INTERNATIONAL JOURNAL OF RESEARCH IN COMMERCE AND MANAGEMENT

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Contributions to books
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FINANCIAL LIBERALIZATION IN SINGAPORE, 1999-2003: THE EFFECT OF FIVE-YEAR LIBERALIZATION PROGRAM ON SINGAPORE'S BANKING SECTOR

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ABSTRACT
This research aims at finding the effect of financial reforms on Singapore's banking industry. And the objective of this report includes: examining if the financial reforms played a positive role for Singapore's financial development, how the reforms impact on foreign banks and where the liberalization brought risks for local banks. This report will adopt the deductive approach to find out the relationship between the financial liberalization and Singapore's banking sector, event the financial center development. And mainly to compare the data of performance from different years to meet these objectives. The findings of this report indicate that this financial reform in benefit for Singapore's banking sector and the financial sector development. Although foreign banks can operate more activities in domestic banking market and get more access to this market, at the same time, they have obtained a great progress, the local banks still dominate the domestic retail banking sector. Because the liberalization program also encouraged local banks to consolidate to become strong enough to compete with foreign banks, and foreign banks still face many limitations when operating their activities. Finally, the recommendations to Singapore government, local banks, foreign banks and Singapore's financial center will be made. The further liberalization will be needs from government, and most important thing for commercial banks that they have to implement the competitive strategies to compete with their competitors.

KEYWORDS
Singapore, financial liberalization, domestic banking market, foreign banks, local banks, reforms, expansion, financial center development.

INTRODUCTION
Singapore is just a small island city-state in South East Asia. Nevertheless, it has been a remarkable success as a regional financial center in South East Asia and has a high status in the world nowadays. For instance, "In 2004, 700 local and foreign financial institutions are in Singapore, many of which are foreign institutions. And they offer a comprehensive range of world-class financial services and with 5% of workforce; contribute 12% of Singapore's GDP." (Lee Hsien Loong, 2004) And the financial services sector grew by 6.0% in 2004, compared with the 4.3% expansion recorded in the previous year. (Economic survey of Singapore 2004) For the banking sector, IMF report shows that Singapore's local banks, which have a 55% share of domestic banking assets, are profitable and well capitalized in 2004. Such a small country attained so remarkable success in financial sector, it can be seen a marvelous achievement. Because the banking sector dominated Singapore's financial industry, many of the achievements it has obtained derived from the contribution of banking sector. Therefore, Singapore's government more opened its banking market, let more foreign banks enter its domestic retail banking market, and awarded more privileges to them for their operations in Singapore's banking market. At the same time, the government sustained and encouraged local banks to extend and strengthen themselves, in order to compete with more foreign competitors in the open banking markets. In fact, after gaining the independence in 1965, Singapore's government began to choose the financial development strategies, with the aim of transforming into a regional financial center. Over the next 30 years, Singapore's government continually implemented financial sector reforms, opened new financial markets, attracted foreign financial institutions to Singapore, etc. The purpose is also to enhance Singapore's position of regional financial center. Since 1998, Singapore has implemented significant financial sector reforms, especially on the banking sector. These reforms are aimed at enhancing Singapore's position as a major international financial center and opening the financial industry to face more foreign competition, gradually liberalizing the restrictions on the international use of the Singapore dollar, etc. In order to reach these objectives, in May 1999, the Singapore's government announced a five-year liberalization program to liberalize the domestic banking sector. This program allowed foreign banks to expand their operations in Singapore and encouraged consolidation among local banks.

RESEARCH MOTIVATION
If the five-year liberalization program on Singapore's banking sector boosted the position of regional financial center for Singapore, if the program met Singapore government's aims, and under the liberalization program, if foreign banks' extending influenced local banks' development, etc. There are too many impacts from the five-year liberalization on Singapore's banking sector, even the whole financial industry. This is the motivation why researching this subject. In order to reflect the effects of liberalization program, there are three research objectives to cater for it: Firstly, to examine is the five-year liberalization program good or bad for Singapore's financial development;
Secondly, to examine how did the liberalization program impact on the foreign banks in Singapore's banking market; Finally, to find out whether are the local banks facing the threats that come from foreign banks under the financial liberalization program

OVERVIEW OF SINGAPORE
Singapore is one of the 20 smallest countries in the world, only about 655 square kilometers in area. In the early 1960s, Singapore was faced with a lack of physical resources and a small domestic market. In order to develop its economies, Singapore has naturally relied on international trade to be a competitive economy. Instead of having the traditional protectionist policy, Singapore has accordingly established itself as a free trade area with very few trade barriers. For example, Singapore implemented an economic blueprint that encouraged inward investments of multinational corporations to Singapore, such as the inflows of foreign direct investment from the UK, US and Japan provided an impetus to the development of the financial sector. Nowadays, Singapore's economy is a world leader. It can be said that the development of such a small state into a renowned vibrant economy, ranked fourth in the most competitive countries in the world in 2002 (HSBC), because Singapore has long adopted economic policies that encourage open trade and investment, and it has the recognition of excellent business and social infrastructure, free-market economy, stable political and corruption-free business environment. Moreover, Singapore's excellent telecommunications network, sophisticated financial infrastructure, world-call transportation and information technology system, all of these advantages made Singapore becoming an ideal location for foreign investors. It can be said that Singapore is an international global business center nowadays. During the recent years, its foreign direct investment, which includes both the outbound and inbound investments are increasing year by year. (Figure 1.1) As the development of

Singapore's international trade, its banking and financial industry will also obtain more opportunities to extend and promote their businesses, such as loans and investment on business companies.

