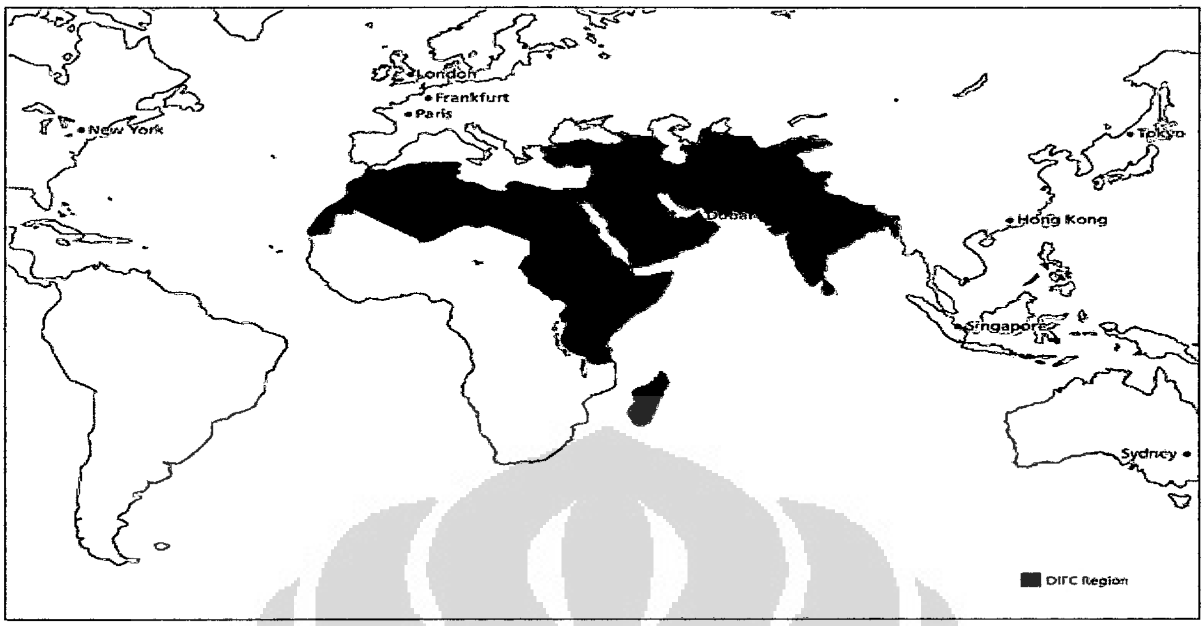
It aims to play a pivotal role in meeting the growing financial needs and requirements of the region, while strengthening links between the financial markets of Europe, the Far East and the Americas. In order to achieve its vision, the DIFC aims to provide a business - friendly environment that offers the following:

- World-class regulation and transparency. As an international financial centre, the DIFC's transparent and well-regulated environment will enable it to gain the trust of the international financial community.
- The creation of a new financial capital market which, it is envisaged, will usher in a wave of growth and prosperity for the whole region. Recognizing that financial capital moves to places where it is safest and best rewarded, the DIFC's combination of transparency and zero tax rate should enable Dubai to benefit from the global "flight - to - quality".
- A safe, friendly, desirable place for people to live and work. Dubai has become internationally renowned for its quality of life, and the DIFC aims to offer a world-class work environment for financial institutions, corporations, and professional services firms that operate in the DIFC.
- An oasis of stability. The DIFC operates in a political climate that is stable, an economic environment of sustainable growth, and a social setting which is cosmopolitan and safe, with a near-zero crime rate.

### 3.3.1. The Gateway to Regional Center of Capital and Investment

Located between the financial centers of Europe and South East Asia, lies a region comprising 42 countries with a population of 2.1 billion people and a combined economy worth US$ 1.8 trillion in terms of GDP. However, this vast region, stretching from the western tip of North Africa to the eastern part of South Asia (comprising North and Eastern Africa, the Levant, the Caspian, the Indian Subcontinent and the GCC States) has, to date, been without a world-class financial centre. Location of Dubai, United Arab Emirates is very strategic for the creation of international business link.

**Figure 1 Dubai Position in the World – DIFC Region**




Sources: PricewaterhouseCoopers Dubai (2006), DIFC

With the recent economic development, rapid expansion of trade, population growth and the vast infrastructure projects currently underway, there is a growing requirement for a financial centre to serve the rapidly expanding needs of institutions and governments in this region. The DIFC concept has evolved as a means of:

- Providing depth to the regional financial markets by broadening the range of traditional methods of financing currently provided by regional banks;
- Attracting liquidity back into investment opportunities within the region, thereby contributing to its economic growth;
- Facilitating planned privatizations in the region and enabling initial public offerings of privately owned companies, thus providing impetus to the programme of deregulation and market liberalization throughout the region;
- Contributing to the development of regional stock markets which, in turn, will contribute towards broadening the capital and ownership base of private sector companies; and,

promoting the growth of Islamic finance and the development of the region's reinsurance sector.

### 3.3.2. Dubai's Value Proposition

Dubai has many positive attributes, which have contributed to its success as an established international business hub, also serve to make DIFC a renowned international financial centre.

#### a. A broad-based economy

Dubai has been an economically dynamic city since the formation of the United Arab Emirates in 1971, and has since achieved remarkable economic growth and political stability. Over this 30-plus-year period, the country has been transformed from an oil and gas-dependent state to a broadly diversified economy based on international trade, banking, tourism, real estate and manufacturing.

The accumulated annual growth of Dubai's economy in the last decade stood at 10 percent, the highest rate of growth in the world. Oil has played a progressively diminishing role in the Emirate's economic profile. In 1985, the oil sector contributed to just under half of Dubai's GDP. By 1993 that figure had fallen to 24 percent, and by 2004, to less than 6 percent. By 2010, oil revenues are expected to account for less than 1 percent of Dubai's GDP.

#### b. A destination of choice for foreign direct investment

A market-orientated economy with complete freedom of movement of capital, no restrictions on foreign exchange, and full convertibility of the Dirham, Dubai has proved to be a highly attractive destination for foreign direct investment. According to the 2004 UNCTAD World Investment Report, the UAE ranked 22nd among the countries considered attractive to foreign investment. Some 150 of the Fortune 500 companies (including all of the top 10) have established a presence in Dubai, and the UAE's 2 free zones are now host to numerous multinational and regional companies - including over 5,000 companies from over 100 different countries located in Dubai's Jebel Ali Free Zone.

**c. A thriving entrepot for trade**

Dubai's well-developed infrastructure – plus its free zones, which offer substantial tax and other incentives - along with its strategic location in the Gulf countries region make it a natural centre for international trade. Reduced delivery lead times are also a major reason for the success of the trade. The UAE accounts for around 14 percent of the region's exports - worth almost US$ 81.4 billion a year - and Dubai has become the world's third largest re-export centre, after Hong Kong and Singapore. In fact re-export trade provides a substantial one-third of the entire trading sector in the UAE. In Dubai, where a large part of the re-export trade is concentrated, it forms an even greater proportion of that emirate's total income. Although Iran and India feature prominently as destination countries there is a fairly even spread of re-exports across at least 35 countries.

**d. A world-class tourism industry**

Tourism is among the fastest growing sectors of the Dubai economy, growing at a rate of 16 percent in 2004. The number of tourists visiting Dubai is forecast to grow from the current level of 0.4 million in 2004 to reach 1 million by 2010. With this in mind, huge investment is being made to develop the city's hotel, leisure and recreational infrastructure.

Dubai also offers a world-class airline - Emirates Airlines, winner of more than 200 industry awards since its formation in 1985 - over 30 five - star hotels, the world's first seven star hotel (the Burj Al Arab), and an international airport recognized as "The Best Worldwide in Overall Passenger Satisfaction" by IATA's Global Monitor.

Among the world - class events attracting tourists to Dubai are the Dubai Air Show; the Dubai Desert Classic Golf Tournament; the Dubai World Cup (the world's richest horse race); the Classic Dubai Rugby Sevens; and the Dubai Shopping Festival, the world's largest family event which, in 2005, registered a total visitor participation of a record million people and an overall expenditure of US$ 1.8 billion.

**e. A multi-cultural community of skilled professionals**

Expatriates comprise over 80 percent of Dubai's population, with over 150 nationalities working and living harmoniously together in a safe, almost entirely crime-free environment. Dubai attracts a highly skilled workforce, which is absorbed by the country's growing number of international companies, professional service firms and financial institutions. Education standards are high, with almost 20 percent of the population possessing a university degree or higher qualification. The literacy rate currently exceeds 90 per cent.

