"INTERNATIONALIZATION OF BANKS: STRATEGIC PATTERNS AND PERFORMANCE"

by
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SUERF – The European Money and Finance Forum
Vienna 2005

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Vienna: SUERF (*SUERF Studies:* 2005/4)

ISBN 3-902109-29-7

Keywords: internationalization, banking, value creation, performance

JEL Classification Numbers: F23, F30, G21, L1

INTERNATIONALIZATION OF BANKS: STRATEGIC PATTERNS AND PERFORMANCE

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Abstract

This essay investigates the relationship between the internationalization of banks, profitability and shareholder value. We argue that in general internationalization has not contributed to profitability, and shareholders have not gained by investing in banks with more international activities. A database with internationalization measures is constructed for the 3 to 5 largest banks in 8 countries between 1980 and 2003, leading to a sample of 44 banks. The transnationality index is calculated for each bank, combining foreign assets, foreign income and foreign staff into one index.

To examine the relationship between internationalization and performance, we calculated the difference between foreign and domestic profitability. We also investigate if more internationalization is related to more profitability. The key finding is that foreign profitability tends to be lower than domestic, and a negative relationship exists between total profitability and internationalization. Also, a "J-curve" shape appears, suggesting that up to a certain degree of internationalization (roughly 40% of foreign staff, income and assets), costs tend to outrun benefits. A similar pattern emerges for

shareholder return: banks that either strongly or moderately increased their internationalization activities generated the lowest shareholder return as a group, while banks that retreated generated the most.

For the future, we identify banks which are likely in the near future to reassess their internationalization strategy, either to develop a business model where internationalization activities are a stable and profitable source of income, or where banks refocus their attention to the domestic banking market.

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1 Overview

1.1 Introduction

After a relatively quiet period in 2001/2002, international mergers and acquisitions have picked up again. Since the 2003 mergers between Bank of America and FleetBoston, and JPMorganChase's acquisition of Bank One, speculations were fueled about comparable cross-border deals in the European banking market. A joint study of PriceWaterhouseCoopers and the Economist Intelligence Unit (PricewaterhouseCoopers, 2004) showed that a European strategic response still had to be formulated. Also, smaller "nuts and bolts" acquisitions were found to be more likely than large cross border deals. JPMorganChase announced its purchase of London based Cazenove in October 2004, while Spanish Banco Santander bought British mortgage bank Abbey National for 12.5 billion euro in august 2004, the largest cross border acquisition since HSBC bought French CCF in 2001.

On the other hand, restructuring also took place. Credit Suisse announced in December 2004 that it would absorb First Boston, its global investment bank, into the parent organization to revive profits. After barely four years, ING sold the largest part of its German bank BHF to Sal Oppenheim while expanding its Internet banking activities.

These examples reflect the increased internationalized nature of banking competitions in three respects (Llewellyn, 1999). Customers that have global financing opportunities are able to arbitrage between domestic, foreign banks and capital markets. Also, banks are not restricted to business in their own country. Finally, regulatory entry barriers have lowered, making it easier for banks to locate in other countries.

In other words, many of the largest banks in the world have been struggling toward a new organizational model where terms as home market seem to become a by-product in a broader strategic vision.

Swiss bank UBS, the fifth largest bank in the world measured by assets in 2000, has more than 80% of its assets outside Switzerland. Netherlands based bank ABN Amro owns a retail branch network in Brazil, 9,500 km from Amsterdam which constituted 15% of total profits in 2000. Successes in international banking are few, failures have been common. One of the more

spectacular failures was the acquisition of American Crocker Bank by British Midland Bank in 1981, costing the bank USD 1bn over the next five years and forcing its strategy to retreat on the British retail banking market. Midland was acquired by Hong Kong based bank HSBC in 1992, a bank who subsequently showed that internationalization can be a profitable activity.

From the 1980s banks internationalized on an unprecedented scale. In 2003 the 30 largest banks held more than USD 7,586bn, or 39% of their assets, outside their home country. To understand whether international expansion has affected the banks' operations, and identify if additional performance and shareholder return was created by internationalization, this study analyzes the internationalization strategies and financial performance of the world's largest banks from eight countries between 1980 and 2003. Internationalization – undertaking banking activities outside the home country – has been a major driver in the transformation of bank organization in the last two decades. The main findings can be summarized as follows:

- In the 1980s the overall degree of internationalization for the whole sample basically did not change much. In the 1990s, the degree of internationalization systematically increased, but the increase was concentrated with a small number of banks. For the bank sample as a whole, internationalization has not led to higher profitability levels. Even though the banks in the sample have been amongst the largest and leading internationalisers, most have not been in a situation to profit from this strategic choice.

- The largest banks, however, have not pursued uniform internationalization strategies. Retreating as well increasingly international strategies could be observed. In the 1980–2000 period, around one quarter of the banks faced a stagnant level of internationalization, one quarter retreated, while one quarter slowly and one quarter strongly internationalized.

- Between 1980 and 2000, the banks in the sample showed on average lower profitability on foreign banking activities than on domestic banking activities. They reported a decrease in total profitability when their degree of internationalization was higher, and also showed higher variability of profitability. If banks had intended to increase their profitability by serving new foreign banking markets and clients, or profit from geographical diversification, then on average they did not succeed.

- Banks with different internationalization strategies realized different returns for shareholders. Banks that either strongly or moderately

increased their internationalization activities showed the lowest shareholder returns. On the other hand, banks that retreated from internationalization activities and (re)focused on their domestic banking business generated the highest shareholder returns. But banks with established internationalization strategies, showing a long term commitment to their international banking activities, generated the highest shareholder return.

1.2 Set up of the research

Several research stages were adopted. First, a broad and representative sample of banks was selected. The 3 to 5 largest banks by assets with substantial international activities were chosen for the United States, the United Kingdom, Germany, France, Spain, Switzerland, the Netherlands and Japan. In 1995 this sample amounted to 34 banks; mergers and acquisitions increased the sample to 44 banks. As a group, these banks command over 48% of total global assets of banks between 1980 and 2003.