FIGURE 1.0: SINGAPORE'S INBOUND AND OUTBOUND FOREIGN DIRECT INVESTMENT, 1999-2003

Source: Singapore statistics

LITERATURE REVIEW

Most of the economic theories and practical experiences indicated that the financial liberalization can stimulate economic development. Maybe just because of this, Singapore's government adopted the five-year liberalization program to develop Singapore's commercial banking sector, at the same time, to stimulate Singapore's economic development. What exactly does financial liberalization mean? And what does the financial liberalization mean for Singapore? Did the financial liberalization really bring the benefits to Singapore? By the way of getting the answers, we will look the definition of financial liberalization from different economists firstly. Generally speaking, the liberalization refers to the freeing of trade, investment and capital flows between countries, and so on. However, what is the financial liberalization? It takes various meanings in the previous literature. A lot of people recognized that it is an integral part of financial sector development. For example, government policies on trade liberalization, interest rate deregulation, and capital account opening. All of these methods may enhance economic growth. This report will introduce two meanings of financial liberalization. Firstly, according to *Kaminsky and Schmukler (2003)*, "the financial liberalization consists of the deregulation of the foreign sector capital account, the domestic financial sector, and the stock market sector viewed separately from the domestic financial sector. A full financial liberalization occurs when at least two of the three sectors are fully liberalized and the third one is partially liberalized. A country is partially liberalized when at least two sectors are partially liberalized." Basing on Kaminsky and Schmukler's theory, it is important to recognize that financial innovation and liberalization are domestic, as well as international phenomena. Not only have restrictions on international financial transactions been relaxed, but also the regulations constraining the operation of domestic financial markets have been removed as countries have moved away from policies of financial repression. Both domestic and international financial liberalization respond to many of the same incentives and pressures. It is experiential that the liberalization occurs in several stages. Typically, the domestic financial liberalization that means the abolition of controls on interest rates and credit allocation usually precedes the international financial liberalization, which means the elimination of capital controls and restrictions on the convertibility of domestic currency into foreign exchange. In Singapore, the government also implemented the reform that relaxed the restrictions for the using of Singapore dollar. Secondly, *Barbara Stalling (2004)* indicates that "financial liberalization in the past two decades has profoundly transformed the financial system in developing economies around the world. Broadly speaking, these changes have come about in three stages. First stage, liberalization changed the rules under which the financial sector operates, moving from a system where governments heavily influenced the volume, price, and destination of loans to one where private-sector institutions make such decisions on their own. Second stage, in many cases financial liberalization was followed by financial crisis, which required rescue programs absorbing large amounts of fiscal revenues and resulting in steep losses of output. Third stage, the resolution of the crises further changed the characteristics of the financial sector."

For Singapore's financial liberalization in 1999, it is more inclined to Barbara Stalling's theory. Singapore's liberalization program aims to liberalize Singapore's banking sector, and then speed Singapore's economic development. Through this program, the government released the restrictions to foreign banks at a certain extent, and government allowed foreign banks to expand their operations in Singapore domestic banking market. At the same time government encouraged consolidation among local banks. It is noticeable Ekin Tokat (2005) addressed that, in the process of financial liberalization, banks become pregnable to external economic shocks if the banking system is not sufficiently developed. However, as the institutional environment gets stronger, the link between the liberalization and vulnerability disappears.

Whether this financial liberalization will bring crisis for Singapore's banking sector, that is to say, whether the Singapore has entered into stage two and It is acknowledged that financial liberalization is an extremely important component of a successful development strategy for economies. However, if financial deregulation is implemented in isolation, it is unlikely to promote growth and may, in contrast, impede economic development. "The importance of achieving macroeconomic stability prior to reform is well know, yet structural reform and institutional development in the financial sector, especially prudential financial supervision, are equally essential as liberalization proceeds." (IMF Working Paper No. 95/123)

FIVE-YEAR LIBERALIZATION PROGRAM IN SINGAPORE

THE REASONS FOR FINANCIAL LIBERALIZATION

Here we simply review the reasons for liberalizing Singapore's commercial banking sector. At the early 1970s, MAS adopted policies to protect the local banks, so that they grew fast and got a larger share of the domestic market. At the same time, MAS restricted foreign banks' activities in domestic retailing banking market. However, as the increased globalization of financial services, government has to liberalize the financial services sector, and let more foreign banks to compete with local banks freely. Thus, in May 1999 the Government announced a five-year program to liberalize retail banking. Deputy Prime Minister (and MAS Chairman) Lee Hsien Loong said the changes would strengthen Singapore's banking system, provide Singaporeans with quality banking services, and enhance Singapore's position as an international financial center. MAS officials asserted that competition, not protection, was the best way to foster the development of strong and large local banks that would be capable of holding their own domestically against the major international banks. The banking liberalization program includes an expansion of banking privileges and a broadening of the range of activities for foreign banks, and the consolidation of local banks.

GOVERNMENT POLICIES

GOVERNMENT POLICIES IN THE FIRST STEP OF LIBERALIZATION

In the first phase of liberalization (1999-2001), MAS announced it will open the door to new full and restricted banking licenses, as well as increase access to the domestic market by foreign full, restricted and offshore banks. For full banks, MAS announced that the existing foreign full banks can re-locate their existing subbranches on a case by case basis. In addition, MAS created a new category of full banking license named Qualifying Full Banks (QFBs), they own the different privileges from the existing class of foreign full banks. 6 QFB licenses will be awarded to foreign banks over 1999-2001. Each QFB are allowed additional branches, off-premise ATMs and ATM sharing, as follows: First, up to 10 locations-branches and off-premise ATMs-of which up to 5 can be branches: No more than 2 new branches and 3 off-premise ATMs to be set up each year following issuance of QFB license QFBs which already have more than 5 branches will be capped at their present number, but will be allowed up to 5 off-premise ATMs

Second, free re-location of existing branches; Third, Sharing of ATMs among QFBs. (MAS, 1999) For restricted banks, the number of restricted bank licensed were increased from 13 to 18 by 2001. For offshore banks, they are given greater flexibility in S$ wholesale business. Qualifying Offshore Banks (QOBs) approved by MAS have privileges that their S$ lending limit increased from the current S$300 million to S$1billion. They also be allowed to engage in S$ swaps, without any restriction on the purpose of the swaps. All other offshore banks' S$ lending limit increased to S$500 million. They are allowed to engage in S$ swaps in respect of proceeds arising from the issue of S$ bonds managed or arranged by them. (MAS 1999) Furthermore, the government removed a 40% limit on foreign ownership of domestic banks in order to reiterate its opposition to any foreign bank acquiring a local bank.

GOVERNMENT POLICIES IN THE SECOND STEP OF LIBERALIZATION PROGRAM

After looking at what happen in the first step, in June 2001, MAS announced the second phase of the banking liberalization program to free up entry to the wholesale market and further enhance competition in retail banking. The new measures as follows: Firstly, replace the restricted banking license with the new Wholesale Banking (WB) license. Wholesale banks have all the privileges currently enjoyed by restricted banks. This will move the three tiers of banking licenses-full, restricted and offshore towards the two-tier licenses-full and wholesale. Secondly, phase-out of the Qualifying Offshore Bank and Offshore Bank licenses and upgrade of all QOB and OB to wholesale licenses over time. 20 wholesale banks will be granted over the next two years. Thereby doubling the number of restricted/wholesale banks in Singapore. The existing offshore banks and banks that do not yet hold a banking license in Singapore are encouraged to apply. This will allow QOBs and QBs to accept S$ fixed deposits above S$250,000 (US$135,000) and offer S$ current accounts, and will also remove limits on the amount of S$ lending they can offer. Thirdly, converting all existing restricted banks to wholesale banks. Fourthly, In December 2001 MAS accepted applications for the remaining 2 QFB licenses and 16 wholesale bank licenses. Of the 16 wholesale bank licenses, 8 were converted from QOBs. Application for the remaining wholesale bank licenses was opened in Dec 2002, and 8 more wholesale bank licenses were awarded in May 2003. QFBs are now allowed to establish up to 15 locations, of which up to 10 can be branches. The 15 locations can include both branches and off-site ATMs. The sub-limit of 10 branches will include branches and limited-purpose branches. The 6 QFBs can share ATMs among themselves.

