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INTERNATIONAL NEW VENTURES AND BASEL CRITERIA EFFECT

Dr.Korhan ARUN
Türk Silahlı Kuvvetleri
e-posta: korhanarun@gmail.com

Abstract

The information and communication technology have the potential to contribute to more rapid growth and productivity gains in world trade; international firms are seen as engines of economic growth, that trying to derive their profits from international activities by using multiple countries resources as they will be addressed as International New Ventures (INVs). But if INVs has to be succesful they have to use international banking system and borrow from international banks. After determined by the global economic and financial crisis reality; Basel Criteria brought standardization to the banking system for risk management, ethical issues and supervising activities all around the world. Eventhough these regulations ensures the health of the system also Basel Accord has affected the bank lending channel or increased the cost of the services. So if positive and negative effects of Basel Criteria on INVs can be understood either Basel criteria or the INVs` organization and management can be improved more effectively or side effects can be adjuseted for the benefit of the both sides.

Keywords: Basel Criteria, Born Global Firms, International New Ventures, The Basel Committee,

ULUSLARARASI YENİ GİRİŞİMLER VE BASEL KRİTERLERİ ETKİSİ

Özet

Bilgi ve iletişim teknolojilerinin daha fazla büyüme ve verimlilik artış potensiyeline sahip olduğu küresel ticarette, kazançlarını farklı ülkelerin kaynaklarını kullanarak sağlayan

uluslararası işletmeler yani Uluslararası Yeni Girişimler (UYG) ekonomik büyümenin motoru olarak görülmektedirler. Bununla beraber UYG'ler, başarılı olmak istiyorlarsa uluslararası bankacılık sistemini kullanmak ve uluslararası bankalardan kredi kullanmak zorunluluğundadırlar. Küresel ekonomik ve finansal kriz geçeğiyle yüzleştikten sonra Basel Kriterleri, dünya genelindeki bankalar sistemine; risk yönetimi, etik hususlar ve denetleme konularında standartlar getirmiştir. Her ne kadar bu standartlar sistemin sağlığını temin etme amacındaysa da Basel Antlaşması kredi kanallarını etkilemiş ve işlem maliyetlerini arttırmıştır. Sonuçta Basel Kriterlerinin UYG'ler üzerindeki olumlu veya olumsuz etkileri anlaşılabilirse; UYG organizasyon ve yönetimleri ve Basel Kriterleri daha etkin olacak şekilde geliştirilebilir veya yan etkileri her iki tarafın da yararına olacak şekilde uyumlaştırılabilir.

Anahtar Kelimeler: Uluslararası Yeni Girişimler, Küresel Doğan İşletmeler, Basel Komitesi, Basel Kriterleri

1. Introduction

The barriers to internationalizing operations are now disappearing due to electronic forms of communication, the rise in the service and information economy, and the growth of e-commerce. Businesses, while addressing provincial and regional markets; smalls and mediums are often seen nation and international markets (Emir, 2009, p 107) relying on banks to fund the trading of all this stuff across borders (BIS Papers No 69, p 1) so called INVs . But a banking crisis can rise the hazard ratio of the duration of trade relations where greater hazard ratio indicates an increase in hazard and shorter duration, therefore meaning that an export relation survives less (Beverelli et al., 2011, p 8). Restoring the link between risk and capital holding is needed because although demand factors might have caused much of the observed slowdown in bank lending during the period, a shortage of equity capital limited banks' ability to extend loans (Zicchino, 2006, p 51)

Although International trade has a WTO (World Trade Organization) to set and enforce the rules of the game; international finance did not (Menon, 2012, p 17). From that point of view; international standarts needed while international business increases, so does the number of the banks which firms are in relation with and the amount of the loan taken at a time and the total amount of the loan received.

These standarts declared by BIS (Bank for International Settlements) thus these standarts adopted more than 125 countrys` banks (Emir, 2009, p 7) it is inevitable that they have effects on way of business and relations between international ventures and banks. Especially after the financial crisis banks took more risk free regulations and have been supervised more strickly. So lending can be constraint between banks and INVs that INVs have to loan from banks on higher rates or can can lose investment opportinities.