The internationalization of banks was investigated between 1980 and 2003. This long period was chosen to take full advantage of the disclosed geographical information, especially for American and British banks. Also, 1980 as a starting year is a natural demarcation point in the internationalization strategies of banks. In particular, the emerging market loans crises from 1981 onwards initiated for many banks a decade of reorientation on the role of their international activities. Arguably, the strategic reorientation in the 1980s also has substantially influenced internationalization activities of banks in the 1990s. An assumption when using a long time period is that banks and their managers have a long term memory: what the bank did in 1980 has relevance for their activities in 1990 or even later. A long time period is not uncommon in management studies – well known examples are “In Search of Excellence” by Peters and Waterman (1982), “Built to Last” by Collins and Portas (1993) or “Good to Great” by Collins (2001) – but longitudinal studies covering most leading companies of one sector remain relatively rare.

Next, a database was developed, collecting internationalization data for different indicators. For each bank the degree of internationalization was calculated which yielded an internationalization index. This provided the basis for developing a strategic typology of internationalization. Different phases of expansion, restructuring and retreat were combined with a scan of

client-arena-products targeted by the bank during these periods. A choice was made not to look at intended or announced strategies but at realized strategies, compiling information from newspapers, annual reports and other sources. This led to the identification of five different types of realized internationalization strategies: *Moderate*, *Accelerating*, *Established*, *Retreating* and *Imploding*.

The types of realized internationalization strategies were then used in the next research phase, focussing on the effectiveness of internationalization. First, it was investigated which incentives are relevant for the internationalization of banks. With a pooled data regression model, several tests were performed, varying the time period, grouping the data per country or per realized strategy. Performance was addressed by first looking at the available data: difference in foreign and domestic profitability was calculated, based on the available data from annual reports. Alternative tests were set up to determine a broader relationship between performance and the degree of internationalization. Finally, integration was pursued by determining the relationship between incentives to internationalize, performance and shareholder return for the five different types of realized internationalization strategies.

1.3 Structure of the paper

The structure of this paper is as follows. First, I introduce the sample of banks and their characteristics. Chapter 3 presents a brief overview of historic developments, after which the patterns of internationalization strategies are discussed. Based on the banks' degree of internationalization, I construct five groups with different realized strategies. Chapter 4 focuses on the relationship between internationalization and profitability, and uses the strategic patterns identified in Chapter 3 to examine their effects on shareholder return. Finally, Chapter 5 assesses the results and speculates on future internationalization.

2 Bank sample and degree of internationalization

The world's largest banks are a highly visible group, not in the least through their physical presence around the worlds, adding global brand names such as Citigroup or HSBC for millions of customers. On the other hands, this visibility exposes banks to criticism in times of financial crises, especially if they emerge relatively unscathed from such crises with adverse consequences for the foreign economies which is not the case for the foreign markets (cf. Greider, 1997). This chapter discusses two themes: the description of the sample and definition of degree of internationalisation. The sample consists of the world's largest banks. What are their characteristics? Studying them as a group, what biases are introduced? Furthermore we define what is meant by internationalisation and calculate appropriate measures.

2.1 The world's largest banks

The sample consists of the five largest banks measured by total assets in the Netherlands, Germany, France, United Kingdom, United States, Switzerland, Spain and Japan, as determined in the benchmark year 1995. These banks have been involved in internationalization activities between 1980 and 2000. In the case of both the Netherlands and Switzerland initially only three banks were included for the benchmark year 1995, due to high concentration of banking activities in these countries.

One bank was added to the Dutch sample: Fortis, the Belgian/Dutch bank whose administrative headquarters is in Belgium but has extensive Dutch operations. For the United Kingdom, HSBC has been included as a United Kingdom bank in 1995. The bank relocated to the United Kingdom from 1992 after the acquisition of Midland Bank. Therefore, HSBC has been included from 1992 onwards in the sample. This leads to an initial list of 37 banks for the benchmark year 1995, whose key characteristics are listed in Table 2.2. Including predecessors, the total sample for 1980–2003 consists of 44 banks.

The banks in the sample have several characteristics in common. First, most banks have not only been among the largest banks in their countries in 1995, but also between 1980 and 2003. All banks combined have taken up a major share of the assets, capital and profits of the world's 100 largest banks. Also,

between 1980 and 2003 all banks in the sample have been engaged in international banking activities.

In this study, internationalization patterns are not differentiated by banking type because most banks in the sample are universal banks, providing a broad range of commercial banking services. European banks have historically provided the widest range of financial services, while United States banks have historically offered a more limited range of financial services, converging over time to universal banks as regulation changed. A limited number of (mostly European) banks also have become part of, merged with, or came to own insurers. In the study, the bank activities of the bank-insurers are considered. Table 2.1 lists the most noteworthy combinations of banks and insurers.

Table 2.1. Combinations of insurers and banks in sample between 1980 and 2000

Year	Country	Activity
1988	United Kingdom	Acquisition of insurer Abbey Life by Lloyds Bank
1989-90	Netherlands/Belgium	Formation of Fortis through merger of Dutch bank VSB and insurer AMEV with Belgian insurer Groupe AG and bank ASLK
1990	Netherlands	Acquisition of insurer Interpolis by Rabobank.
1991	Netherlands	Formation ING Group through merger NMB Postbank with insurer Nationale Nederlanden.
1997	Switzerland	Acquisition of insurer Winterthur by Credit Suisse
1998	United States	Formation Citigroup by merger Citicorp and insurer Travelers group.
2000	Germany	Acquisition Dresdner Bank by insurer Allianz

Finally, most banks in the sample have had publicly traded bank shares. Banks, who did not have publicly traded bank shares either were nationalized, owned by government institutions or have had a co-operative status. Two banks have been nationalized (Paribas, Société Générale in 1982) and re-privatized (Paribas in 1986, Société Générale in 1987). Crédit Lyonnais was effectively nationalized between 1992 and 2000. Furthermore, three banks have a co-operative structure and have had no publicly traded shares. The Rabobank and Crédit Agricole share co-operative ownership, and are mainly owned by the local associated banks, while West Deutsche Landesbank is owned by the state government. Mergers and acquisitions

determine the dynamics of the sample; the number of banks decreased from 34 banks in 1980 to 29 banks in 2003.