Expatriates enjoy tax - free salaries, schools accredited to international standards, a high standard of health care and excellent recreational facilities - including four championship Golf courses. In a recent report by Jones Lang Lasalle, comparing 400 cities world-wide, Dubai was selected as one of the top three, on the basis of office construction, office absorption, office rents, employment and population growth.

**f. An empower government**

Much of Dubai's remarkable economic development and growth can be attributed to a progressive, and enlightened, government with a clear vision and strategy for the Emirate's economy. It is also a government which has a remarkable track record in executing large, complex, and ambitious projects.

The Commitment to support any project plan and project implementation by every party in UAE market have created speed of the development in UAE market in conformity with the rules and regulation that formed clearly and with high enforcement.

### 3.3.3 Benefits of Setting up overseas office in the DIFC

Institutions establishing in the DIFC can potentially gain from the following key benefits:

- 100 percent foreign ownership.
- Zero percent tax rate on income and profits.
- An extensive tax treaty network for UAE incorporated entities.
- Freedom to repatriate capital and profits - without restrictions.
- Internationally accepted laws and regulatory processes.
- A world-class, independent, regulatory agency working alongside other financial regulatory agencies located in major global jurisdictions.
- A wholly transparent operating environment, complying with global best practices.
- A dollar denominated environment.
- A pool of skilled professionals residing in Dubai and the region.
- A modern and efficient transport, communications and internet infrastructure.
- A responsive one - stop shop service for visas, work permits and other related requirements.

The DIFC is a Federal Financial Free Zone attached to the Government of Dubai, established in accordance with United Arab Emirates Federal Law and by Dubai Law. The President of DIFC is His Highness Sheikh Mohammed Bin Rashid Al Maktoum, Ruler of Dubai.

### 3.3.4 The Evolution of Law and Regulation of the DIFC

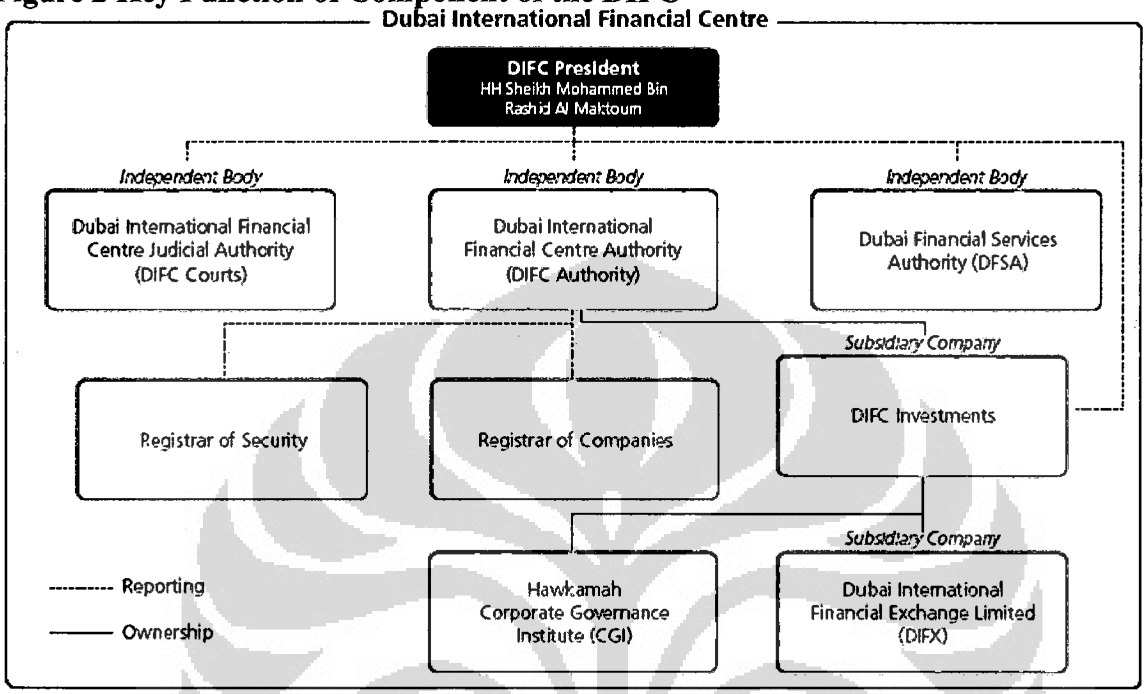
The creation of DIFC required a unique legal and regulatory framework, made possible through a synthesis of the following Federal and Dubai Laws:

- An amendment to the UAE Constitution was required, in order to allow the Federation to enact a Financial Free Zone Law. This law, in turn, allows each Emirate to create its own Financial Free Zone.
- Federal Law No. 8 of 2004 was enacted, establishing the basis for Financial Free Zones throughout the UAE. More importantly, it exempts Financial Free Zones from all federal civil as well as commercial laws within the UAE, except UAE Criminal Laws, Administrative Laws and the Anti Money Laundering Law. The DIFC is, therefore, empowered to create its own legal and regulatory framework for all civil and commercial matters.
- Federal Law No.35 of 2004 was enacted, establishing the DIFC as a financial free zone in Dubai and prescribing the geographical area and location of the DIFC in the Emirate of Dubai.
- Dubai Law No. 9 of 2004 was enacted, marking the operational launch of DIFC. This law recognizes the financial and administrative independence of the DIFC, and also exempts it from rules and regulations otherwise applicable in the Emirate of Dubai. It establishes the component bodies, which are considered necessary for DIFC's operations, and also authorizes the President to create other bodies that may be deemed necessary.
- Dubai Law No. 12 of 2004 was enacted, establishing the DIFC Judicial Authority and the DIFC Court System. This law guarantees the independent administration of justice in the DIFC and sets out the powers, procedures, functions and administration of the Court.

### 3.3.5 The Key Function of Components of the DIFC

The DIFC has three independent centre bodies, the DIFC Authority, the Dubai Financial Services Authority and the DIFC Judicial Authority.

**Figure 2 Key Function of Component of the DIFC**




Functions of the Centre Bodies:

**DIFC Judicial Authority**

- *Administering and Enforcing Commercial and Civil Justice at the DIFC*
- *Hearing and Determining Claims and Disputes Related to the DIFC and DIFC Entities*
- *Establishing and Operating Special Tribunals as Required*

**DIFC Authority**

- *Developing Overall Strategy and Policies for the DIFC, other than Financial Regulatory Policies*
- *Incorporating and Registering Companies in the DIFC*
- *Developing Laws Relating to Non Financial Services Activities at the DIFC*
- *Business Development and Marketing*
- *Client Relationship Management*
- *Communication and Public Relations*
- *Registration of Security Instruments*
- *Registration of Securities*

**Dubai Financial Services Authority**

- *Developing the Regulatory Framework*
- *Authorizing, Licensing, and Registration of Financial Services and Related Activities.*
- *Regulating Financial Services and Related Activities at the DIFC*
- *Supervising Market Activities*
- *Investigation and Enforcement*

Sources: PricewaterhouseCoopers Dubai (2006), DIFC

### 3.3.6 Limitation of Transactions in DIFC

Doing business in Dubai, United Arab Emirates (UAE), especially in DIFC, has some restrictions or limitations applied to all foreign banks as follows:

- Dealing with individual clients with less than USD 1 million in liquid assets.
- Dealing with institutional clients with called up share capital or net assets of at least USD 5 million.
- Accepting deposit from the United Arab Emirates.
- Accepting deposit or providing credit in UAE Dirham currency.
- Dealing in Dirham currency.
- Provide money services unless it is connected with another financial service for which the firm is authorized.

# CHAPTER IV

# ANALYSIS AND SOLUTION

This chapter will elaborate and comprehend the analysis of the market entry strategy decision factors which consists of internal factors and external environment factors analysis. Another important aspect to be considered is the cost and benefit of entering the new market. The company should not decide to enter a new market if it is financially not profitable unless the Company have another purpose in the new market other than financial reason. The analysis of risk embedded to the selected type of office structures to be established in Dubai, UAE is also important thing to be performed to support the decision making. Last aspect to be analyzed in order to support the decision of entry to new market is the timing of entry. The timing of entry is important in order to maximize the benefit and or minimize the risk of failure. The final section of this chapter will summarize all determinant factors, cost and benefit analysis, risk analysis and timing of entry that used to select the suitable mode of entry in the form of overseas office structure of Bank XYZ that will be established in Dubai, UAE.

## 4.1. Market Entry Strategies

There are several decision factors that influence the market entry strategy of Bank XYZ into UAE market. Those decision factors consist of internal factors and external environment factors. The internal factors determinants to be analyzed in this final paper consists of corporate objectives, cultural or psychic distance, need for control (decision making authority-centralize or decentralize), internal resources, assets and capabilities (this paper will focus on the firm size and international experiences). Meanwhile, the external environment factors to be analyzed that relevant to the market entry strategy are including competitive environment, government regulation, market size and growth, country risk, and local infrastructures. Both internal factors and external environment factors analyses will be based on current situation of Bank XYZ and the UAE market especially Dubai.