2. International New Ventures (INVs)

Since the late 1980s a growing number of firms have challenged the traditional stages models by simply being start-up firms with limited resources and no international market experience and still successfully competing on international markets were called Born Global firms. The term was broadened by introducing the concept of using multiple countries resources to seek competitive advantage and became ‘‘International New Ventures’’ (Aspelund, 2012, p 127). But INVs have some distinctive features including founders, environment, processess (Evangelista, 2005).

Evers (et al., 2012, p 47) and Spence (et al., 2011, p 4) define INVs as "business organisations that from inception seek to derive significant competitive advantage from the use of resources and the sale of outputs in multiple countries”. An important discourse in theories about firm internationalization is the creative tension between the process theory of internationalization and INV theory. The former theory addresses a firm's incremental

internationalization in stable environments, and the latter theory suggests that new ventures internationalize rapidly into multiple markets under dynamic environmental conditions (Evers et al. 2012, p 48). In an age of knowledge assets, combining resources internationally may mean pooling specific capabilities, knowledge, and skills located in different countries, and distributing resources internationally by using technology to deliver or market products in different countries. The firms can be faced with the prospects of rapid growth on one hand and the constraints posed by limited resources, on the other (Evangelista, 2005, p 192). So firms must recognize these conditions and exploit them, thereby creating an INVs (O'Sullivan, 2010, p 272).

It was evident that both internal and external factors motivated the facility managers to adopt INVs to higher levels of the following variables:

1. International work experience;

2. Industry experience;

3. Aggressiveness (measured by entry order into the industry, market share objectives, and growth objectives);

4. Differentiation strategies (product innovation, quality, service and marketing);

5. Channels of distribution; and

6. Presence in industries characterized by a high degree of global integration. (O'Sullivan, 2010, p 273-274)

Evangelista (2005) also mentioned that to form the INVs some factors are; founders, environment, processes, and the born global organisation.

Establishing a born global firm involves a number of activities, raising capital solely from personal and private sources was under-taken by half of the sample while the remaining

half obtained loans from a bank to supplement personal funds. In general, there was hesitation to obtain bank loans, the dominant reason being the requirement of a collateral and risks involved (Evangelista, 2005, p 190). But firms are more likely successful when they are working with multiple creditor rather than single (Agostino et al., 2012, p 910). Also for internationalization direct investments in the markets entered create value (Keupp and Gassmann, 2009, p 620) that if INVs will make direct investments they have to use international banking system and borrow from international banks.

Especially as the industries emerging, both entrepreneurs and their financial backers have difficulties in understanding the nature of these new ventures but legitimacy has a key role to overcome these liabilities (Turcan, 2011, 215). Key constraints of INVs` are poor access to economies of scale, lack of financial and knowledge resources and aversion to risk taking (Aspelund and Moen, 2012, p 129). In that case international standartization and regulations help firms to gain and access to international resources and can overcome the constraints because INVs at the first stage of growing are dependent on bank loans. Also bank and financial services may better lower borrowing costs for INVs that capitalized banks experienced where Basel standards can be seen as an opportunity toward the banks to keep their own houses in order.

3. Capital Adequacy Standards

After the spectacular collapse of two large international banks, Long Island's Franklin National Bank in the US and Bankhaus Herstatt in Germany in 1974, monetary authorities and policy makers throughout the world decided that the increasingly more common cross-border capital flows and the resulting integration of financial markets that had been going on for some time, required a new global regulatory framework which would help ensure the stability of the international financial system (Jablecki; Emir, 2009, pp 8-9).

These problems led supervisory authorities, for Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Sweden, Switzerland, the United Kingdom, and the United States to form the Basel Committee on Banking Supervision. They met regularly in Basel, Switzerland, under the name of the Bank for International Settlements. The first major result of these meetings was a document entitled International Convergence of Capital Measurement and Capital Standards". This was referred to as "The 1988 BIS Accord" or just "The Accord". More recently it has come to be known as Basel I. Later Basel II recognized but having some deficiencies like failed to adhere to polices concerning operation risks defined by BSA, which would make banks using it vulnerable to illegal activities like money laundering (Pramod et al.,2012, p 173); Basel III was recognized.