Provide debit services through an Electronic Funds Transfer at the Point-of-Sale (EFTPOS) system from 1 July 2002. For example, customers of the QFBs will be able to pay for their purchases and withdraw cash at participating retail outlets using debit cards. Provide Supplementary Retirement Scheme (SRS) accounts and CPF Investment Scheme accounts and accept CPF fixed deposits from 1 July 2002. Lastly, MAS has loosened restrictions on the internationalization of the Singapore dollar, so that only limited S$ restrictions remain.

FURTHER POLICIES FOR THE COMMERCIAL BANKING SECTOR

Despite liberalization, foreign banks are still not treated as the local banks. That means the retail banking sector in Singapore remains heavily tilted in favor of the local banks. Key restrictions, for example, including the numerical quota on the number of foreign retail banks and the 15 location (branch/ATM) limit for QFB foreign retail banks, a policy that effectively prevents a foreign bank from accessing local banks' ATMs. As the continuing rapid globalization of the financial industry, it is necessary to open domestic market to foreign countries, because "competition from foreign banks can increase services for consumers, and then allowing local banks to diversify their earnings by providing new banking services." (Lee) Therefore, in 2004, the MAS decided to take a few further steps to liberalize the banking industry. The measures as follows: Firstly, from Jan 1, 2005, QFBs will be permitted to establish up to 25 service locations from the existing 15. And the 25 locations can either be brick-and-mortar branches or offsite ATM locations. With 6 QFBs permitted to share ATMs amongst themselves, this could result in a QFB shared ATM network of about 150 locations across Singapore. This provides QFBs with significant scope for expanding their presence in the domestic market. Secondly, MAS is prepared to grant a limited number of new Wholesale Bank licenses to applicants that meet Singapore's admission requirements. Thirdly, QFBs will with immediate effect be allowed to negotiate with the local banks on a commercial basis to let their credit card holders obtain cash advances through the local banks' ATM networks. MAS will regulate the measures for foreign banks due to the changes of global banking market.

LOCAL BANK CONSOLIDATION

Of course, when relaxing the restriction on foreign banks, MAS still focus on the ongoing process of consolidation among the local banks.

PROCESS OF LOCAL BANK CONSOLIDATION

In 1998, Development Bank of Singapore (DBS) successfully acquired the Post Office Savings Bank (POSB), which encouraged domestic banks to consolidate to compete with foreign banks. The merger and acquisition activity among Singaporean banks increased during 2001. Firstly, in April 2001, DBS acquired Hong Kong's fourth largest bank--Dao Heng Bank, for US$5.7 billion as part of its regional expansion plans. Secondly, on 12 June 2001, Singapore's third largest banks-Overdeas Chinese Banking Corporation (OCBC) announced a S$4.8 billion bid for Keppel Capital Holdings (KCH), which owns Singapore's smallest Bank, Keppel TatLee Bank. Thirdly, on 22 June 2001, only two weeks later, DBS Holdings Group (which owns Singapore's largest bank, DBS) made an unsolicited bid of S$9.4 billion for Overseas Union Bank (OUB), the fourth largest bank. Finally, on 29 June 2001, second largest United Overseas Bank (UOB) made a competing bid for OUB, consisting of a cash and stock offer. UOB's bid succeeded in August 2001 and the merger will form Singapore's largest bank in terms of assets. By 2004, seven local banks consolidated to become three large local banking groups in Singapore. They are Development Bank of Singapore (DBS), United Overseas Bank (UOB) and Overseas Chinese Banking Corporation (OCBC). (Adrian T. H. Kuah, 2005)

BACKGROUND OF THREE LOCAL BANK GROUPS

DBS is one of the largest financial services groups in Asia. The largest bank in Singapore and the fifth largest banking group in Hong Kong as measured by assets, DBS has leading positions in consumer banking, treasury and markets, asset management, securities brokerage, equity and debt fund raising. The Bank's credit ratings are one of the highest among banks competing in the Asia-Pacific region, and the highest among banks in Singapore.OCBC group is one of the Asia's leading financial services groups and one of the largest financial institutions in the combined Singapore-Malaysia market in terms of assets. As Singapore's longest established local bank, it enjoys one of the highest bank credit ratings in the region, OCBC is also one of the most respected in Asia. Their extensive network of branches and ATMs in Singapore enables us to better service the needs of our clients, who get to choose from a full range of consumer, business, investment, and international banking services, insurance, securities trading, asset management, and global treasury. It is Singapore's longest established local bank, with a rich heritage that can be traced as far back as 1912.UOB was founded in 1935. Since then, UOB has grown from strength to strength. It is today a leading bank in Singapore and a dominant player in Asia-Pacific. At the end of 2004, the UOB Group had total assets of S$134.9 billion and shareholder's funds of S$ 13.4 billion. (MAS)

ANALYSIS OF SINGAPORE'S COMMERCIAL BANKING SECTOR AFTER THE FINANCIAL LIBERALIZATION

ENTRY BARRIERS, SUPPLIERS AND BUYERS

It is obvious that the government released a lot of restrictions for foreign banks' operations in domestic retail banking market, at the same time, removed or relaxed some barriers for foreign banks entering the banking market. And it is much difficulty for foreign banks to extend their activities such as establishing new branches in banking market immediately because of the limited fund. That is to say, today, Singapore's banking sector still not completely open for foreign investors. The most powerful buyers are loans to consumers for all the commercial banks. They are increasing all the time in recent years. Increasing loans to customers means the buyers are becoming stronger than before. In addition, more loans also indicate there are more business companies established. The business consumers are also one of the main buyer groups for commercial banks. This can prove the buyers become more powerful as well. The business consumers are also banks' supplier. Moreover, the higher educated workforce, supported from MAS, increased IT technology, etc. all of these show the increasing supplier forces.

SUBSTITUTES
For commercial banks, the merchant banks and financial companies are their main substitute institutions. Figure 5.2 and 5.3 indicate the differences between commercial banks and other two financial institutions.