### 4.1.1 Internal Factors Analysis

Bank XYZ as the biggest bank in Indonesia has some internal factors that will be considered as main relevant factors to develop its foreign market entry strategy to UAE market. They are consisting of corporate objectives, cultural or psychic distance, need for control (authority level of making decision), internal resources, assets and capabilities (firm size and international experiences)

**a. Corporate Objectives**

Corporate objectives are key influences in choosing of entry modes. Firm that has limited aspirations will typically prefer to an entry option that entails a minimum amount of commitment. Proactive companies with ambitious strategic objectives, on the other hand, will usually pick an entry mode that give them flexibility and adequate control over the overseas office to achieve their goal. Corporate objective of Bank XYZ in international banking activities are as follows:

- To extent international network in the UAE center of financial activity to increase revenue through international transactions and treasury.
- To support the government program to promote Indonesian export – import activity in UAE market.
- To initiate business relationship with UAE businessmen those have plan and interest to invest in Indonesia.
- To provide banking services to Indonesian Companies those have business in UAE.

Bank XYZ vision to be a Regional Champion Bank which represented by achieving the level of international bank status, is in line with the purpose of Indonesian Banking Landscape (Arsitektur Perbankan Indonesia (API)) that formulated by Bank of Indonesia. In order to realize that vision, Bank XYZ has designed a Three phases of transformation that consist of Phase I (2000-2004) to be Universal Bank, Phase II (2005-2009) to be a Domestic Dominant Bank and Phase III (2010 and so on) to be Regional Champion Bank.

**b. Cultural or Psychic Distance**

A greater psychic or cultural distance will lead firm to adopt an entry that is more independent. This is attributed to the problems encountered by "double layered acculturation", which requires a firm to adjust to both a different national and organizational culture (Barkema et al., 1996). It could be also, where a firm enters a distant market; it is more likely to adopt an entry strategy that incorporates an indigenous firm (Luo and Chen, 1995), by sharing the equity ventures that enable foreign firm to delegate certain culturally sensitive management function to the local firm.

Dubai's culture is rooted in Islamic traditions. Courtesy and hospitality are amongst the most highly prized of virtues, and this is reflected in the warmth and friendliness of the local people. Dubai society is marked by a high degree of tolerance for different lifestyles. It is a liberal society by any measure and is rated as among the safest in the world. Foreigners are free to practice their own religion, and the dress code is liberal. Women, whether married or single, do not face any form of discrimination and may drive, work, and move around unescorted. In spite of its rapid economic development in recent years, Dubai remains closely linked to its heritage. For instance, many of the local citizens dress in the traditional robe and headdress. Arab culture and folklore also find clear and articulate expression in poetry, dancing, songs, and traditional art. And, traditional sports such as falconry, camel racing, and dhow racing at sea continue to thrive.

Indonesia whose culture is partly influenced by Arabic culture as well as its large population religion that the same as UAE population. These aspects of cultures and religion give much help and contribution to Bank XYZ in formulating its market entry strategy. Additionally, the distance between UAE country and Indonesia is not too far. A long time good relationship between Indonesia and Middle East countries in terms of religion and trade have given a goodwill to Bank XYZ to easily align its strategy to enter the UAE market.

In line with UAE regulation that allow foreign bank to have 100 percent of shares in DIFC area and the closeness of the culture, Bank XYZ may open fully own branch in UAE which have consequence to Bank XYZ to increase its commitment with a high cost/high control entry strategies through opening a branch rather than a representative office.

### c. Need for Control (Authority Level of Decision Making)

Authority level of decision making influence the market entry strategy since it will impact on the forming of overseas office structure. Authority level of decision making is divided into two types consist of centralization and decentralization. Centralization has been defined as "the amount of delegation of decision-making authority throughout an organization and the extent of participation by organizational members in decision making (Jaworski and Kohli, 1993, p.56). As centralization is primarily a control issue, then it can be argued that more centralized structure would prefer entry strategies that afford a high level of control from headquarters management. It means in contrast that decentralized or autonomous decision making structure will adopt low control entry strategies.

Bank XYZ, based on its annual report, will open a fully branch and put the decision making authorities under head office management of Bank XYZ. This decision has consequences on a high commitment to the market or adopts a high control entry strategy.

### d. Internal Resources, Assets and Capabilities

Internal Resources, Assets and Capabilities are represented by human and financial resources to support the opening of the overseas office. The analysis will be concerned on the human resources availability in terms of their skill and experiences to operate the overseas office (international experiences). The other aspect of resources is financial aspect that represented by the size of the firm in terms of financial aspect such as total assets, and equity and net income.

#### 1) International Experiences

International experiences are one of important factors on entry strategy selection. Firms with much international experiences can reduce the level of uncertainty of foreign markets. These experiences in turn will increases the likelihood the firms to use a high cost/high control entry strategies. Correspondingly, those firms with less international experiences are more likely to enter a foreign market through other kind of entry strategy such as joint venture as a means of sharing the risks and responsibility (Caves and Mehra, 1986).

Bank XYZ, have gain some international experiences in international market as Bank XYZ has opened and operated some overseas offices in some countries such as Shanghai (China), Hong Kong (China), London (England), Singapore, Cayman Island, and Dili (East Timor). Previous entry strategies that implemented by among existing Bank XYZ overseas offices that consist of 1 subsidiary, 1 representative office and 4 branches as follows:

- Bank XYZ – London : Subsidiary
- Bank XYZ – Shanghai : Representative Office

- Bank XYZ – Singapore : Branch
- Bank XYZ – Hong Kong : Branch
- Bank XYZ – Cayman Island : Branch
- Bank XYZ – Dili : Branch

**i. Bank XYZ – London**

The Bank XYZ – London was opened as subsidiary rather than as a branch or other types of office, is solely due to regulation requirements of British authority that required a subsidiary type of overseas office. Bank XYZ opened a subsidiary in London due to its role as the biggest financial market for money market in the world and to serve and support many customers of Bank XYZ that have business with London market.

**ii. Bank XYZ – Shanghai (Representative Office)**

Bank XYZ in Shanghai, China was opened as representative office rather than a branch or subsidiary in conformity with Government of China regulation. The Government of China ruled every foreign bank that intent to open an overseas office in China by opening a representative office as the first phase of their operation in China market. The foreign bank, after two year operation, is allowed to submit a proposal to Government of China to change its overseas office status become a branch or subsidiary. Bank XYZ currently is in process to upgrade the status of Shanghai representative office to be a Branch office in order to increase its banking service activity.

**iii. Bank XYZ – Singapore (Branch)**

Singapore branch of Bank XYZ is established in the form of branch (restricted license) due to its commitment to the Singapore market. Singapore office was used as an offshore financial centers or hub for Bank XYZ to serves the foreign customers in Singapore market.

Singapore was selected as one of Bank XYZ based for its offshore financial center considering some key consideration as follows:

- Low taxes,
- Services are provided mainly but not exclusively for non resident clients,
- There are few foreign exchange controls,
- Geographical location.
- A legal regime that uphold bank secrecy
- A high degree of political stability.

**iv. Bank XYZ – Hong Kong (Branch)**

Hong Kong is a former British colony and has geo-strategic location that has helped stimulate their development as a trading and financial hub. Hong Kong has extensive international links, relative political stability, state of the art communications, excellent air and sea transportation links, English speaking labor pools, well developed service infrastructures in the legal, accounting and labor sectors and a British-influenced efficient civil service.

Hong Kong evolved as a major hub for the arrangement, syndication and management of euro-credits to borrowers from the Asia pacific area. Considering its strategic role and location, Bank XYZ, open an overseas office in Hong Kong in the form of branch. In addition to have services in banking transactions such as trade finance, project finance etc., the branch also provides services as a remittance office/kiosk to serve Indonesian workers (TKI) in Hong Kong as part of it international network development strategy.

**v. Bank XYZ – Cayman Island (Branch)**

Bank XYZ opened its branch in Cayman Island as an offshore Financial Center of Bank XYZ, considering its tradition of confidentiality, privacy, anonymity, and no direct taxation, which have been complemented by considerable political stability, talented local workforce, geographic location and modern communication means and the time zone in which it falls allows operation in the island-state to trade in New York market at the various time of the day.

**vi. Bank XYZ – Dili (Branch)**

Bank XYZ – branch in Dili, was opened mainly due to offering proposal from the Government of East Timor to Bank XYZ to maintain its branch office in Dili, East Timor, after their separation from Indonesia.

**2) Firm Size**

In terms of firm size, a firm with greater financial resources will likely to use acquisition as entry strategy, whereas small firms will evaluate the relative benefits of using distributors and agents (White, 1995).