BIS (Bank for International Settlements) is an international organization that fosters international monetary and financial cooperation and serves as a bank for central banks. Established on 17 May 1930, the BIS are the world's oldest international financial organization. Within the BIS, the most significant group is possibly the BCBS (Basel Committee on Banking Supervision), a Committee that provides a forum for cooperation on banking supervisory matters. This Committee develops guidelines and supervisory standards (Emir, 2009, p 7).

Not only financial crisis but also rapid developments in international financial markets stimulated regulatory bodies to establish common supervisory standards for financial institutions and public sensitivity toward ethical issues, lending firms, and non-financial companies, operating in a highly competitive environment, in order to achieve the market discipline and effective global risk management and ethical standards for their daily functions around the world (Uzun, 2008, p 30; Chun et.al, 2011, 854). Goals of supervision in financial institutions:

- Protection of depositors and debtors, which helps financial institutions and their services, gain the trust of depositors and debtors. Certain means should be employed to achieve this (e.g. deposit insurance system) that would minimize the risk of losses for the customers of financial institutions.

- Monetary and financial stability, which has to ensure the required optimal amount of money and to keep up a stable payment system. This will prevent issuing of money surplus and inflation related to it.

- Establishment of regulatory systems, promoting efficiency and competition; this will increase the effectiveness of the activities of the financial sector, which in turn will condition the increase in benefits for consumers and faster development of the financial sector.

- Protection of consumer rights strives to ensure that depositor and debtor groups are not discriminated. (Kraujalis, et al., 2006)

The Committee then defined a number of factors that would weigh the balance sheet amounts to reflect their assumed risk level . The Basel Accord classifies assets according to four risk-weight categories-zero percent, 20 percent, 50 percent, and 100 percent-which are measured at book value rather than market value (Uzun, 2008, 23).

4. Basel I

The 1988 Basel Capital Accord was a milestone. For the first time, supervisors in the main banking markets agreed on a definition of capital and a minimum requirement.

Basel I addressed only the largest, internationally active banks in G-10 countries and encouraged countries outside the G-10 to adopt the principles for their banks that were operating internationally.

To achieve these goals, the committee set out a framework for measuring capital adequacy in relation to credit risk. The main objectives of this approach are to strengthen the soundness and stability of the international banking system secondly to diminish existing sources of competitive inequality among international banks. (Uzun, 2008, pp 19-23)

Then on June 26, 2004 the “International Convergence of Capital Measurements and Capital Standards” was finally published by the Basel Committee on Banking Supervision (BCBS). This framework is known in the market as Basel II and it replaces the current framework (Basel I) for banks as to how they calculate their capital requirements (Drigă, 2007, p 130). Even though Basel Criteria does not allow banks themselves to determine all of the elements needed to calculate their own capital requirements; some determinations are being done by internally; like Internal ratings-based approach in the New Basel Capital Accord (Pitschke and Bone-Winkel, 2006, p 12)

Since the 1970s, there have been more than 100 episodes of systemic banking crises in 93 countries, with the frequency and severity of the crises increasing till 2001. To the extent Basel I has contributed to those crises, but it turned out to be a project with very costly unintended consequences (Rodriguez, 2003).

5. Basel II

The Basel Committee on Banking Supervision (BCBS) released, in 2004, the new Basel Capital Accord (usually referred to as Basel II) to address some of the major shortcomings of the previous Basel Accord of 1988 (Basel I) (Drumond, 2009, p 798).

The purpose of Basel II is to create an international standard that banking regulators can use when creating regulations about how much capital banks need to put aside to guard against the types of financial and operational risks banks face (Drigă, 2007, p 131). Basel I goal was to set restrictions on activities of banks, curbing those gains that

were due mostly to cost advantages created by differences in regulation. Basel II, instead, intends to nudge banks into improving their methods of risk management (Emir, 2009, p 17).

Basel II also reinforced the requirements by setting out principles for banks to assess the adequacy of their capital and for supervisors to review such assessments to ensure banks have the necessary capital to support their risks. It also strengthened market discipline by enhancing transparency in banks' financial reporting. The deadline for implementation of the Basel II framework by member jurisdictions was the end of 2006.