Table 2.2. Key indicators banks in benchmark year 1995

Country	Bank	Total assets, mln US dollar	Capital and reserves, % total assets	Profit before tax, % capital and reserves	Costs, % total income	Staff
France	Crédit Agricole	381,386	5.35	11.88	63.12	74,380
	BNP	320,954	5.94	3.27	74.96	53,600
	Crédit Lyonnais	334,911	2.27	5.51	83.36	59,018
	Paribas	268,618	4.63	-0.64	82.30	25,841
	Société Générale	322,194	3.42	10.27	74.10	45,374
Germany	Bayerische Hypobank	207,229	3.06	14.85	59.23	16,239
	Commerzbank	280,527	3.05	9.69	70.36	25,826
	Deutsche Bank	500,898	3.89	12.71	71.56	74,119
	Dresdner Bank	336,273	2.85	14.50	74.09	46,890
	Bayerische Vereinsbank	247,472	2.89	12.97	64.31	22,188
	Westdeutsche Landesbank	294,826	2.98	8.73	74.91	9,670
Spain	Argentaria	106,641	5.05	12.89	52.78	16,715
	BBV	115,429	5.38	19.10	60.02	34,178
	BCH	91,597	4.48	5.10	71.18	29,369
	Santander	134,453	5.21	17.03	67.11	42,023
Switzerland	Credit Suisse	358,536	4.21	12.12	63.14	34,310
	SBC	250,569	4.89	9.68	73.55	27,236
	UBS	336,193	6.17	8.44	69.19	29,071
United Kingdom	Barclays	261,681	4.37	27.91	70.17	92,400
	HSBC	351,457	6.80	23.31	55.69	101,070
	Lloyds TSB	204,213	4.78	25.79	65.99	91,044
	National Westminster	287,541	6.74	7.75	69.07	72,500
	Standard Chartered	60,348	5.15	32.98	59.20	26,953
Netherlands	ABN-Amro	338,785	6.13	11.47	67.48	63,694
	Fortis	174,571	6.19	13.16	74.18	30,388
	ING bank	153,217	6.49	10.93	70.87	28,015
	Rabobank	181,956	6.18	10.99	67.07	37,437
United States	Bank of America	232,446	8.70	22.58	61.51	79,900
	Chase Manhattan	121,063	7.37	20.70	67.47	33,618
	Chemical Banking	182,926	6.51	24.89	59.15	39,078
	Citicorp	269,000	7.28	28.52	59.44	85,300
	JP Morgan	184,879	5.65	18.24	67.72	15,613
Japan	Dai Ichi Kangyo	519,193	3.70	8.37	46.61	18,069
	IBJ	383,301	3.25	-8.02	45.01	5,362
	Mitsubishi Bank	514,187	4.53	3.76	60.03	14,977
	Sumitomo Bank	528,217	3.46	1.44	83.30	18,104
	Bank of Tokyo	250,102	5.23	5.28	47.38	17,538

Source. Annual reports, the Banker top 1000 1995, issue July 1996

Asset growth and distribution on a country level are presented in Table 2.3. Total reported assets increased from USD 2,260bn in 1980 to USD 19,513bn in 2003. Total assets increased with an 11.7% annualized growth rate from 1980 to 1990 levelling off to 8.3% between 1990 and 2003, generating an annual average asset growth of 9.8% over the total period. The difference in asset growth might indicate:

- *Change in currency*. Fluctuations in the currencies have increased or decreased relative positions in US dollar terms. For example, the surge in

the Japanese Yen substantially increased the size of Japanese banks in dollar terms.[1]

- *Saturation*. Due to their large size, it may have become more difficult to maintain high levels of asset growth.

- *Change in monetary regime*. Total assets are positively correlated to the level of money supply, whose growth has been more restricted in the 1990s than the 1980s.

- *Change in management focus*: The focus of a bank may have shifted from asset growth as a management goal to other goals such as profitability and capitalization.

- *Change in regulation*. The implementation of the capital adequacy rules from 1988 onwards provided a regulatory framework for new management drivers. For example, when banks evaluated granting new loans, it also became important to consider the effect on capital reserves, effectively lowering asset growth. Clearly, change in regulation and change in management focus are intertwined.

Table 2.3. Distribution of assets in sample

	1980			1990			2000		
	Sum of total assets	% Sample	N	Sum of total assets	% Sample	N	Sum of total assets	% Sample	N
France	452,493	20.5	5	1,295,341	19.3	5	1,743,338	12.8	4
Germany	348,658	15.8	6	995,102	14.8	6	2,791,265	20.5	5
Spain	na	na	na	194,630	2.9	3	600,240	4.4	2
Switzerland	121,990	5.5	3	494,405	7.4	3	1,268,023	9.3	2
United Kingdom	315,480	14.3	5	757,639	11.3	5	1,774,937	13.1	5
Netherlands	162,845	7.4	4	481,777	7.2	4	1,559,380	11.5	4
United States	442,337	20.0	6	653,430	9.7	6	1,909,146	14.1	3
Japan	368,055	16.6	5	1,843,810	27.5	5	1,937,306	14.3	4
Total	2,211,857	100.0	34	6,716,134	100.0	37	13,583,635	100.0	29

Note: Total assets in million US dollar. N is the number of banks in the sample for the specified country
na: Spanish banks are not included in the sample prior to 1990 due to data availability

If the distribution of assets in the sample per country for 2000 is compared to 1980, then the asset share of French banks has decreased, as have United States banks and to a lesser extent banks in the United Kingdom. German banks have shown the largest increase, followed by Swiss and Dutch banks.

[1] Cf. the introductions to the yearly Banker Top 500 or 1000 listings, where currency fluctuations are a recurring theme in explaining fluctuations in the ranking of banks.

Japanese banks have maintained roughly the same asset share in 1980 and 2000, but dominated the sample in 1990 with 27.5%.

The number of banks is relatively small but represents a large portion of the country's assets, profits and capital. These figures are presented in Table 2.4 where these key-indicators are compared to the top 100 banks and top 1,000 banks as compiled by The Banker.

Table 2.4. Bank sample compared to Banker Top 100 and Top 1,000, in USD bn.