Bank XYZ size is smaller in terms of total assets, total equity and net income compare to its several competitors that operates in DIFC, UAE as described in exhibit 10.

**Exhibit 10 List of Foreign Banks in UAE**

| No | Bank Name | Total Assets 2006 in USD '000 | Total Equity 2006 in USD '000 | Net Income 2006 in USD '000 | Origin |
|---|---|---|---|---|---|
| 1 | Deutsche Bank AG | 2,070,022,389 | 44,419,860 | 8,006,058 | Germany |
| 2 | UBS AG | 1,963,870,360 | 45,038,105 | 10,448,250 | Switzerland |
| 3 | Barclays Bank Plc | 1,956,152,095 | 53,209,532 | 10,317,616 | British |
| 4 | JP Morgan Chase & Co. | 1,351,520,000 | 115,790,000 | 14,444,000 | USA |
| 5 | ABN Amro Holding NV | 1,299,965,758 | 34,103,780 | 6,295,272 | Netherland |
| 6 | Credit Suisse Group | 1,029,219,044 | 48,270,098 | 9,339,507 | USA |
| 7 | Fortis Bank | 888,569,735 | 22,254,708 | 6,243,909 | Netherland |
| 8 | Sumitomo Mitsui Banking Corporation | 806,606,060 | 45,586,060 | 3,947,301 | Japan |
| 9 | Lloyds TSB Bank Plc | 678,544,227 | 24,490,597 | 5,928,311 | British |
| 10 | Standard Chartered Bank | 268,554,000 | 18,386,000 | 2,298,000 | British |
| 11 | State Bank of India | 186,988,049 | 10,144,647 | 1,518,477 | India |
| 12 | Japan Bank for International Cooperation | 164,265,202 | 76,743,731 | 2,328,092 | Japan |
| 13 | Standard Bank Group Limited | 139,023,099 | 7,921,808 | 1,794,835 | South Africa |
| 14 | DBS Bank | 128,770,866 | 13,669,797 | 1,583,203 | Singapore |
| 15 | Millennium bcp-Banco Comercial Português, SA | 104,383,910 | 6,674,437 | 1,095,614 | Portugal |
| 16 | ICICI Bank Limited | 90,454,117 | 5,694,366 | 604,060 | India |
| 17 | Bank XYZ | 29,077,956 | 2,863,116 | 263,196 | Indonesia |

Sources: The financial statements 2006

Bank XYZ, as the biggest bank in Indonesia, is still exploring its role in banking industries outside domestic markets in order to expand its business and to support government of Indonesia program to have a leading bank in regional area outside Indonesia. The Bank XYZ competitors in DIFC, UAE markets are not only bigger in size in terms of assets and equity, but also their image, their quality of services and credibility. Bank XYZ must have some of unique services to be competitive or have a certain competitive advantage compare to its competitors. Bank XYZ – Dubai must focus its services to a market segment that unattended/ avoided by both local bank and other foreign bank in UAE market such as transaction of business with Indonesian customers which they considered as high risks. The services to be concentrated in UAE market would be focus on trade services, trade finances and loan facility to selected customers with measurable risk. As mentioned before, the target of Bank XYZ in UAE market is to serve companies/customers in UAE, those that have business with Indonesian companies/businessman in UAE and Middle East area. By focusing on those target market, Bank XYZ can open branches or representative office in UAE to serve the target customer well.

### 4.1.2 External Environment Analysis

Most firms face external environments that are highly turbulent, complex, and global conditions that make interpreting them increasingly difficult. The external factors are including competitive environment, UAE government regulation, market size & growth and country risk. All the external environment factors have big influence to the market entry strategy in terms of the level of commitment. The higher the level of alignment by Bank XYZ to the external factors in this case UAE market, the higher the commitment to be given in the market, that can be represented by the type of overseas office established or opened in Dubai, UAE.

### a. Competitive Environment

Competitive environment among foreign bank in UAE banking industry market is very fierce. The five forces model of Michael Porters and SWOT analysis are used to analyze the level of competition in UAE market.

#### 1) Five Forces Model

A key concept in Michael Porter's five forces model is the view that some industries are attractive and others as less attractive. The ability to identify industry attractiveness is therefore very important. Porter's Five Forces Analysis is an important tool for assessing the potential for profitability in an industry. With a little adaptation, it is also useful as a way of assessing the balance of power in more general situations

Using the Michael Porter Five Forces model, the level of competition in UAE market as follows:

i. **Barrier to entry is low.**

Every foreign bank is allowed to enter UAE market through DIFC area with a full ownership subject to some limitations in accordance to UAE banking regulations. It means that there is no entry barrier to enter UAE market especially through DIFC area where all foreign banks are only allowed to serve the corporate banking service in conformity to DIFC law and regulation. Bank XYZ can enter the market and form any type of office structure to enter the market.

ii. **Competition among the existing competitors is high**

All banks include local and foreign bank will compete to each other to win the market. Large numbers of well established foreign bank and local bank with big capital, credibility and image have operated in UAE market. A big number of foreign banks operated in UAE market have increased the level of competition in UAE market. Bank XYZ, as new entrant will directly fight with other established banks in UAE markets.

iii. **Bargaining power of suppliers is high.**

The power of supplier is heavily depend on the ability of bank to provide better interest rate and bank security. Many foreign banks have operated in UAE market and the levels of competition among banks are very high. The competition level has stressed every bank to be efficient to lower the cost then has opportunity to give attractive interest to its depositors and enhance its security matters. The level of competition has put the supplier (depositors) with high bargaining power in the UAE market as the switching cost to move from one bank to another is low. Bank XYZ, in this regard must design a strategy to gain the market as many of its competitor has operated in efficient way.

iv. **Bargaining power of buyer is also high**

Bank instituting more of a marketing-oriented approach, where the consumer (borrower or debtor) is at the heart of everything the company does. This implies that the ultimate focus of bank is to satisfy its consumers' needs and wants. Due to a large number of banks with similar specification and low switching cost for consumers to move to other bank, the bargaining power of buyer become high. Bank XYZ must set a unique and specific target of customer before entering the market.

v. **Threat from substitution is high**

There are many substitution of banking products that might become threat in UAE market such as product of capital market, mutual fund and other intermediation product such as leasing. In UAE market where the rule and regulation are well established as well as the capital market, the substitution threat from capital market product will become high.

**Conclusion of Five Force Model over Competitiveness Level of UAE Market**

| Forces | Degree of Condition |
|---|---|
| Barrier to entry | Low |
| Competition among the existing competitors | High |
| Bargaining power of suppliers | High |
| Bargaining power of buyer | High |
| Threat from substitution | High |

From the above summary of forces facing by Bank XYZ, it revealed that:

- The **threat of new entry** is quite high as the barrier to entry is low. If anyone looks as if they're making a sustained profit, new competitors can come into the industry easily, reducing profits. The competition level to survive due to increasing the number of players in the UAE market becomes a big challenge to Bank XYZ.
- **Competitive rivalry** is extremely high. If one bank raises prices, they'll be quickly undercut. Intense competition puts strong downward pressure on prices. Bank XYZ must improve its operation efficiency in order to improve its competitive effort by giving a competitive service fee.
- **Buyer Power** is strong, again implying strong downward pressure on prices. In this regard Bank XYZ again must improve its efficiency to improve its competitive service fee to compete against its competitor effectively.
- There is some **threat of substitution**. Bank XYZ will not only compete with other competitor in banking industry, but also product from capital market such as mutual fund, bonds and shares. UAE capital market is strictly regulated and provides information with a lot of information to invest in capital market easily.

Unless Bank XYZ is able to find other way to change this situation, this looks very tough to survive in this industry. Bank XYZ might need to be specialized in a sector of the market that's protected them from some of these forces, or find a related business that's in a stronger position.

From the perspective of the five forces model, we noted that the level of competition in UAE market is very fierce. Bank XYZ will face a very tough competition in UAE market. Look at Bank XYZ competitiveness ability it would be better for Bank XYZ to open a representative office rather than other type of office structure such as a branch or subsidiary. Bank XYZ is better to adopt a low cost entry through establishing a representative office in order to test its competitiveness before increase its commitment in UAE market.

**2) SWOT Analysis of Bank XYZ**

One particular useful technique in analyzing Bank XYZ competitiveness in international market especially in UAE market relative to its competitors, is referred to as SWOT that stand for Strengths, Weaknesses, Opportunities and Threats. Based on SWOT analyses, Bank X conditions are as follow.