Basel II consists of three pillars: minimum capital requirements; the supervisory review process; and improved disclosure to enhance market discipline (Table 1) (Kern, 2003). Pillar II and III are expected to complement the requirement of Pillar I.

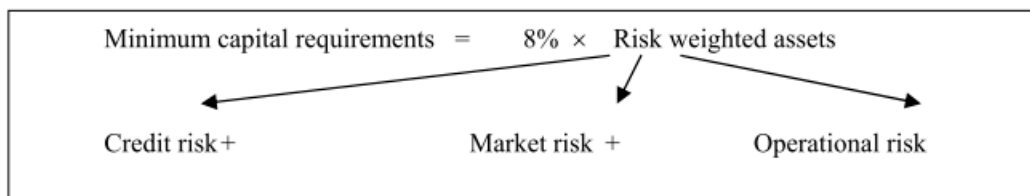
Pillar I: minimum capital requirements - aims to achieve a far closer link between regulatory and economic capital charges, dealing with maintenance of regulatory capital calculated for three major components of risk that a bank faces, namely: credit risk, operational risk and market risk. The credit risk component can be determined in three different ways of varying degree of sophistication: standardized approach, foundation internal rating-based approach and advanced internal rating-based approach. For operational risk, there are three different approaches, namely: basic indicator approach, standardized approach, advanced measurement approach and for market risk the preferred approach is VaR (value at risk).

Pillar II: the supervisory review process - allows the national regulator to potentially set minimum capital requirements that exceed those outlined in Pillar 1, depending on the risk profile of the bank. Banks also have to assess credit concentration risks and credit stress-tests in an economic slowdown. Thus, it deals with the regulatory response to the first pillar, giving regulators much improved tools over those available to them under Basel I.

It also provides a framework for dealing with all the other risks a bank may face, such as systemic risk, pension risk, concentration risk, strategic risk, reputation risk, liquidity risk and legal risk, which the accord combines under the title of residual risk.

Pillar III: market discipline - allows the market to verify the banks' internal capital calculations because banks are required to publish their risk-weighting calculations, capital breakdown and capital adequacy. Thus, it provides the disclosures that the bank must make, being designed so as to allow the market to have a better picture of the overall risk position of the bank and to allow the counterparties of the bank to price and deal appropriately (Drigă, 2007, p 131).

Table 1: Minimum Capital Requirements (Dănilă, 2012, p 124)



This means (Uzun, 2008, p 35);

$$\text{Bank's Capital ratio (min. 8 \%)} = \frac{\text{Total Capital (unchanged)}}{\text{Credit Risk + Market Risk + Operational Risk}}$$

On July 2009, enhancements to the measurement of risks related to securitisation and trading book exposures were agreed in response to early lessons from the 2007/08 crisis. An implementation deadline of the end of 2011 was set for these reforms, referred to as Basel 2.5.

6. Basel III

In December 2010, the Basel Committee published Basel III, a comprehensive set of reforms to raise the resilience of banks.

The implementation period for Basel III capital requirements starts from 1 January 2013 and includes transitional arrangements until 1 January 2019. The transitional arrangements are available to give banks time to meet the higher standards, while still supporting lending to the economy. (Report to G20 Finance Ministers and Central Bank Governors on Basel III implementation, 2012, p 4)

6.1. Basel Standards

Basel III addresses both firm-specific and broader, systemic risks by:

- Raising the quality of capital, with a focus on common equity, and the quantity to ensure banks are better able to absorb losses;
- Enhancing the coverage of risk, in particular for capital market activities;
- Introducing additional capital buffers for the most systemically important institutions to address the issue of “too big to fail”;
- Introducing an internationally harmonised leverage ratio to serve as a backstop to the risk-based capital measure and to contain the build-up of excessive leverage in the system;
- Stronger standards for supervision (Pillar 2), public disclosures (Pillar 3), and risk management;
- Introducing minimum global liquidity standards to improve banks’ resilience to acute short term stress and to improve longer term funding; and
- Introducing capital buffers which should be built up in good times so that they can be drawn down during periods of stress. (Report to G20 Leaders on Basel III implementation, 2012)

7. Basel Accord And INVs

After the Basel Accords introduced many of the principles therein remain sound today although over the years we have of course seen substantial evolution in the range and complexity of financial instruments, the globalization of markets, and the volatility of banks' risk positions.