	Assets			Capital			Profit before tax		
	1980	1990	2000	1980	1990	2000	1980	1990	2000
Sample	2,208.3	6,472.3	14,914.0	83.0	255.5	580.7	14.2	31.5	128.5
Top 100	4,200.2	13,065.2	26,577.4	147.9	535.1	1,133.1	24.3	69.9	224.5
Top 1000		19,900.0	36,700.0		828.5	1,784.8		113.3	309.7
Sample, % Top 100	52.6	49.5	56.1	56.1	47.8	51.2	58.3	45.1	57.2
Sample, % Top 1000		32.5	40.6		30.8	32.5		27.8	41.5

Source: The Banker July issues 2001, 1991, 1981. Totals Top 1000 for assets, capital, profit before tax are listed in the Banker July 2001 issue, p. 158

Table 2.4 shows that the sample dominates the 100 largest banks in terms of total assets, capital and profits before tax, averaging between 48 and 54% for the reported periods, compared to the top 100 banks. Exception is the share of profits in 1990, although this measure is bound to be more volatile than assets or capital. Total assets of the sample as a share of the Top 100 largest banks increased by 5.7% from 48.1% in 1990 to 53.8% in 2000, while the asset increase of the sample as a share of the 1000 largest banks was 7.4% in the same period. This suggests that the Top 100 as a whole has increasingly grown in size at a higher pace than the Top 1000. On the other hand, the capital share increase of the sample compared to the Top 100 and Top 1000 between 1990 and 2000 is much more subdued 3.0% for the share in the Top 100 and 1.5% for the share in the Top 1000.

Summarizing, a sample based on the five largest banks for eight countries with the benchmark year 1995 has led to a group of banks with relatively stable characteristics. The choice of size as a selection criterion implies that the banks, in terms of assets, capital or profitability, form a large part of the largest 100 or largest 1000 banks in the world. There is no indication that they have a relatively higher share of profitability or capital though. Based on asset size, the concentration in the sample has remained stable and low between

1980 and 2000. There have however been shifts in relative sizes: for example, the Japanese banks dominated the sample in 1990.

2.2 Degree of internationalization

The aim of this study is to measure and to analyze the level of internationalization of the banks in the sample. There are different approaches to measure a banks' degree of internationalization, and estimating the degree of internationalization of a firm or bank is to some extent arbitrary. An initial approach could be to construct a single item indicator; Sullivan (1994) reviewed 17 studies which all applied a single item indicator to measure the degree of internationalization, i.e. foreign sales to total sales. However the use of a single item indicator increases the potential error of measurement, because it is for example more prone to external shocks. An alternate approach is to combine several indicators into one index. Depending on the choice of indicators, this might provide a better approximation of the degree of internationalization, but the choice of indicators may be restricted on data availability rather than theoretical induction (Sullivan, 1994).

This study applies three single item indicators, which are combined in a composite index to analyze the degree of internationalization of a bank, the Transnationality Index (TNI). The TNI is one of the most cited indicators for internationalization (cf. United Nations Conference on Trade and Development, 1998, van Tulder, van den Berghe, & Muller, 2001). The index is expressed as a percentage and calculated as an unweighted average of 1) foreign assets to total assets ratio, 2) foreign gross income to total gross income ratio and 3) foreign employment to total employment ratio.[2]

The general appeal of the TNI is that the degree of internationalization is presented in one scale, which by definition moves between 0 and 100. Also an internationalization index that incorporates income, staff and assets captures a richer picture of the bank's foreign activities than that which would be captured by income, staff and assets separately (cf. Sullivan, 1994). Another attractive characteristic is that the TNI dampens the effect of finance companies or off shore funding constructions if a ratio were only based on foreign assets relative to total assets. A substantial amount of assets can *a priori* be expected to be located in tax havens or countries with lenient fiscal regimes. Such reported assets would

[2] See Van den Berghe (2004) for a review of research on the use of these internationalization indicators.

be accompanied by low number of employees. Combining both employees and assets in the TNI would then create a more balanced view. The same argument also applies to investment banking activities that are concentrated in financial centers outside the home country; these activities tend to generate a relatively high degree of income with fewer employees.

There are several disadvantages when using an internationalization indicator like the TNI: technological change, geographic boundaries, and data availability.

- *Technological change.* A disadvantage of the TNI might be that the construction of such an index cannot take account of the effects of technological change. Changes in technology can for example raise productivity and increase the assets or income per employee; if these changes are distributed evenly over the total bank organization then its effect on the TNI is probably limited. If the ratio of foreign assets per foreign employee increases in the same amount as the ratio of domestic assets per domestic employee, then technological change has no effect on the TNI. From the mid 1990s however technological advances have had other geographic distribution effects. For example, the development of "Internet" banks like ING Direct implies that the share of foreign assets and foreign income increases while staff and operations working for the Internet bank basically remain at home. This might potentially depress the true extent of internationalization measured by the TNI.

- *Geographical boundaries*. For Fortis, Belgian/Dutch corporate structure creates a problem to determine what region is home or foreign. This is solved in the database by denoting Benelux as home. Similarly, HSBC is the only bank not disclosing information for the home country, instead reporting Europe as 'home region'.

- *Data availability.* Not all banks have consistently reported detailed information on foreign assets, staff, income or profitability. Banks like SBC, UBS or Deutsche Bank did not report this information although they progressed significantly with their internationalization activities. A general remark is usually found in the financial report stating something like "due to the integrated nature of our activities worldwide a geographical breakdown does not provide additional information"; the information provided by British and American banks in the 1980s proves otherwise. Data collection from other sources provided valuable information. For example, foreign banks in the United States have to report their balance sheets to the Federal Reserve.