TABLE 1: SINGAPORE: STRUCTURE OF THE FINANCIAL SYSTEM
(At end-September 2003)

	Number of Institutions	Total Assets 1/ In billions of Singapore dollars	In percent of total assets in the financial system	In percent of 2002 GDP
Commercial banks	115	1,049.6	85.6	674.0
Local banks	5	257.0	21.0	165.0
Foreign banks	110	792.6	64.6	509.0
Qualifying full banks	6	224.9	18.3	144.4
Other full banks	16	63.8	5.2	41.0
Offshore banks	50	192.9	15.7	123.9
Wholesale banks	38	311.0	25.4	199.7
Merchant banks	51	58.3	4.8	37.4
Finance companies	4	11.1	0.9	7.1

Source: (IMF Report, 2004)

From figure 1.2, there are wide gap the proportion of total asset of GDP between commercial banks and other two financial institutions. Therefore, these two institutions will not bring much threat for commercial banks.

COMPETITORS
No matter for local banks or foreign banks, the threats from their rivalries is becoming stronger and stronger than before. On one hand, foreign banks are allowed to operate more activities, just because of this reason, local banks will lose some of their customers, and so losing the market share and profits. Thereby, all the local banks must implement some competitive strategies to compete with other competitors. Take the OCBC as an example. In February 2003, the bank announced the new Horizons strategy according to its business goals. OCBC wants to seek international growth and to build a high performance bank. Appendix B lists some of its goals and strategies. Not only OCBC, the other two local bank groups also implemented competitive strategies to meet their goals, and compete with foreign banks. On the other hand, because of the local banks' consolidation, they are much stronger than before, so the foreign banks will take more pressures. In addition, although government awarded many privileges for foreign banks, they still cannot gain the fair treatment with local banks when operating their business activities. Under such pressures, foreign banks also implemented a lot of competitive strategies to thrive and extend their market share. The Case study of Citibank will give an example for how the foreign banks implemented the strategies.

CASE STUDY OF CITIBANK

AIM OF ANALYZING CITIBANK
The aim of analyzing Citibank is to show how foreign banks can neutralize the advantages that local banks enjoy from having an extensive branch network and government protection, and so achieve their own goals.

BACKGROUND OF CITIBANK IN SINGAPORE
Citibank first established its operations in Singapore on 1 July 1902. It was the first American bank to set up a branch in Singapore. In 1982, Citibank established the Consumer Bank to cater to the needs of individuals and small business. It can be seen a relative latecomer to the retail banking sector. Citibank was one of the first four foreign banks who awarded the QFB license by MAS in 1999. Today, Citibank's customers have access to a full and complete range of financial services through a broad array of distribution channels and network. And in June 2004, Citibank announced its move to incorporate a wholly-owned subsidiary of Citigroup in Singapore, know as Citibank Singapore Ltd, with a paid-up capital of S$1.5 billion. This is part of Citibank's strategy to grow its international businesses.

STRATEGIES
Adopting which strategy to compete with rivalries mainly base on the banks own objectives or other decisive conditions. Citibank has already established the well-established phone banking and Internet banking services, focused on the credit card services, and debit card services. At the same time, Citibank pays attention to the business environment, such as demographics of customers. This will be mentioned later. In fact, one of the key rewards for the liberalization program was that "globalization and further rapid development in electronic delivery channels will allow foreign banks to reach out extensively to domestic consumers. This would neutralize the advantages that local banks enjoy from having an extensive branch network and government protection." (MAS) In a manner, this clearly indicated that the foreign banks such as Citibank, which have the abilities can obtain more benefits by having the Internet as a channel for their clients' banking services, providing a high level of quality customer service, Firstly, take the CitiPhone banking service as an example. Citibank's staff are able to resolve their customers' queries quickly, because the CitiPhone services are empowered and have a fairly high degree of autonomy in decision-making. This will hold many loyal customers for Citibank. In addition, Citibank's Internet banking infrastructure also gained an excellent repute. It is deemed to be one of the best around. For two consecutive years in 2002 and 2003, Citibank was voted the "Best Consumer Internet Bank in Singapore" by Global Finance magazine in its "World's Best Internet Banks" survey. Secondly, improving the bank's service quality, moving faster, and continuously coming up with innovative and consumer-driven products and services are part of Citibank's other goals. These can be reflected by the credit card services. In the domestic market, Citibank's credit card services have done exceptionally. Citibank has co-branded its cards with a retailer, an airline and a telecommunications operator to issue the Citibank Tangs Visa card, the Citibank Cathay Pacific Visa card and the M1 Citibank Visa card respectively. The innovation here is to offer the cardholders' benefits, in addition to the savings they enjoy when paying with such cards. They offer the right value proposition by identifying the customers' needs, try their best to cater for customers' tasters. The Citibank Tangs Visa card, for example, is one that is related to the segment that shops and spends. Even the Citibank Clear card has become popular. This credit card is innovative as it is probably the first translucent one available here. Due to the key benefits such as priority admissions to cinemas and trendy outlets, the card is more popular for the young and trendy segment. Smart Investor magazine indicated that, Citibank credit cards are the most popular in Singapore and it is followed closely by UOB. In reality, one in every four cardholders has a Citibank credit card. That means "25% of cardholders make purchases with Citibank cards and, interestingly, when it comes to appeal Citibank ranks the highest in consumers' minds, as most consumers aspire to be a Citibank cardholder as compared to other credit-card issuing banks. The study, which covered around 450 respondents aged 25 to 64 years old, concluded that the main reason for credit-card appeal is its loyalty program. The other main factors are advertisements and promotions, and the design of the card." (Smart Investor magazine) In fact, the number of cards on issue is rapid growing in Singapore now. It means that many Singaporeans have three or more credit cards in

their wallets. This poses a problem for card issuers--how do they differentiate their cards and ensure that cardholders use their cards rather than those of their competitors? All banks provide varies promotion to attract customers. HSBC, for example, it provides broad services such as internet banking, phone banking, day night centers, for self-service channels, credit card, debit card, etc. Only for credit cards service, it includes HSBC platinum card, classic visa and master card, secured visa card, corporate card, HSBC premier master card and so on. Therefore, Citibank, and other foreign banks face challenges from not only local banks, but also other foreign banks in Singapore's banking sector. The business strategies are the main tool for them to battle with their rivalries.