**i. Strength Analysis**

- **Well known among businessmen in Asia Pacific and Indonesia**

  Bank XYZ is the biggest bank in Indonesia and has operated many branches in Indonesia and connected on line. Additionally, Bank XYZ through its overseas offices in some countries has maintained its existence among foreign banks. Bank XYZ is included as one of 500 biggest banks in the world by Fortune 500.

- **Have experiences in doing international banking transactions**

  Bank XYZ has overseas offices in some important countries such as British, China, Singapore and Cayman Island. These experiences have equipped Bank XYZ to do expansion strategy activity including to UAE market.

**ii. Weaknesses Analysis**

- **New entrant in UAE market**

  Bank XYZ is conscious that they have no direct experience in UAE market and aware of the competition level of the market particularly in Dubai. The barriers to entry are seen as meeting regulatory approval; newly set up DIFC culture; generating market awareness of services; and establishing and building relationships in the local market.

- **Higher cost of fund**

  Cost of fund is relatively high compare to other foreign and local bank in UAE, due to higher country risk of Indonesia compare to other foreign bank origin country. If Bank XYZ to do a borrowing to other bank, Bank XYZ will pay higher premium or cost of fund as the risk embedded to Bank XYZ from the country that classified as high risk like Indonesia.

- **Other established foreign banks have operated early in UAE market.**

  Many of established foreign banks from developed country have operated early in Dubai such as Standard Chartered bank, UBS bank, DBS bank, ABN Amro, etc. They earliest operations has established a better company image and strong based of customers.

- **Negative perception over Indonesian country by UAE market.**

  Negative perception over Indonesia mainly due to its political matters, security, corruption, bad infrastructures and country risk have put Bank XYZ bargain in UAE market lower compare to other foreign bank operated in UAE market such as ABN Amro, Barclays Plc, Citigroup.

**iii. Opportunity Analysis**

- **WTO agreement implementation**

WTO agreement implementation will open the market of UAE without any restriction to foreign bank. Bank XYZ can take a benefit from this opportunity as long as Bank XYZ make better preparation before entering UAE market such as increase its resources and capabilities during the implementation process of WTO agreement.

- **Increase in trade and investment between Indonesia and UAE**

The Branch of Bank XYZ will be exceptionally well placed to benefit from the continued growth of the Indonesia and UAE trade which has been expanding particularly in the recent years. This growth of trade and investment is expected to continue over the coming years.

- **UAE strategic region location**

UAE is interesting market due to its economic growth, stability in politic and security, and as important hub to the region of Europe, Middle East and North Africa. Bank XYZ can have much benefit on the strategic location of Dubai (UAE) to expand its business to the other area around the Dubai UAE, mainly to Middle East market and Europe.

**iv. Threat Analysis**

- **Unrest situation in Middle East Region**

It is well know that the continued political unrest in the Middle East Region is one of the significant factors to be considered as threat in doing business in Dubai, UAE. However, based on some market research, a careful planning of the Dubai authorities and their politically neutral stance should mean that these will be less disruptive in the UAE than anywhere else in the region. This condition might increase Bank XYZ confident and considered that the potential rewards of opening a Branch outweigh the risks

- **Other established foreign banks have operated early in UAE market.**

  Many of established foreign banks from developed countries have operated early in Dubai such as Standard Chartered bank, UBS bank, DBS bank, ABN Amro, etc. They have established a better company image and strong based of customers from their early operation in Dubai or we said that they have a first mover advantage. In the literature, theoretical and empirical evidence suggests that at times first movers (pioneers) have advantages in that they could earn positive economic profits (Lieberman and Montgomery, 1988). These advantages include technological leadership, preemption of assets, and buyer switching costs (Lieberman and Montgomery, 1988).

- **Negative perception over Indonesian country by UAE market.**

  Negative perception over Indonesia mainly its political matters, security, corruption and bad infrastructures and country risk have put Bank XYZ bargain in UAE market lower. Negative image over the Bank XYZ origin country (Indonesia) has caused a lower trust over the Bank XYZ credibility and capability.

Bank XYZ must consider this high level of competition of UAE market and justifies the selection of its international market entry strategy in UAE market. From the combination of Five Forces Model and SWOT analysis over the competitiveness of Bank XYZ relative to its competitors in UAE market, we noted that Bank XYZ competitiveness in UAE banking industry is ranging from low to moderate level as it brings negative image of Indonesian country, less experiences in UAE banking system, and lower ability to compete with other well established foreign bank. Same with Five force model analysis, the Bank XYZ competitive ability is low, it would be better for Bank XYZ to open a representative office rather than other type of office structure such as branch or subsidiary.

**b. UAE Government Regulation**

The Government of UAE has ruled and implemented some rules and regulations in their financial market. All foreign banks are allowed to operate in UAE with some restrictions as follows:

- Regulations of UAE prohibit the establishment of foreign bank since 1987, except in the area of Dubai International Financial Centers (DIFC).
- Dealing with individual clients with less than USD 1 million in liquid assets.
- Dealing with institutional clients with called up share capital or net assets of at least USD 5 million.
- Accepting deposit from the United Arab Emirates.
- Accepting deposit or providing credit in UAE Dirham currency.
- Dealing in Dirham currency.
- Provide money services unless it is connected with another financial service for which the firm is authorized.

Upon those restrictions, Bank XYZ must consider the cost and benefit of doing business in UAE market and develop a suitable market entry strategy to Dubai, UAE market. These regulations have put Bank XYZ to compete head to head with other established foreign bank in Dubai, UAE incorporate banking services.

**c. Market Size and Growth**

UAE market is one of emerging markets in Middle East region and its geo-strategic location is very essential as a hub to the market of Middle East, Europe and North Africa. The UAE accounts for around 14 percent of the region's exports - worth almost US$ 81.4 billion a year - and Dubai has become the world's third largest re-export centre, after Hong Kong and Singapore.

As the leading regional trading hub, Dubai offers access to a market of out-standing potential for overseas companies in a wide range of sectors. Among its key characteristics are:

- Accessible market - Dubai is served by more than 125 shipping lines and 110 airlines.
- Diversified market - wide import requirements and opportunities for suppliers of most products.
- Growing market - Dubai's imports have more than doubled since 1998 and regional economic growth and liberalization are set to boost demand.
- Large market - AED. 100.7 billion in trade was recorded for 2004. Exports totaled AED. 5.3 billion and imports AED. 69.4 billion.
- Open market - no exchange controls, quotas or trade barriers.
- Prosperous market - Dubai is strategically located at the heart of one of the world's richest regions.

In addition to its strategic location, UAE with high GDP amounted to USD 132.2 billion and USD 157.6 billion for year 2005 and 2006 respectively and GDP per capita USD 32, 208 and USD 36,411 for year 2005 and 2006 respectively, shown the high market size of UAE market and high growth of the economy. Low and stabile inflation rate, high transactions of export and import and increase trend in economic growth, UAE market is very attractive.

Bank XYZ has already conducted some business with UAE especially in trade finance and remittances services. This numbers of transactions expected to be increased in the future years. The types and volume of transaction are summarized in Exhibit 11 below.

**Exhibit 11 Bank XYZ Transactions with UAE**

| Descriptions | Year | Amount |
|---|---|---|
| **Trade Finance** | | |
| Export to UAE - Transactions Value | 2006 | Between USD 80 - 100 Million |
| Import from UAE - Traanscations Value | 2006 | Between USD 0 - 20 Million |
| | | |
| **Remittances** | | |
| Incoming transfer - Transaction Numbers | 2005 | 23,121 |
| | 2006 | 24,462 |
| | | |
| Incoming transfer - Transcations Value | 2005 | USD 23,105 Thousand |
| | 2006 | USD 38,080 Thousand |
| | | |
| Outgoing transfer - Transactions Numbers | 2005 | 406 |
| | 2006 | 877 |
| | | |
| Outgoing transfer - Transactions Value | 2005 | USD 16,790 Thousand |
| | 2006 | USD 67,270 Thousand |

Sources: Bank XYZ

These are the main reasons of Bank XYZ to open an overseas office in Dubai, UAE.

**d. Country Risk**

The UAE's macro economy has performed strongly in recent years. This reflects sustained high oil and gas prices, increased oil production and strong investor confidence matched by steady inflows of foreign direct investment. This activity has generated large current account and fiscal surpluses, which are being used to accumulate substantial net foreign financial assets and official currency reserves, fund infrastructure investment and ramp up efforts to broaden the UAE's economic base.

But this strong macroeconomic performance has come at a cost where inflation has been high and looks set to remain so. Inflation has probably been exacerbated by the pegged exchange rate to the US$, increasing the pressure on the government to introduce more flexibility into the exchange rate. Even so, a sudden or sharp revaluation appears unlikely.

The UAE's prosperity is underpinned by abundant reserves of oil and gas. The oil is cheap to extract and projected to last for more than a 100 years at current rates of extraction.