Table 2.5. Key statistics of internationalization indicators of total sample, selected years

Statistic	Year	Foreign/total assets	Foreign/total gross income	Foreign/total employees	TNI
Average[a]	1980	34.83	47.66	20.95	28.97
	1985	35.10	40.29	20.42	28.61
	1990	32.51	32.29	23.16	28.34
	1995	36.10	33.49	26.71	31.93
	2000	39.72	40.55	41.41	39.36
	2003	39.21	39.99	45.37	40.45
Weighted Average[b]	1980	34.91	48.86	21.30	35.02
	1985	35.00	41.18	24.28	33.49
	1990	34.20	33.16	25.02	30.79
	1995	36.91	34.53	29.78	33.74
	2000	41.78	39.95	43.45	41.73
	2003	38.88	34.71	47.67	40.42
Median[c]	1980	35.63	53.49	13.80	28.98
	1985	34.29	40.51	13.85	30.46
	1990	31.12	36.00	20.24	29.31
	1995	31.71	31.98	26.76	30.18
	2000	33.42	35.67	37.45	34.24
	2003	34.00	43.12	45.00	40.19

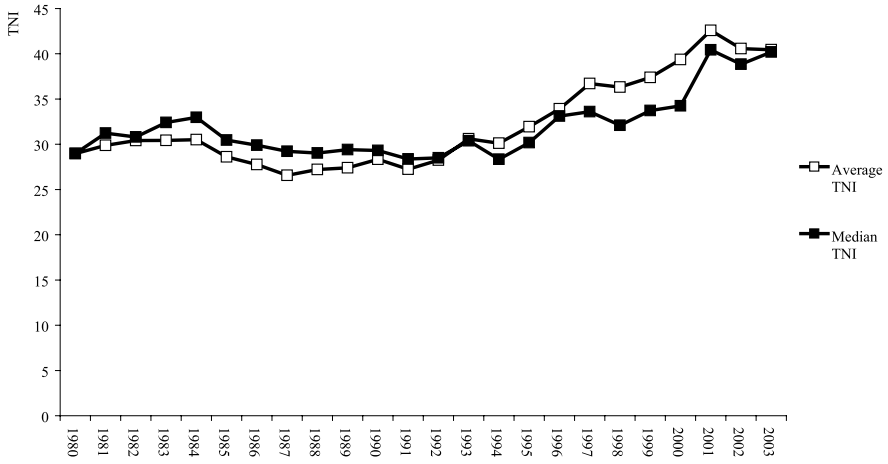
Note a: Indicators 1,2,3 and TNI are calculated as arithmetic average; the sum divided by the number of cases.
Note b: Indicators 1,2,3 are calculated as weighted averages. For example, foreign/total assets for one bank is weighted by the share of total assets of a bank in total assets of the sample, and then aggregated for all banks. For the TNI, the average of the weighted averages of indicators 1,2,3 is then calculated.
Note c: Indicators 1,2,3 and TNI are median values, i.e. the value above and below which half the cases fall.

Table 2.5 presents the key internationalization indicators for selected years between 1980 and 2003. The average bank in the sample has operated roughly one-third of its banking activities outside the home country between 1980 and 2000. The average TNI was 29% in 1980, remaining stable in the 1980s, rising to 39% in 2000. These percentages are consistent with the ones reported in the annual listings of the Banker from 1992 onwards. Other comparisons however are not available; the degree of internationalization for non-financial firms has been better documented. For the top 100 trans

national (non-financial) corporations, as compiled for the UNCTAD World Investment Report, the average degree of internationalization moved between the 50-55% range between 1995 and 1998. Another measure of internationalization is the one compiled by the SCOPE project, where the degree of internationalization is determined for the 200 largest (non financial) firms worldwide. For the year 1995 an average TNI is reported of 29.7 agreeing with the banks' TNI to some extent; this however might simply be a coincidence.

For the bank sample, the decrease in the 1980s is mainly due to the decrease of foreign gross income. This decrease can largely be ascribed to British and American banks, on the one hand reducing their activities in LDC loans and selling off related activities outside the home country, on the other hand increasing the share of domestic activities. Figure 2.1 shows the trend in more detail, displaying average and median values for TNI.

Figure 2.1. Average TNI development between 1980 and 2000 (in %)



Initially in 1983-84, TNI was at its highest, declining until 1991. From that period, TNI increased again, reaching higher levels (both for median and average TNI) than in 1980. Between 1980 and 1993, median TNI was higher than average TNI, indicating that there were relative many banks with a low degree of internationalization. On the other hand, between 1994 and 2002 average TNI was higher than median TNI, suggesting a concentration of banks with relatively high TNIs.

The country averages for TNI can also provide useful information; if banks in a country are considered as separate groups, then the development of internationalization activities of banks has differed between countries. In other words, there is a certain country-of-origin effect observable in banking.[3] At the beginning of the 1980s, American and British banks showed the highest degree of internationalization. In the 1980s, the degree of internationalization decreased systematically for American banks, while this applied to British banks from the mid 1980s.

The ascent of Japanese banks in the late 1980s in the international banking arena also filled a relative void created by American and British banks in the 1980s. The internationalization activities of Japanese banks increased until the early 1990s, their descent followed from the mid 1990s.

Table 2.6. Average TNI values per country

	1980		1985		1990		1995		2000		2003	
	TNI	N	TNI	N	TNI	N	TNI	N	TNI	N	TNI	N
France	19.73	5	24.93	5	26.75	5	30.53	5	30.13	4	40.34	3
Germany	8.45	6	8.95	6	12.17	6	23.20	6	39.04	5	42.52	5
Spain	a.		a.		20.39	3	21.34	4	57.72	2	51.80	2
Switzerland	31.95	3	31.69	3	41.30	3	42.78	3	67.39	2	68.77	2
United Kingdom	44.22	5	46.05	5	37.98	5	44.31	5	40.77	5	39.98	5
United States	18.34	4	21.61	4	23.23	4	29.75	4	47.61	4	46.23	4
USA	49.06	6	39.77	6	31.77	6	32.88	6	27.24	3	25.11	3
Japan	28.05	5	28.13	5	33.14	5	34.20	5	27.20	4	19.07	3
Average	28.97	34	28.61	34	28.34	37	31.93	37	39.36	29	40.45	27

a. Spanish banks are not included in the sample prior to 1990.
The TNI is calculated as arithmetic average, i.e. the sum divided by the number of cases.