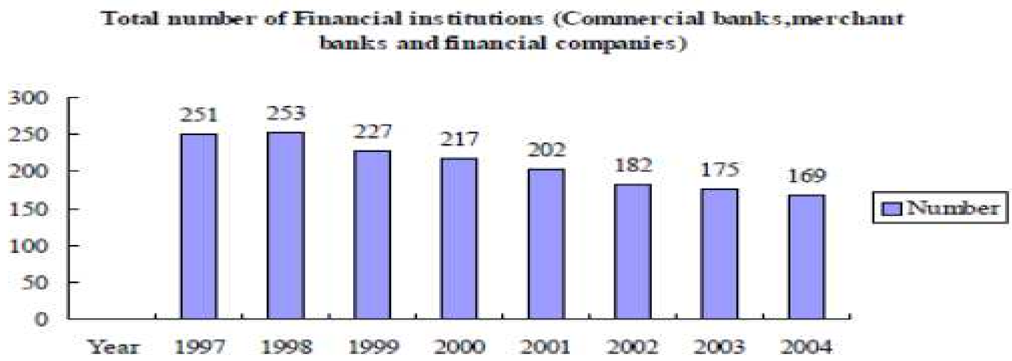
Thirdly, according to the financial liberalization, the QFB status allowing foreign banks to provide debit services, this is a growth opportunity has been made available. "The debit system has opened another segment for growth. Credit cards are restricted to those earning S$30,000 per annum but not for debit cards," explains Mr. Lee. If only one has enough funds in the account, the International Citicard debit card issued by Citibank can be used to make purchases both locally and globally. Under this activity, this debit card overtops a normal ATM card with its global payment capabilities. Debit cardholders can even withdraw pre-determined amounts of funds from their Citibank accounts when making purchases at selected retail outlets. This can overcomes the inconvenience associated with locating a Citibank ATM to withdraw cash. Such ability to provide premium services meant that Citibank cleverly skirted around the constraints of a limited branch and ATM network in the domestic market. This is a good way for foreign banks to extend their activities under government's restricted policies. Fourthly, Citibank in Singapore has grown so fast in the tough, mature market and intense competitive market, one of the main reasons is Citibank belongs to a global bank, their branding helped a lot. Lee said "We have managed with three branches and we actually grew with the trend by providing products and services that met the changing lifestyle needs of our customers." To support that growth, the capacity of CitiPhone will be increased and Internet services will be enhanced further. Actually, all the global banks own the same advantage. Finally, following the QFB status, Citibank has opened a fourth branch at the Esplanade and installed several ATMs there. But they put a research before establishing the branch and offering ATMs. Because they think implement these serves in the right places basing on the balanced against the demographics of our customers has helped. In despite of Citibank is viewed favorably for its product innovations, the biggest problem is the relatively high prices that it charges consumers for its products and services. "Our services are core to our success. Our quality service is our brand promise. By our standards, the satisfaction level has been acceptable. At least our customers see the value in our services and that is key. The market knows and accepts our premium pricing." says Mr Lee. In fact, Citibank's service level seems to be one of the best in Singapore's banking market.

THE RESULTS OF THE FINANCIAL LIBERALIZATION

CHANGES OF ALL COMMERCIAL BANKS

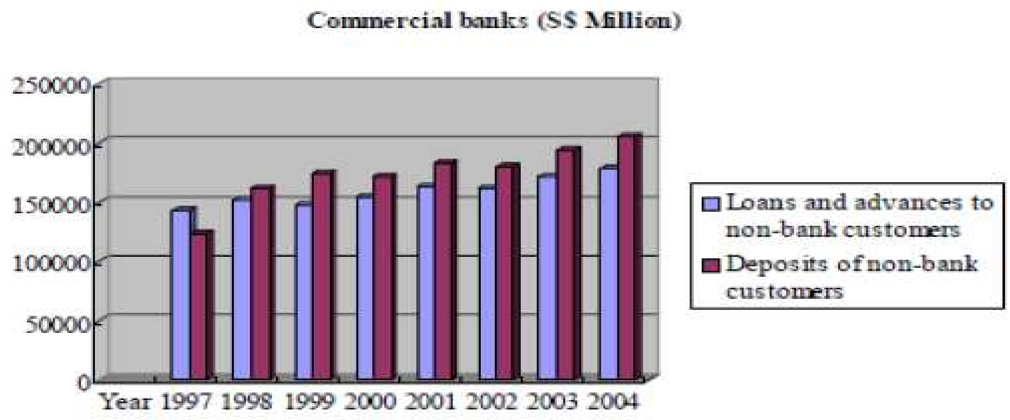
Since the liberalization program has been implanted, the numbers of Singapore's commercial banks are becoming smaller gradually. And the number of the merchant banks and financial companies also shrank. Though the number became smaller, their total assets, total investment, loans and advances to non-bank customers are increased gradually. Figure 6.1 and 6.2 show how they changed during this period. According to John A. Cochran's theory, "the growth of deposit can increase the amount of reserves available to a banks. For a bank, and generally for the banking system as a whole, the acquisition of added excess reserves means that these reserves will be used to acquire new earning assets, such as loans and investment, and thereby result in a corresponding increase in total bank deposits." And the lending is known as being at the heart of the function of a commercial bank by some bankers. Figure 6.2 shows that the loans and advances, and the deposits both increased from 1997 to 2004. See from the figure 6.3, the bank loans of commercial banks decreased in recent years. However, their non-bank loans increased vigorously. And the growth in non-bank lending was supported by lending to the household and general commerce sectors. As a result, they brought a certain profits for these commercial banks. The profits can be reflected by the increased total assets. The total assets increased to S$362,528.4 million in 2003 from S$289,572.3 million. Although the total assets in 2002 fell suddenly compared with that in 2001, however, it still higher than that in 2000. IMF report (2004) indicated the commercial banking sector (excluding merchant banks) accounted for more than 85% of total financial sector assets in September 2003. During the economic downturns' periods, Singapore's banking sector could achieve such achievement, because the financial liberalization operated a primary effect.

FIGURE2: TOTAL NUMBER OF FINANCIAL INSTITUTIONS IN SINGAPORE



Source: (MAS Annual report 2004/05)

FIGURE3: ASSETS/LIABILITIES FOR COMMERCIAL BANKS



Source: (MAS)

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TABLE 2. A PART OF SINGAPORE'S FINANCIAL SOUNDNESS INDICATORS-COMMERCIAL BANKING SECTOR, 1998-2003 SINGAPORE: FINANCIAL SOUNDNESS INDICATORS- COMMERCIAL BANKING SECTORS. 1998-2003