The aim of Basel Accords are to standardize and stabilize the financial system by setting out principles for banks to assess the adequacy of their capital and for supervisors to review such assessments to ensure banks have the necessary capital to support their risks. It also strengthened market discipline by enhancing disclosure requirements (Basel Report, October 2012). Therefore it concerns in the first place the banking sector and secondly bank customers (Pitschke and Bone-Winkel, 2006, p 9). The starting point for the the common margin calculation of banks for credit risk measurement methods are; risk-free rate, administrative costs (credit rating, credit-monitoring, appraisal), risk premium (product of loan volume, probability of default and exposure at default) and equity costs (product of equity costs and volume of recourse equity capital) which directly effects the interest rates of the banks (Pitschke and Bone-Winkel, 2006).

Basel II has specially gained attencion after 2007 crisis because banks have had an important role; when bank capital decreases, banks find it difficult to seek alternative sources of finance and are forced to cut back lending to firms, which, in turn, affects negatively firms' investment. The reverse is also true that when banks have full discretion they have higher levels of non-performing loans (Barth et al., 2006, p 26).

But entrepreneurs (borrowers) can choose between different projects and have an incentive to undertake the riskier projects in order to enjoy private benefits (Drumond, 2009, p 801). So banks lendig to enterpreneurs can be described as risky from the beginning.

We can say that although Basel Capital Accord standardized the system it also negatively effects the system:

PROS

- Domestic regulations with the international agreements will be complied.
- Competitive environment for banks give firms a change to borrow with lower rates (Agostino, 2012)
- Lowering interest rates, greater competition increases the likelihood that borrowers are able to remain solvent and repay their loans (Agostino, 2012).
- Supervision of financial institutions enhances Protection of the customers of financial institutions (Kraujalis et al., 2006, p 7)
- Can compete on international banking systems on the same terms of level
- For competitive reasons, banks need to maintain a higher credit rating so this decrease interest of loans (Jarrow, 2007, p 4).

CONS

- Calculating capital requirements for SMEs to become INVs were too stringent (Scellato and Ughetto, 2010, p 70)
- Capital charges are significantly higher under Internal Ratings-Based (IRB) approach than under the standardized approach (Rodriguez, 2003).
- It is not clear that the benefits of implementing IRB, in terms of lower capital charges, from the banks' perspective, and a more stable financial system, from the regulators' (and taxpayers') perspective, should justify the costs (Rodriguez, 2003).
- INVs` success can highly be uncertain due to the environment of outer markets.

- So of INVs` success are dependent on R&D activities and banks can have financial constraints for innovative companies for the nature of R&D activities (Scellato and Ughetto, 2010)
- If the capital constraint becomes binding, banks will need to decrease their supply of credit (Zicchino, 2006 p 52) so for INVs.
- The need for monitoring raises the cost of borrowing externally (Mizen et al., 2012, p 5)

8. Conclusion

International trade is important for financial system and world trade; therefore INVs have an important role for the trade system sustainability. But sustainabilty of INVs are dependent on use of outer resources especially loans and finacial system. Over the years, there has been a growing number of large, internationally active financial groups that operate in several financial sectors. But the years prior to the global financial and economic crisis were marked by rising current account and merchandise trade imbalances. According to some authors, these imbalances either contributed to or precipitated the crisis (Juan et al., 2012, p 3). So Bank supervision system is a necessary element of safe and effective financial market. It ensures the reliability of financial market with regard to its members and customers (Kraujalis et al., 2006, p 14) and Basel Accord has brought standards for international banking system but capital regulation has some impacts on banks' behaviour whilst enforced self-regulation (IRB), provides the benefits of flexibility.

We can say that Basel Standards have a positive effect on internatial trade because it lowers the risk for financial system failure and has brought standards for the system while encouraging competition between banks.

But also Basel Capital Accords have negative effects like rising the interest rate or taking more strict rules against lending especially to high risk profile INVs as we disscussed earlier.

Succintly even though Basel Capital Accords has brought some standards that have negative effects on system, overall sustainabilty of system is more important especially for the banking system so tied to sustainability of INVs.

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