Continental European banks showed the strongest increase in degree of internationalization between 1980 and 2003; the largest banks from the Netherlands, Germany, Spain, France and Switzerland steadily increased internationalization in the 1980s, which accelerated in the mid 1990s. From 1994 onwards, the TNI increased steadily, mainly propelled by German, Dutch, French and Swiss banks. On average the TNI for British banks has

[3] Country averages have shown structural differences. For example, for TNI data from 1990 to 2003 the variability of the country means is tested with ANOVA, and the Bonferroni procedure has been applied to determine which country means are different. The average TNI from banks in Germany differ significantly (with p values < .05) from all other countries in the sample. Average TNI in the United Kingdom differs significantly from French, German, American and Japanese average TNI, but not from Dutch and Swiss. Finally, Japanese average TNI differs significantly from average TNI in the United Kingdom. Although the sample is small and these statistics should thus be treated with caution, it is an indication that country of origin matters in internationalization.

increased in the 1990s; however the increase is caused by the addition of HSBC in the sample in 1992. The bank had a higher TNI than Lloyds, National Westminster and Barclays, but also increased its TNI throughout the 1990s while the other British banks did not. American banks tended to show decreasing TNIs at the end of the 1990s when domestic mergers in the United States raised the relative weight of domestic activities between 1990 and 2000. In other words, in the 1980s the reduction of TNI for American banks was caused by divestment of foreign activities, while domestic acquisitions in the 1990s reduced the average TNI of American banks.

The individual components of TNI (foreign assets ratio, foreign income ratio, foreign staff ratio) provide additional information; they are presented in Figure 2.2. Foreign income was relatively high in the early 1980s, decreasing between 1983 and 1989, steadily increasing again since 1991. Foreign assets showed a similar pattern, but with less volatile changes than foreign income, especially in the 1980s. On the other hand, the ratio of foreign employees was relatively stable in the 1980s, but steadily increased in the 1990s.

The different trends of the underlying indicators illustrate that the combination of income, staff and assets captures a richer picture of the bank's foreign activities (Sullivan, 1994). The three indicators suggest that internationalization up to the early 1980s was income driven, while the internationalization activities in the 1990s were both asset driven and employee driven. In other words, setting up and acquiring investment banking and corporate finance activities in the 1980s, while the major component of internationalization activities of bank in the 1990s consisted of acquiring retail banks.

Figure 2.2. Average development key internationalization indicators

Note: variables are calculated as arithmetic average; the sum divided by the number of cases

3 Realized internationalization strategies

3.1 Introduction

Internationalization for banks has progressed at different paces, with different purposes. This chapter identifies these internationalization patterns. Several motives are grounded in history. Therefore, we start with a brief historic overview of internationalization in 3.2, after which stylized findings from the case studies are discussed. In 3.3. we discuss the five different realized internationalization strategies in more detail.

3.2 Historic overview

Internationalization of banks is not a new phenomenon. In 1913 there were approximately 2,600 branches of foreign banks worldwide. The dominating factor at that time was colonization, over 80% of those branches belonged to British banks. The share of foreign banks accounted for one third of banking assets in Latin America and over one half in countries like South Africa, Turkey or China (Goldsmith, 1969). The financial empire of J.P. Morgan started out as a partnership financing American civil war loans from England (Chernow, 1990). International banking has in some respects not changed that much. Over time, innovations in financial instruments, telecommunication, information technology, organization innovation and the growing sophistication of customers have meant a dramatic transformation in the conduct of banking business and client relationships in international banking.

What sets the current internationalization of banks apart, and why does it merit a study? The major reason is that the sheer size of international involvement of banks has increased dramatically (cf. De Nicoló, Bartholomew, Zaman, & Zephirin, 2004). Foreign assets of the thirty largest banks as a percentage of total assets have changed from 35% in 1980 to over 38% in 2003. However, the absolute size of foreign assets of the thirty largest banks has risen eleven fold from USD 650bn in 1990 to USD 7,571bn in 2000. The increasing importance of foreign activities has affected profitability and stability of internationalizing banks in their home country; it can also have serious effects – positive as well as negative – on the host economies. The vehemence with which banks have pursued internationalization strategies also warrants an investigation.

The dissolution of the British Empire meant that British banks represented the "old" internationalization of banking. American banks on the other hand have been on the rise since the Second World War. American financial aid, exports of American firms and the export of American ideology such as freeing of competition or creation of uniform markets were feeding ground for internationalization activities of American banks, usually using London as a springboard for activities in Europe and reversing the decline of London as a financial center as a side effect. From the 1960s onwards income in Western economies rose and banks developed more financial products to cater households and businesses as increasing scale of firms raised transaction volumes in corporate finance. American banks formed an apparent threat, seeking out the more profitable activities in investment banking in Europe, being equipped with better staff, more financial resources and more experience.

The creation of off shore markets to circumvent (American) regulation and the political potential of seizure of capital belonging to communist states induced the first series of international activities, later propelled by the inflation of capital markets when oil producing countries forced serious wealth transfers. European banks either tried to work together in consortium banks to participate in these activities (Roberts & Arnander, 2001) which in the beginning was a cost saving and knowledge rewarding construction or set up foreign activities themselves. Redistribution of the surpluses of oil producing countries found their way to emerging markets, with American banks leading the way. The growing volume of loans masked growing economic imbalances, brought to light from 1981 onwards when Latin American countries defaulted in their loans. Internationalization of banks became a worldwide event (United Nations Centre on Transnational Corporations, 1991). Institutions like the IMF aided governments with restructuring loans, dealing with severed banks and capital markets in distress. Governments of the lender banks, especially the United States, faced potential crisis at home when the losses in emerging markets were transferred by the large banks to their home country.

A consequence of this restructuring period was that in the 1980s capital strength and adequate supervision of internationally operating banks were major issues for bank regulators. A major coordination initiative took place in the Basle Accord of 1988, creating more transparency and uniformity among regulatory policies for internationally active banks. Among others, the Basle Accord became one of the drivers for the Japanese banks to retreat from the international arena. Japanese banks increased international activities sharply

from the early 1980s fuelled by strong domestic economic growth, a fast pace of deregulation and large flows of foreign direct investment by Japanese industrial firms. The Japanese stock market decline from 1989 showed that (international) banking strategies had not been based on sound banking practices, affecting bank capital and loan quality at the same time (Canals, 1997). Japanese banks found ways to stave off restructuring of their bad loans for almost a decade, contributing substantially to the prolongation of economic recession, and steadily relinquishing their importance in international banking.