Asset quality						
Classified loans to total loans 3/						
Local banks 1/	7.8	8.5	5.6	5.7	5.5	5.3
Foreign banks 4/	11.8	10.9	8.8	7.7	8.0	5.1
NPLs to total loans						
Local banks 1/	...	5.3	3.4	3.6	3.4	3.5
Foreign banks 4/	...	6.5	5.4	3.7	3.7	2.5
Classified loans net of specific provisions to regulatory capital (local banks) 1/ 3/	28.7	26.4	23.5	25.1	25.0	20.3
NPLs net of specific provisions to regulatory capital (local banks) 1/	...	11.3	10.7	11.4	10.7	9.7
Total provisions to classified loans (local banks) 1/	51.1	53.8	53.8	56.9	60.2	64.3
Total provisions to NPLs (local banks) 1/	...	86.2	87.2	90.1	96.7	96.6
Specific provisions to classified loans (local banks) 1/	28.8	34.2	29.5	32.6	33.8	35.7
Specific provisions to NPLs (local banks)	...	54.7	47.9	51.5	54.3	53.6
Loan concentrations (local banks) (in percent of total loans) 1/						
Bank loans	28.1	31.2	35.4	30.0	29.3	25.7
Non-bank loans	71.9	68.8	64.6	70.0	70.7	74.3
Of which:						
Manufacturing loans	9.2	8.8	9.1	8.2	8.4	8.9
Building and construction loans	17.2	16.6	16.3	15.5	14.1	13.0
Housing loans	18.2	21.3	22.3	26.0	27.5	28.3
Loans to professionals and private individuals	12.6	13.1	13.8	13.5	14.1	14.0
Loans to nonbank financial institutions	15.4	14.0	14.7	13.1	13.4	13.5
Profitability						
After-tax return on assets (local banks) 1/ 5/	0.4	1.2	1.3	0.8	0.8	0.8
After-tax return on assets (foreign banks) 4/	-0.1	0.3	0.5	0.5	0.8	...
After-tax return on equity (local banks) 1/ 5/	4.2	10.7	12.6	7.7	7.6	7.8
Net interest margin (local banks) 1/	2.3	2.2	2.2	2.0	2.1	2.0
DBU net interest margin (foreign banks) 4/	2.3	2.5	2.1	2.0	1.9	1.7
DBU income to total income (local banks; Singapore operations only)	74.2	71.2	62.9	65.4	70.0	67.5
DBU income to total income (foreign banks) 4/	21.4	28.0	28.1	25.4	26.8	31.7
Non-interest income to total income (local banks) 1/	26.8	31.8	29.3	36.4	32.4	37.9
Non-interest income to total income (foreign banks) 4/	46.5	36.7	51.6	45.4	47.6	...
Non-interest expenses to total income (local banks) 1/	33.5	33.3	39.6	43.6	40.3	39.5
Non-interest expenses to total income (foreign banks) 4/	54.8	55.9	46.9	48.9	46.3	...

(In percent, unless otherwise specified)

Although the number of commercial banks reduced, the total assets increased during the past years. Compared with other region financial centers such as Hong Kong, the gap between them became smaller than before. Because in Hong Kong, the number of financial institutions fell, and their total assets and the customer deposits increased slowly in the last five years. (Appendix E: Hong Kong's financial total assets, the number of financial institutions and customer deposits) In other words, the position of Singapore financial center improved during the financial liberalization period. However, the performance of ADM changed slightly, such as the interbank funds. This will not influence the development of Singapore's financial center in the Asia, even in the world, because during the period of 1999 and 2003, the part of commercial banks made a progress. They are the main part in banking sector. So their progress can contribute to the development of Singapore's financial center.

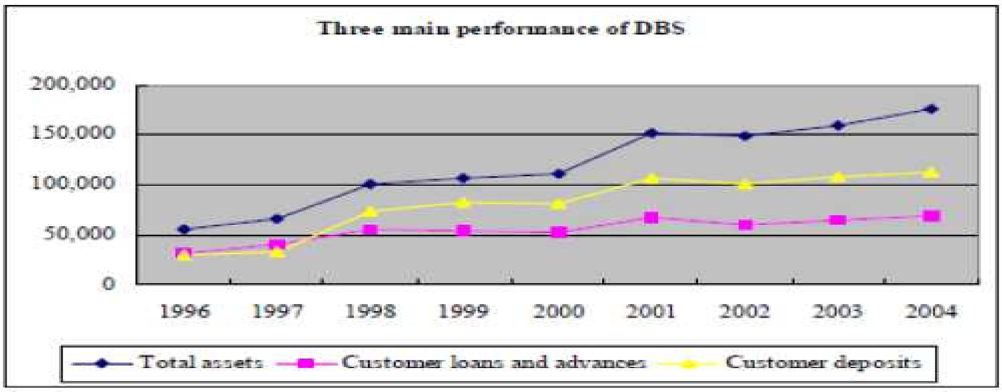
RESULTS OF FOREIGN BANKS

Actually, the financial liberalization brought less benefits for foreign banks than for local banks. Just take the Nonperforming loans (NPLs) and non-interest income as the example. Foreign banks' NPLs' to total loans sharply fell to 2.5% in 2003 from 6.5% in 1999. And the non-interest income remained the same level from 1999 to 2003. Most of the reasons are the government's restrictions on their business activities. However, foreign banks indeed gain the benefits from the liberalization program, they have increased their presence in Singapore's domestic banking market. Those banks with privileges of full banks and qualifying full banks accounted for about 31% of domestic lending to nonbanks and 27% of domestic nonbank deposits at end of September 2003. Moreover, the total asset also increased. All these outcomes came from the financial liberalization. If the government did not implement the liberalization program, they could not earn so many profits. Despite a markedly increased foreign banks' presence in the domestic banking market, after comparing the total assets with that of local banks, it will be found that no single bank has a large market position.

RESULTS OF LOCAL BANKS

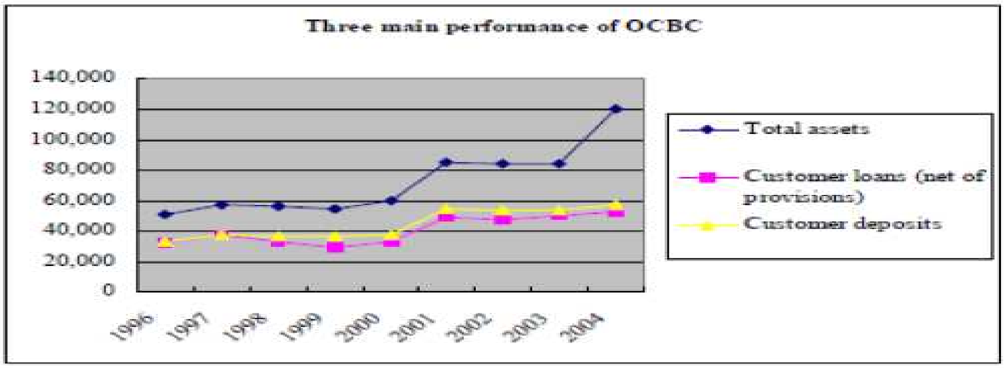
However, there is the very different situation on the local banks. In reality, three local banking groups dominate the domestic retail banking sector. Their total assets, customer loans and advances, etc. are always raising or fluctuated slightly under the umbrella liberalization program from MAS. Figure 6.4, 6.5 and 6.6 shows the changes of main performance of three banking group respectively.