Proactive diversification policies will probably see manufacturing, tourism and financial services account for a greater share of economic activity in the future.

Although the economy depends heavily on oil and gas revenues, the UAE appears to be well equipped to weather any price shocks. A strong net foreign asset position and prudent fiscal policies means that the country is in a much stronger position than it might have been a few decades ago. Past episodes of high oil and gas prices fuelled irrational fiscal policies and locked the emirates into a permanently higher level of spending, leaving them exposed when oil prices turned down.

The UAE is generally viewed as an island of relative stability in an otherwise unstable region. But a serious rise in geopolitical tensions in the region, perhaps as a result of stepped-up US confrontation with Iran, or a terrorist attack, could undermine this reputation. Facing up to political and social tensions will test the political maturity of the Emirates' ruling families, and could spill over to other countries in the region. Although the last few years have seen some calls for wider political participation, most analysts consider that any moves to liberalize will be measured and staged so as to minimize the chance of political and economic instability. More likely sources of instability are signs of growing discontent among Emirates about the number of highly-paid expatriate workers and rumblings about poor conditions among imported workers from South Asia.

World Bank governance indicators suggest the UAE's governance framework is reasonably well developed by global and regional standards. The UAE's rankings on five of the six indicators are above the 65th percentile, with an 83rd percentile ranking for control of corruption, implying that only 17% of surveyed countries are 'cleaner'. This places the UAE well above the Middle East and North African regional average on all five indicators. However, on voice and accountability the UAE is on par with its regional peers at just above the 25$^{th}$ percentile.

Based on rating issued by certain credible rating institution, credit and country risk ratings of UAE is both creditworthy and at low risk of external default. Moody's gives the UAE a foreign debt country ceiling of Aa2. S&P and Fitch don't rate the UAE, but S&P does rate one of the seven emirates – Abu Dhabi - at AA, two notches below AAA.

Especially in 2006, according to Moody's, the country risk of UAE is scored at 30 or rating of A (very good level). The overall country risk (30) is derived from the average of scores for sovereign risk (22), currency risk (31) and banking sector risk (36).

The good score and rating of UAE country risk based on Moody's rating are much influenced by strong political and social development in UAE especially strong relation among the emirates. Until recently, the UAE has resisted the trend of gradual democratization adopted in varying degrees by other Gulf Cooperation Council (GCC), that represent five oil-exporting member states.

The banking sector risk is stable. Most UAE banks are highly liquid and have accumulated substantial assets during the past few years of rapid economic growth. However, profit have been negatively affected by the steep falls on the region's stock markets over the past and there are concerns over the pace of credit growth and the quality of the credit extended, as well as over the sector's exposure to the real estate market.

Sovereign risk is stable. The public external debt stock and servicing costs are very low and the government's liquidity position is strong, making it highly unlikely that payment pressure will emerge.

**e. Local Infrastructure**

Dubai offers incoming businesses all the advantages of a highly developed economy. Its infrastructure and services match, if not exceed, the highest international standards, facilitating efficiency, quality and service.

Benefits include:

- Cosmopolitan lifestyle.
- First-class hotels, hospitals, schools and shops.
- Free-enterprise system.
- High-quality office and residential accommodation
- Highly developed and modern transport infrastructure.
- Maturing financial and service sector.
- Reliable power and utilities.
- State-of-the-art telecommunications.
- Top international exhibition and conference venues.

## 4.2. Cost and Benefit Analysis

Another important aspect that must be considered before establishing an overseas office in target countries is the cost and benefit of opening the overseas office.

Cost represent the cost of the opening of overseas office that are mainly including initial investment in office equipment such computer and support cost for set up the computer system, and other cost as describe as follows.

- Fee payable in respect of Authorized Firms such as Application fee, Initial annual fee, Recurring annual fee, Registration fee and Supervision fee
- Rental Expenses, Honorarium Expenses and Taxes Paid
- Third Party Goods & Services including Communications Expenses, Utilities Expenses, Office Supplies, Entertainment and Travel, Expedition/Postage, Advertising, Travel & Subsistence – Board
- Repair and Maintenance Expense including General Office Maintenance & Repairs, Residential Maintenance & Repairs, Vehicle Maintenance & Repairs

- Depreciation Expenses
- Other Expenses including Fees Paid, Commissions Paid, Insurance Paid
- Other Operational Expenses
- Other Non-Operational Expenses

Benefits are positive outcomes that can be reasonably identified as the change resulting from opening the overseas operating office. Benefits represent income projected to the following years that derived from trade financing and trade services.

Benefits (income) are derived from existing income of Head office that allocated to Bank XYZ – Dubai as initial support to operate the Bank XYZ-Dubai and additional income that generated from its own operating activity result that assume to be increased at rate 20 percent per year in following years of its operation in UAE market. By operating in UAE market, Bank XYZ-Dubai is expected to gain more experience and high understanding over the UAE market and then could make some innovation in its operating strategy such as proposing some banking product and services that accepted in UAE market and finally can generate more income form their own effort in the future.

Based on estimated initial investments (USD 1.3 million) and projected income and expenses for the 10 following years since establishment, using weighted average cost of capital rate of Blumberg for the first quarter 2007 17.94% as the discount rate for the cost and benefit calculation, the Net Present Value (NPV) of the opening Bank XYZ overseas office in Dubai is positive. The payback period of the initial investment for the opening overseas office of Bank XYZ in Dubai is 4.23 years with Return on Investment of 39.46%. See the calculation in exhibit 12 below.

**Exhibit 12 Cost and Benefit Calculation**

| No. | Descritions | | Year | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | | 0 | 1 | 2 | 3 | 4 | 5 |
| 1 | **Investments** | | | | | | | |
| | IT Investments | | 1,086,023 | | | | | |
| | Non-IT Investments | | 200,000 | | | | | |
| | **Total Investments** | | **(1,286,023)** | | | | | |
| | | | | | | | | |
| 2 | **Benefit (incremental)** | | | | | | | |
| | Direct Revenue | | | 1,272,209 | 2,044,478 | 2,479,415 | 3,001,339 | 3,622,856 |
| | Indirect Revenue | | | 0 | 0 | 0 | 0 | 0 |
| | **Total Benefit** | | | **1,272,209** | **2,044,478** | **2,479,415** | **3,001,339** | **3,622,856** |
| | | | | | | | | |
| 3 | **Cost** | | | | | | | |
| | Labor cost | | | 698,700 | 726,750 | 810,900 | 891,990 | 981,189 |
| | Depreciation | | | 257,205 | 257,205 | 257,205 | 257,205 | 257,205 |
| | General and administrations | | | 817,500 | 857,650 | 953,515 | 1,000,887 | 1,133,715 |
| | **Total Cost** | | | **1,516,200** | **1,584,400** | **1,764,415** | **1,892,877** | **2,114,904** |
| | | | | | | | | |
| 4 | **Net Benefit** | | **(1,286,023)** | **(243,991)** | **460,078** | **715,000** | **1,108,462** | **1,507,952** |
| | | | | | | | | |
| 5 | PV Factors | 17.94% | | 0.8479 | 0.7189 | 0.6096 | 0.5168 | 0.4382 |
| | | | | | | | | |
| 6 | **Present Value (PV)** | | | **(206,877)** | **330,757** | **435,835** | **572,897** | **660,818** |
| 7 | **Balance** | | **(1,286,023)** | **(1,492,900)** | **(1,162,143)** | **(726,308)** | **(153,411)** | **507,407** |
| 8 | NPV | | **507,407** | | | | | |
| 9 | Return on Investments | | 39.46% | | | | | |
| 10 | IRR | | 27.92% | | | | | |
| 11 | Payback Period | | 4.23 | | | | | |

### 4.3. Risk Analysis over the Office Structure

Uncertainty about a situation can often indicate risk, which is the possibility of loss, damage, or any other undesirable event. Most of people/company desire low risk, which would translate to a high probability of success, profit, or some form of gain. In this regard, the selection of market entry strategy especially in the selection of office structures to be established in Dubai, UAE are also have some risk that may be incurred and taken by Bank XYZ. The risks taken by Bank XYZ are associated with the risk embedded in disadvantage condition over the selection of office structure that could be in Branch Office, Representative Office or Subsidiary. Bank XYZ is assumed not to select a joint venture with local bank structure as Bank XYZ has planned to implement an internal development strategy to grow its business in UAE market.

### 4.3.1. Branch Office

Opening up a branch usually indicates a higher level of commitment to the foreign market than a representative office. A branch is an integral part of the parent bank and it acts as a legal and functional arm of the head office. Bank XYZ plan to establish a branch office Dubai, UAE is mainly supported by its objective, internal factors factor such as need of control over the branch, international experiences and external environmental factors such as size and growth of UAE market, local infrastructure, government regulation and country risk.