A general trend fuelling international activities was the ongoing process of disintermediation from mid-1960: large firms found it more profitable to arrange loans directly with institutional investors, thereby bypassing the role of banks as financial intermediaries. Additionally, stricter monetary policies introduced from the late 1970s onwards eventually led to a steady decrease of interest rates consequently lowering income from the core business of banks. These trends forced banks to reconsider their strategic business portfolios. Non-interest income, especially the high margins of fees and commissions in investment banking, became a promising route. The liberalization of British securities markets in 1984 was followed by an unprecedented wave of acquisitions by host banks. By the end of the 1990s British owned investment banks or securities houses in London were few in number; London as an important financial center had become a manifest of internationalization activities of banks.

Internationalization of banks was also a response to further regional integration and deregulation (cf. Group of Ten, 2001, January). In Europe especially, banks were aware that the competition for larger clients extended over the geographic borders, but the competition for retail clients remained a domestic issue. By the mid-1980s European integration created momentum in Europe, redefining markets for banking activities on a multinational scale. Mergers and acquisitions became an important strategic tool for banks. They generally took place in two phases: domestic consolidation and then, international expansion; the creation of higher domestic concentration in order to more effectively compete internationally. Opportunity was provided by the capital markets (lower interest rates and higher stock market prices) and the regulators, privatizing banks or not opposing the takeovers.

The close of the decade shows the financial might of just a handful of banks: the top 25 banks in 1980 had total assets of USD 1,858bn, equal to 30% of GDP. In 2000 this had risen to 64% of GDP, a combined total of USD 12,781bn. Of

this amount, 41% are assets outside the home country. In fact, foreign banks practically control the banking sectors in many Eastern European countries; for some observers the "single global banking space is almost a reality" (Mullineux & Murinde, 2003). The foreign owned assets of the largest banks exhibit uneven geographic patterns, "regions and/or countries of the developed world currently represent the most interconnected cluster of national banking systems" (De Nicoló, Bartholomew, Zaman, & Zephirin, 2004).

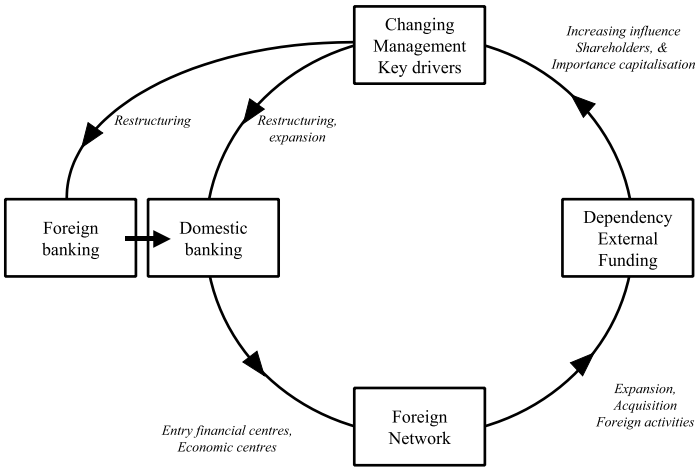
3.3 Internationalization patterns: stylized findings

What did the banks with internationalization strategies have in common, and how did they differ? Using a case study approach, realized internationalization strategies for 44 banks from 8 countries were analyzed. Internationalization patterns were analyzed, supported by the TNI development of the bank. The different phases in TNI development were clustered in strategic phases. First, some generic commonalities and differences in internationalization activities are discussed, using a framework to cluster phases in internationalization, clients, products and organizational forms. Commonalities and differences for clients and products are first reviewed after which organizational form and phases in internationalization are discussed. Integration is pursued by applying the previous findings to five stylized types of realized internationalization strategies.

3.3.1 Internationalization cycle

The case studies suggest the following stylized internationalization cycle: starting in the 1970s, bank internationalization originally consisted of setting up banking activities in financial centers and economic centers. Part of this was related to incentives such as "follow-the-client" or aimed at increasing overall profitability. Additionally, restructuring and expansion in the domestic markets might have been cumbersome for some and impossible for other banks, further stimulating internationalization. Regulatory idiosyncrasies in the home market might be one explanation for this, but also the existence of a home bias 'inertia': restructuring the domestic retail networks in the early 1980s might have been more difficult with vested interests in the home country such as labor unions. In particular, banks in smaller countries had to expand abroad for fear of anti-trust regulation at home.

Figure 3.1. Stylized Internationalization patterns of banks



For most banks during the 1980s, international expansion supported their domestic strategies and was relatively small compared to the home country. So banks did not have to attract additional capital. When banks initiated larger acquisitions in the late 1980s and 1990s, external capital became more important as a source of financing. (Domestic and foreign) shareholders not only provided additional capital to expand. They also followed management more closely, and pressed for changes when expected results were not delivered. An increasing shareholder role and foreign profitability that was below expectations, led bank managers to change objectives in the mid 1990s: profitability should be internally generated, the domestic base strengthened and foreign activities divested if they did not contribute satisfactorily to total profitability.

Banks can offer in principle five product categories: credit, securities, asset management, financial services and insurance. Also, five client types can be distinguished that banks can target: governmental clients (nation states, supra national institutions), corporate clients, institutional clients (other banks, asset managers and insurers), retail clients and private clients. The case studies show that banks which entered new market activities actively serviced and targeted a wide range of clients and products. Two specific patterns have been identified: capital market activities, and foreign retail banking.

3.3.2 Capital market activities

For capital market activities banks offer credit, securities, asset management, and financial advice to governmental, institutional and corporate clients. The

majority of the banks in the sample had set up such operations by 1980: they participated in the Euromarkets, issued bonds to finance their own activities, and took advantage of the financial deregulation in the financial centers. Expanding capital market activities was spurred in the mid-1980s with the financial liberalization in the United Kingdom, and in the mid-1990s with the prospect of restructuring in the European Union.

For several banks, the decision to participate in the capital markets heavily influenced their overall strategy. Paribas and J.P. Morgan decreased their commercial banking activities and transformed themselves into investment banks. Both banks however did not have the scale by the end of the 1990s to remain a major market participant in investment banking and sustain the increasing (IT) investments: J.P. Morgan was subsequently acquired by Chase Manhattan in 2000, and Paribas by BNP in 1998. Most of the acquisitions of UBS, SBC, Credit Suisse and Deutsche Bank in the 1990s were capital market related, steadily increasing their reliance on fee income instead of net interest income. The composition of the fee income changed: more lucrative (but volatile) fee income from financial advice and securities (re)distributions on mergers and acquisitions was combined with more stable income from asset management activities.