FIGURE4: THREE MAIN PERFORMANCE OF DBS, 1997-2004 (S$MILLION)



Source: DBS Group

FIGURE5: OCBC PERFORMANCE, 1997-2004 (S$MILLION)



Source: (OCBC Group)

For DBS, its total assets increase to S$175,553 million in 2004, compared S$100,037 million in 1998. Moreover, its other performance such as the profit, increased to S$2,435 millions in 2004 from S$1,386 millions in 2003. The most important thing is that its loans and deposits all increased from 1996-2004. These activities did not fell down because of the economic shock. Just like DBS, the other two local banks: OCBC and UOB also gained a positive financial performance. For instance, OCBC's total assets grew about 39% to approximately $117 billion. (OCBC, 2004) And the UOB's total income increased 3.1% to $3,259 million for 2004 from $3,160 million for 2003. At the same time, the group's provision charges decreased 42.3% to $209 million for 2004 from $362 million for 2003. (UOB, 2005) In addition, OCBC's loans and deposits all creased. Especially for its total assets, increased significantly from 1999 to 2004. Compared with these two groups, UOB's total assets and customer loans greatly increase from 2000 to 2001, besides the financial liberalization, maybe the group implemented some strategies to increase its loans to customers. Appendix D shows the local banks' performance from 1998 to 2003. For the three local banks, all of them have obtained growth. This can be seen from the increased total assets, total loans and deposits. They can earn more benefits from the increased lending and investment activates. All three local banks see regional expansion as their preferred means of future growth and have expressed internal goals to increase their returns on equity.

RESULTS OF ADM

Because the centerpiece of Singapore's financial center is the ADM, and the key players in the ADM are local banks and large internationally active financial institutions, therefore, to know the changes of ADM's total assets, interbank or nonbank lending flows is very necessary to research Singapore's financial development.

FIGURE6. ADM NON-BANK LOANS

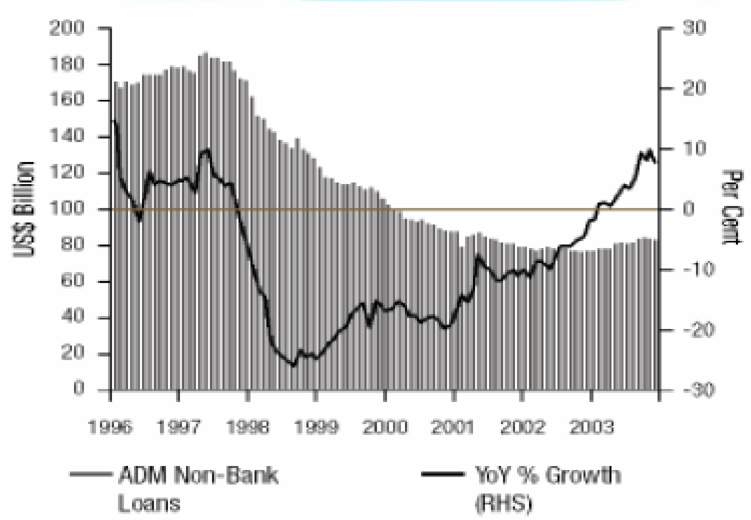
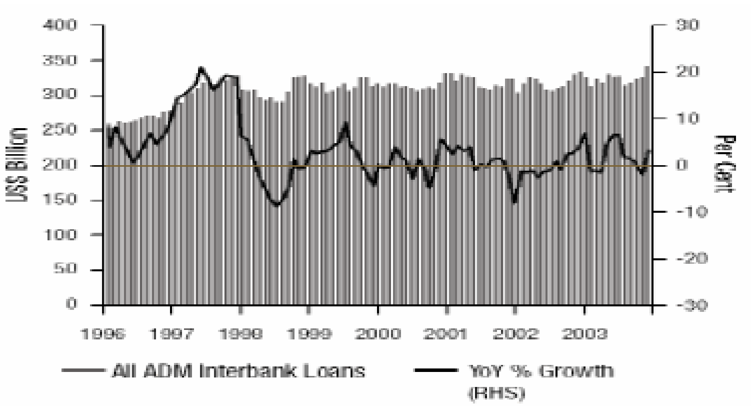


Figure7. ADM interbank loans



Total assets in the ADM were S$385,302.4 million at the end of 2004, while in 1997, total assets were S$330,685.5. The growth of assets has been weak during 1997 and 2004. Like the total assets, changes of interbank funds are slight during this period. (See figure 6.7) Growth has been weak in the past few years because of the regional economic environment, however, it remained a certain range, some of reasons are financial liberalization program played a vital role. Compared with the interbank loans, the rate of growth to non-bank loans had a significant growth from 1999 to 2000.

BENEFITS FROM THE FINANCIAL LIBERALIZATION

BENEFITS FOR BANKING SECTOR

There is no doubt that the five-year financial liberalization program indeed strengthen Singapore's domestic banks through consolidation of local banks and increasing foreign participation in the financial sector. The biggest benefit is that it created a more competitive banking environment because, in the increasing globalization trends world, closing market can only cumber the development of the banking sector development. In contrast, the competitive environment can inspirit both local banks and foreign banks to improve their services to compete with competitors. In particular, since the government has opened the banking market, the local banks are facing an intense competition from foreign banks because of the extending business activities of foreign banks in domestic banking market. For instance, local banks have to share the consumers which only belonged to them previously such as the ones using the ATMs. Whereas, just the intense competition gave an impetus to local banks to improve and expand their services, force them to upgrade their financial products as well as management expertise, such as OCBC. In addition, under the two phase of liberalization, foreign banks' participation in the domestic wholesale market broadened. Although they still face many limits, the foreign banks regard these restrictions as the impetus. In order to neutralize these disadvantages, just like local banks, they have to improve the financial products to attract more consumers and compete with the increasing competitors in the banking market. The case study of Citibank showed how they implemented strategies in competitive banking market. Doing so let foreign banks earn more profits, and so let them become stronger and stronger.

BENEFITS FOR SINGAPORE'S FINANCIAL CENTER DEVELOPMENT

Under the financial liberalization, foreign banks not only can launch more ATMs network and branches, removed the limit on foreign shareholdings of local banks, reduced restrictions on Singapore dollar swaps, increased lending limits for restricted banks, etc. but also can undertake most non-residents accessing Singapore dollar credit facilities for economic and financial activities in Singapore, including undertaking trading activities in Singapore dollars. This reform aims to broaden Singapore's capital markets to transform Singapore into an international financial center. In fact, MAS reached the objective after implementing the reform. In addition, banking sector development can be sure to spurred the whole financial center development because the banking sector dominates Singapore's financial services markets, though it is not the exclusive reason to improve the status of Singapore's financial center in the world.