Potential risk that may be embedded to the establishment of a branch office would be as follows:

- **Unlimited liability of parent**

  A branch is not a separate part from its parent company and acts as a legal and functional arm of its parent operations. Then, any failure in its business will impact on its parent Company condition especially financial difficulties. The increase of parent company burden over the failure of branch office business will then increase the liability of the parent at all cost and unlimited.

- **Risk of exposing worldwide income of parent to taxation in host country**

  Since a branch is an integral part of the parent bank, all information about parent company including parent income will be disclosed by the authority of the branch country. This condition might impact on different tax treatment over the branch income.

### 4.3.2. Representative Office

Representative office is established commonly to serve as liaison and marketing function for the parent bank, which is not legally present in the host country with regard to legal or tax liability.

The risk over the establishment of Representative office is lower compare to Branch or Subsidiary, since the lower commitment in term of cost of establishment. There are two kind of risk over the establishment of Representative office.

- **Limited use only -- parent cannot conduct business through this office**

  Since its limitation of scope of activity to serve banking services as it cannot conduct business through this office, the ability of representative office to anticipate any changes or catch business opportunity in the market or business low. The risk of loss of business opportunity is one of the business risks over this type of overseas office. Bank XYZ, in terms of UAE market level of competition that very fierce, can adopt this type of overseas office structure, in order to mitigate of failure.

- **Unlimited liability of parent company**

  Similar with the branch office structure, the Representative office is an integral part of its parent company (bank). Any failures in its business activity will the liability of its parent company. However, the loss exposure if this type of office structure is much lower compare to Branch type or Subsidiary type of office in terms of cost commitment of office establishment. Again, Bank XYZ, in terms of UAE market level of competition that very fierce, can adopt this type of overseas office structure, in order to mitigate of failure.

**4.3.3. Subsidiary**

A Subsidiary is separate legally from the parent bank and organized under the laws and regulated by the authorities of the host country. It may engage full banking activities as permitted by host country regulations.

The risk over the establishment of Subsidiary is higher compare to Branch or Representative Office, since its higher commitment in term of cost of establishment. There are two kind of risk over the establishment of Subsidiary:

- **Business Risk**

Subsidiary is separate legally from the parent bank and organized under the laws and regulation issued by the authorities of the host country. The higher the level of competition in certain industry including banking industry in certain countries will increase the business risk of every company. The level of competition in the banking market of UAE is very fierce, since too many well established foreign banks such as Barclays Plc Bank, ABN Amro bank, Citigroup etc., are opening their overseas office there. By bringing their good image and reputation in UAE market, their ability to compete to its competitor is high. Bank XYZ that bring a lower international experiences compare to its competitor and lower image and reputation, will find difficulties to compete to its competitor. A subsidiary that separate legally from its parent, will find difficulties to compete with other foreign bank without any direct support from its parent bank, due to its lack of experiences, reputation and image. The failure of its business will increase the loss due to higher commitment of the subsidiary establishment.

- **Local registration and disclosure laws often require the company to publicize confidential information.**

As separate legally from its parent bank, a subsidiary usually must follow and comply fully as independent entity with the local law and regulation requirements such as disseminate more comprehensive and confidential information or report to be published publicly. The UAE Government authorities have established and enforce banking law with high transparency in reporting matters. Bank XYZ must ready for the transparency requirements and the impact of this disclosures to their customer and competitors that in turns will disclose its level of competitive ability.

## 4.4. Timing of Entry

Timing of entry must be considered as International market entry decision. It covers the timing-of-entry question: when should the firm enter a foreign market? In this case, whether Bank XYZ has enough resources and experiences to open new overseas offices? In other word, what is the competitive advantage of Bank XYZ to UAE market? Bank XYZ must strongly calculate it decision about the timing of entry and the cost and benefit of the entry decision before it start to open the office in the highly competitive market like UAE market.

If competitive advantages could be achieved through even in late entry into the marketplace, then the timing of entry deserves special attention. Many studies have examined multidimensional entry strategies and argue that firm resources and organizational attributes influence entry timing (Day, 1986; Green and Ryans, 1990). Most of the studies that have emerged since the seminal work of Lieberman and Montgomery (1988) are, however, fragmented and isolated, focusing on only certain aspects of the advantage and disadvantage, its antecedents, conditions, environmental factors, or performance outcomes (Kerin and Varadarajan, 1992). It is therefore not utterly surprising that the results on the relationship between entry timing and performance have been equivocal. Anecdotal evidences have shown that firms with superior product strategies could achieve superior advantages either as first or late movers in an industry.

One study examined the timing of entry decision of US Fortune 500 firms in China, the entry of timing is suitable if:

- The higher the level of international experiences
- The larger the firm size
- The broader the scope of product and services
- When competitors have already entered the market
- The more favorable the risk (political, business) condition

- When non-equity modes entry e.g. licensing, exporting, non-equity alliances, are chosen.

Based on the above criteria, Bank XYZ timing of entry factor to international market (UAE market) is only supported by its international experiences in which Bank XYZ really able to do the business and aligned with the international manner, even though that experiences if compare to its competitors that already exist in UAE market might be less. The other factor such as size of firm, Bank XYZ is smaller against its competitors in terms of total assets, equity and net income such as Deutsch Bank, Barclay Bank Plc, UBS Bank, ABN Amro, Standard Chartered Bank etc. as summarized in Exhibit 10. For the factors of broader scope of product and services, in this regard Bank XYZ only serves corporate banking services in conformity of DIFC regulation the prohibit retail banking services and especially will serve trade finance activity. The other factors such as due to the competitor early entered the market and favorable risk, in this regard Bank XYZ more concern on the country risk of the UAE that very good according to Moody and this factor is the main factor to entry decision. The timing of entry is more to the readiness of Bank XYZ resources and capabilities to open and operate the overseas office in Dubai, UAE.

In terms of timing of entry, Bank XYZ must consider its competitive advantage to be offered to UAE market. This competitive advantage is the main driver of Bank XYZ to enter the market place. The international experiences and the resources and capabilities of Bank XYZ is enough to running the business and strongly support by the Bank XYZ strong commitment to support its international market strategy to Dubai, UAE. In addition to Bank XYZ declaration to be one of regional champion bank recently, look at the UAE market that growth steadily and the traffic of trade from and to UAE market increase, it's about time to Bank XYZ to enter the UAE market.

## 4.5. Selection of Market Entry Strategy

Although some factors based on analyses result favor high control entry modes, other criteria suggest a low control mode. The different modes of entry can be classified according to the degree of control they offer to the entrant from low-control (e.g. indirect exporting) to high control mode e.g. wholly owned subsidiaries or branch.

To some extent, the appropriate entry mode decision boils down to the issue of how much control is desirable. Ideally, the entrant would like to have as much control as possible. However, entry modes that offer a large degree of control also entail substantial resources commitment and huge amounts of risk. Therefore, the entrant faces a tradeoff between the benefits of increase control and the cost of resources commitment and risk.

An empirical study of entry decisions made by the 180 largest MNCs over 15 year periods found that MNCs are most likely to enter with wholly owned subsidiaries when one of the following condition hold:

- The entry involves an R&D intensive line of business
- The entry involve an advertising-intensive line of business (high brand equity)
- The MNCs has accumulated a substantial amount of experiences with foreign entries.

On the other hand, MNCs are most likely to prefer a partnership when one of these holds:

- The entry is in a highly risky country
- The entry is in a socio-culturally distant country
- There are legal restrictions ob foreign ownership assets

Based on internal and external environment factors analysis for the selection of market entry strategy of Bank XYZ in UAE market, the result of analysis and the level of risk faced by Bank XYZ, the level of ability of Bank XYZ to cover or mitigate the risk and the possible structure of the overseas office in Dubai, UAE as the representation of the entry strategy are summarized in Exhibit 13 as below.

**Exhibit 13. Summary of Analysis Result**

| No | Determinat Factors | Degree of Condition | Degree of Ability to Align with the Degree of Condition | Possible Structure of Overseas Office |
|---|---|---|---|---|
| | **Internal Factors** | | | |
| 1 | Psychic / Cultural Distance | Medium | High | Branch |
| 2 | Need for Control | High | High | Branch |
| 3 | International Experiences | Medium | High | Branch |
| 4 | Size of Firm | Low | Low | Rep Office |
| | | | | |
| | **External Factors** | | | |
| 5 | Competitive Environment | High | Low | Rep Office |
| 6 | UAE Government Regulation | High | High | Branch |
| 7 | Market Size and Growth | High | High | Branch |
| 8 | Country Risk | Low | High | Branch |

From the above summary, it's suggested that the suitable structure of Bank XYZ overseas office in Dubai is a branch instead of Representative Office. Based on Internal factors analysis, except size of firm factor, all other internal factor suggested the suitable office structure to be established is a branch. Meanwhile, based on external environment factors analysis, except for competitive environment factor, all other external environment factors indicated the suitable office structure to be a Branch rather than a Representative Office.

A Branch is office structure that indicates a higher level of commitment to a foreign market than Representative Office. A Branch is an integral part of the parent company and it acts as a legal and functional arm of the head office. A Branch may perform all banking functions that are permitted by host country such as accepting deposit and extending the loan. A Branch is not a separate legal or financial entity from the parent company and not separately capitalized from the parent.

A Representative Office is an office structure that physically presence in the foreign market with limited functions. A Representative Office can not provide traditional banking services. Rather, its officers troll for business opportunity in the foreign market and the Representative Office can not accept deposits or lend fund on its own book. It essentially serves as liaison and marketing function for the parent company, which is not legally present in the host country with regard to legal or tax liability. It has low budget and can easily closed down, making them useful to explore new and high risk market.

Overall result of all determinant factors that influence the mode of entry strategy of Bank XYZ in UAE market, recommend Bank XYZ to open a Branch office, rather than subsidiary or representative office. This choice of entry mode is in line with the Bank XYZ objective to open a branch. Bank XYZ according to their management press conference in one of national newspapers, have explained that Bank XYZ is prefer to open a branch in order to maintain the control authorities over the overseas branch office since the market entered is relatively new.

According to Davis and Macho, 2004, there are some advantages and disadvantages of establishing a branch office as follows:

**Advantage**

- Usually quicker to establish
- Usually fewer restrictions on corporate ownership and control
- Fewer requirements to disclose confidential company information

**Disadvantages**

- Unlimited liability of parent
- Risk of exposing worldwide income of parent to taxation in host country
- Some countries have a less advantageous tax treatment for branches than local companies

Based on above list of advantages and disadvantages of establishing a branch in Dubai, UAE, Bank XYZ can capitalize the benefit from the establishment of the branch office advantages as this will encourage Bank XYZ to plan and implement its business strategy well. The other factors of disadvantages of opening a branch that become the main concern of Bank XYZ are the unlimited liability of parent obligation if the branch fails in the businesses. In order to cover and mitigate this risk of failure, Bank XYZ must control adequately the operation of the Dubai office and keep support the Dubai branch with adequate and capable resources (human and financial) and allocated some business to Dubai office to speed up their business transactions growth. Based on cost and benefit calculation analysis, Dubai branch office is financially feasible and the initial investment will be recovered after 4.23 years of branch operations. It means that with a prudent plan and well manages operation, the branch will be expected to run well.

Look at the above table of summary, Bank XYZ is relatively low in size of firm in terms of financial resources such as total assets, total equity and total net income (see exhibit 10). This condition will influences the ability of Bank XYZ to compete in UAE market as it will shown the lower credibility of Bank XYZ compare to its competitors. Competitive environment of UAE market is high as there are many well established foreign banks operated in UAE markets and again in this regard Bank XYZ is relatively weaker against its competitors in UAE market. From these points of view, it looks better for Bank XYZ to open a Representative Office as initial entry strategy instead of a branch or subsidiary in order to minimize the risk of failure.

Other determinant factors such as cultural distance, centralization of decision making, international experiences, UAE Government regulation, market size and growth and country risk (Scored A or very good, in accordance to Moody's in 2006) Bank XYZ has a good shape to enter the UAE market and has high ability to overcome the risk factors. It means that Bank

XYZ can increase its commitment by opening a branch in UAE market with high control and cost. Bank XYZ can increase its commitment in UAE market by changing the status of its branch become a subsidiary considering the very good banking regulation and high income per capita of UAE in the future years.

Other factor that influences a firm market entry strategy is its degree of commitment to a new market (Hughes and McDonald, 2002). Bank XYZ's degree of commitment to enter UAE market is very strong that driven by its vision and commitment to be one of regional champion bank and to establish a good image. Bank XYZ considers that the location of Dubai, UAE as a hub to the market of Middle East, Europe and North Africa is very strategic, in addition to the good external environment factors of UAE.

# CHAPTER V

# CONCLUSION AND RECOMMENDATION

This chapter will elaborate the conclusion of this final paper that combine all analysis made over the market entry strategy factors such as internal factors, external environment factors, the cost and benefit calculation analysis, the risk analysis and the timing of entry analysis. In addition to the conclusion, some recommendations are also suggested to Bank XYZ to strengthen its market entry strategy decision.

## 5.1. Conclusion

In summary, firm's internal factors and external environment factors prescribe the market entry strategies to be adopted and entry strategies are constrained by firm's entry timing. Companies have many approaches to select entry strategy choices to implement their global expansion efforts. Each alternative has its pros and cons. There is no one-size-fits all alternative.

This Final Paper has generated some principal conclusion as follows:

1. The expansion strategy by opening overseas office in Dubai, United Arab Emirates (UAE) especially in Dubai International Financial Centre (DIFC), in terms of cost and benefit is feasible. Based on cost and benefit calculation, the branch initial investment will be recovered after 4.23 years.
2. The type of office structure that suitable to be established in Dubai, UAE based on the analysis result over internal factors, external environment factors, cost and benefit, risk analysis, is a branch office.
3. Branch office structure has some benefit to the Bank XYZ such as (i) it usually quicker to be established, (ii) it usually have fewer restrictions on corporate ownership and

control and (iii) it have fewer requirements to disclose confidential company information. Meanwhile, branch office type disadvantage that become a concern of Bank XYZ is the unlimited liability of parent bank for the failure of the branch business. It means that a prudent plan and well operation management must be conducted to mitigate the risk of operation failure in Dubai, UAE market.

4. Internal factors that relevant to decision of selection of market entry strategy to UAE market such as corporate objectives, need of control, internal resources, assets and capability have shown a favorable conditions to support Bank XYZ decision to open a branch office in Dubai, UAE.

5. External environment factors that relevant to the decision of selection of market entry strategy to UAE market such as Government of UAE regulation, market size and growth, country risk and local infrastructure are also looked favorable for the Bank XYZ to open an overseas branch office in Dubai, UAE.

6. The commitment of the Bank XYZ to open an overseas office in Dubai, UAE is very strong to support the establishment of Dubai, branch office in order to enlarge their international business network and to realize its vision to be one of regional champion bank.

7. United Arab Emirates (UAE) provides all sophisticated infrastructures required by all investors and means completely in Dubai International Financial Centre (DIFC), detailed, and modern. These infrastructures are available to support business operations of Bank XYZ in UAE market.

8. In terms of risk, the selection of Branch office as type of overseas office structure, have two main potential risk that must be considered by Bank XYZ such as follows:

- Unlimited liability of parent

  A branch is not a separate part from its parent company and acts as a legal and functional arm of its parent operations. Then, any failure in its business will impact on its parent Company condition especially financial difficulties. The increase of parent company burden over the failure of branch office business will then increase the liability of the parent at all cost and unlimited.

- Risk of exposing worldwide income of parent to taxation in host country

  Since a branch is an integral part of the parent bank, all information about parent company including parent income will be disclosed by the authority of the branch country. This condition might impact on tax treatment over the branch income

9. The primary objectives of opening a branch are to extend international networks of Bank XYZ within the world's financial center to support international transactions that is continuously growing. It would also contribute to the Indonesian government's program to promote Indonesia's exports. Additionally, it would undoubtedly assist trade transactions between Indonesia and UAE as well as all other projects in both countries.

## 5.2. Recommendations

1. Dubai (UAE) is currently considered to be the banking and financial center of United Arab Emirates (UAE). It is predicted that it will become one of financial center that hub three main regions including Middle East, Europe and North Africa in the future. In order to realize the vision of Bank XYZ to be a regional champion bank that recognized and respected in the regional area, it is appropriate for Bank XYZ to open its overseas office in Dubai, UAE as soon as possible.
2. Considering the high competitive environment in UAE market as many well established foreign bank operated in UAE market and the prohibition to do a retail banking service

or only allowed to do corporate banking, it is necessary to Bank XYZ to do a strong research over its potential customers in UAE market in order to empower its market image creation and generate income for its survival in the fierce market like UAE market.

3. The timing-of-entry question: when should the firm enter a foreign market? In this case, whether Bank XYZ has enough resources and experiences to open new overseas offices? Bank XYZ must strongly calculate its decision before it started to open an overseas office in a very competitive market like UAE market. In decision of timing of entry, Bank XYZ must have a certain competitive advantage as the main driver or other factors that support the existence of the branch office to compete in UAE market.
4. Bank XYZ is strongly recommend to employ more staff in marketing and business development to expedite the creation of public image and expanding the business in UAE market instead of employ many administrative staffs.

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