BENEFITS FOR SINGAPORE'S ECONOMIC DEVELOPMENT AND GROWTH

The financial liberalization also boosts Singapore's economic development and growth. It has been proved that the deposits of all the commercial banks in Singapore increased. The increasing of deposits can provide the reserves for the banks to extend credit to their customers and to invest to more business, such activities could contribution to the growth of GDP in Singapore, at the same time, the increased GDP will attract more investors, including both local and foreign investors, to establish companies or do international trade in Singapore, on one hand, more foreign direct investment will develop the local economic growth, on the other hand, more investors will supply more opportunities for banks to provide loans to customers, this will help banks obtain more profits. Gaining more profits means the banks got more opportunities to develop their scopes and got more reserves. Moreover, the increasing growth of Singapore's economies let residents earn more income, and so they are also one of the sources of obtaining more reserves for banks. This just returned to the beginning of how the reserve can improve Singapore's economic development and growth.

OVERALL CONCLUSION

Under the pressures of global financial center trends, Singapore's government implemented the five-year financial liberalization program to the commercial banking sector. The aim of this liberalization program is to move towards a more open and competitive environment in order to boost the development and upgrading of local banks, so as to enhance Singapore's position as an international financial center. The major aim of this report is to find out the effect of the financial liberalization on Singapore's commercial banking sector, which includes to find out the liberalization is good or bad for Singapore's financial center development, how the liberalization impact on foreign banks, and if local banks are facing the threats from the foreign banks under the liberalization program. Chapter four firstly analyzed Singapore's environment to examine if it is suitable for developing a successful financial center. And the financial liberalization program in Singapore is presented in chapter five, including government's polices to foreign banks and local banks. In order to follow the methodology introduced in chapter two, chapter six analyzed the three performances of local and foreign banks as well as some ADM's performance. And found that all their perform increased or kept the same level during the period of liberalization. The findings proved that the financial liberalization is good for Singapore's financial development. It brought many benefits for Singapore. Furthermore, it also promoted Singapore's economic development and growth. Foreign banks awarded more privileges to operate business activities in domestic banking sector. However, they are still subject to varying restrictions on domestic retail operations. But just because of this, in order to continue to develop and survive in Singapore's banking sector, they have to establish competitive strategies to compete with local banks. Under liberalization program, local banks obtained the widest range of permissible banking activities. And although foreign banks brought many challenges for local banks, just these competitions strengthened incentives for local banks to improve efficiency, which in turn boosts the resilience of the domestic financial system. In addition, the findings also indicated that despite a markedly increased foreign banks' presence in the domestic banking market, there is no single bank has a large market position. In addition, though government removed the elimination of limit on foreign shareholding and let foreign banks own significant stakes in local banks, that is not mean the authorities allow foreign banks take-over of local banks. MAS declared that local banks need consolidation to reach a certain scope in the face of numerous opportunities emerging in Asia, but they do not hope foreign banks to merge local banks and control the domestic banking sector. Therefore, they are pococurante for merging local banks by foreign banks. By this token, foreign banks will not threaten the local banks, at least in nowadays.

IMPLICATIONS OF FINANCIAL LIBERALIZATION FOR BANKING SECTOR

At present, Singapore is strengthening its position as a regional capital center for Southeast Asia through the five-year financial liberalization program. However, whether the financial liberalization will bring financial crisis for Singapore in a long-term period depends on the government polices. Now, the foreign banks have no abilities to control the local banks, and they are not allowed to take-over local banks. However, the increasing global financial trends decide Singapore's further liberalization in banking sector if Singapore wants to enhance its position as a global financial center. Therefore, the government needs to let more foreign banks enter and operate more business activities in domestic banking sector to create a more competitive environment for local banks. At the same time, the most important thing is that government has to manage the implementing of the financial liberalization. Because strengthening and improving local banks and Singapore's financial center is the objective to liberalize the banking sector. We can find that during the whole process of liberalization, the role of government's regulation is more important than the trends of market development in Singapore's banking sector.

CHALLENGES

CHALLENGES FOR BANKING SECTORS

As the ongoing financial liberalization program, the banks in Singapore will face more upcoming challenges. Firstly, there are more and more risks in Singapore's banking market. The investors, especially the foreign investors, will face a high uncertainty prospect for their businesses in Singapore because of the more and more open markets. Secondly, it is difficult for all the banks to develop new strategies to continue growing and extending their business activities in a high competitive market. When banks implementing their strategies, the increasing costs is emerging, such as Citibank. Although consumers can accept their high cost services at present, some of consumers will be attracted to try other banks' services if those banks provide the same quality but lower cost services to consumers. The same situation existed in local banks. Thirdly, the liberalization of ATM network for foreign banks present a particular challenge to local banks.

According to IMF report, if all QFBs join in a network, they will have ATMs in 90 locations around Singapore. IMF Report (2004) indicates the number of ATMs network of local banks just over 1,700. As the increasing number of QFBs awarded by MAS, more ATMs will be established, therefore, more challenges for local banks will also be increasing. Besides above challenges, the persistent weakness in the labor market, the sharp increase in interest rates, and declines in asset prices also can negatively affect the banking sector. For example, the declines in household incomes and corporate earnings will result in a decline in household wealth and depressed investment. These will reduce demand for loans. Thereby reduce the profits and reserves for banks.

CHALLENGES FOR SINGAPORE'S FINANCIAL CENTER

Because one of the objective for the five-year liberalization program is to develop Singapore's financial center globally, therefore, we will also analyze the risks that financial center will face. The challenges to Singapore's financial center will increase in the future. Firstly, the reduced reserves will influence the development of banking sector, so as to influence the financial center development. Secondly, IMF (2000) indicated that financial restructuring in East Asia since the 1997 crisis may result in the consolidation of financial activity into fewer center. This may make it harder for Singapore to find and sustain a niche as a financial center. And Singapore is situated in a region of increasing economic and political instability since the 1997 financial crisis as well as the 11 September 2001 terrorist attacks on the United States and the Bali bombing incident in October 2002. All of them have raised the risk premium on foreign investments into Singapore. It is adverse for Singapore's financial center development. Thirdly, more competitors such as China begin to threaten Singapore's role as a regional financial center under the increasing global financial trends. Thirdly, the challenges from Singapore's biggest rivalries—Hong Kong, are increasing in recent years. Because Hong Kong increases the foreign direct investment in China, whose growing of economic development will increase the demand for Hong Kong's financial services. At the same time, Hong Kong's economic growth developed rapidly. All these reasons will benefit for Hong Kong's financial center development. Furthermore, "the Chinese government has been aggressively investing and promoting Shanghai as a future financial center. The Hong Kong-Shanghai combination could potentially be a formidable competitor to Singapore. China's expanding economy need for funds could be sourced from Singapore as well as from Hong Kong.

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