Table 3.1. Development capital market activities

Period	1970s	1980s	1990s
Reason	• Growth Eurocurrency markets (London, Paris, Zurich) • Financial liberalization American stock market	• Financial liberalization European capital markets (London, Paris, Amsterdam) • Financial liberalization Japanese capital markets	• Catch up new entrants to profit from current bull market, consolidation existing players
Example Banks	• Chase, Citicorp	• Deutsche Bank, ABN, Société Générale	• Crédit Suisse, Deutsche Bank, J.P.Morgan

3.3.3 Retail banking

International retail banking has been the domain of a selected number of banks. Chase and Citicorp set out to expand a retail network in Belgium, The Netherlands, Germany and the United Kingdom in the 1950s and 1960s.

European banks in the 1970s and 1980s on the other hand did not expand in retail banking in Europe, but expanded in the United States, especially in California where British and Japanese banks bought retail banks helped by lenient regulation. For most Californian banks, their sale was either instigated by regulation (banks that cannot be bought by domestic competitors due to an increase in market share or banks that need outside capital) or poor performance. By the early 1990s a large number of banks exited from the United States market: they found it difficult to transform these banking operations into profitable ones, and their exit was speeded by the deregulation of interstate banking (cf. Tschoegl, 1987). The general expectation was that this would raise the minimum scale of operations to compete effectively, requiring large amounts of additional investments. Banks that remained were for example HSBC and ABN Amro.

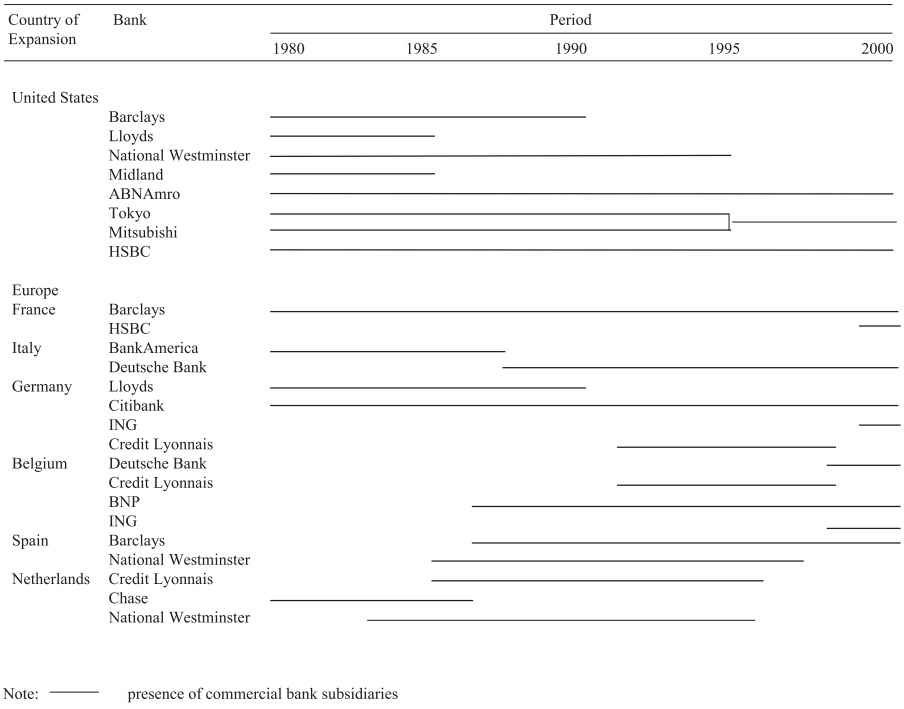
Figure 3.2 suggests a transition in foreign retail banking activities. Eight foreign banks, including all of the British banks, held retail networks in the United States in the early 1980s; by the late 1980s five had opted out. For European banks, the growth of foreign commercial bank networks took place from the mid-1980s. A limited number of banks (HSBC, ABN and Citicorp) have maintained these foreign networks throughout the period. From the 1990s, the following banks pursued retail banking strategies:

- Santander in Argentina, Mexico, Chile
- BBVA in Argentina, Chile, Mexico
- ABN Amro in Brazil and the United States
- ING in Belgium
- HSBC in Mexico, Brazil, the United States/Canada and Hong Kong
- Citibank in Germany

Two groups of banks did not enter foreign retail banking, or only to a limited extent: Swiss banks and Japanese banks. Swiss banks had retail banking activities in their domestic market, but not outside Switzerland. Switzerland was a major financial center and as an economy ran a capital surplus; an explanation might be that setting up foreign capital market activities was a more logical foreign extension of activities then setting up or acquiring foreign retail banks. Japanese banks also entered foreign retail banking to

a limited extent. Their activities were mainly concentrated in California, where the banks initially had some links with Japanese immigrants. More important, lenient regulators allowed takeover of Californian banks by foreign competitors. The existence of an opportunity set – the ability to buy – compared to other more regulated banking markets has probably been the main incentive.

Figure 3.2. Foreign commercial bank networks in selected countries, 1980–2003



3.3.4 Organizational form

Banks which decided to enter new markets or to strengthen their market position have had a wide range of options available to them as to how they could proceed in implementing their foreign banking activities. Looking back at activities for the case studies, there has been a strong rise in the number of each of the approaches used. Two specific developments in organizational form have been identified: branch network, alliances and joint ventures.

Branch network
In general, the objective to build a branch network has been to assist foreign clients, finance activities more cheaply or to evade home country regulation. Activities in financial centers were set up, usually starting with London, New York and Singapore or Hong Kong. This was then expanded to second tier financial centers and economic centers in Europe, the United States, Asia and Latin America.

Table 3.2. *Development of branch networks*

Period	1970s	1980s	1990s
Incentive	• Breakdown consortium • Trade related, service existing clients	• Increase trade and exports • Liberalization of capital markets • Opening up markets (Spain)	• Growth Asian (capital) markets • Opening of Eastern European markets • Increase volume securities markers
Example Banks	• Citicorp, BankAmerica, Lloyds, Barclays, ABN,	• Amro, NMB, WestLB, Crédit Agricole	• Deutsche Bank, Dresdner Bank

Alliances and consortium banks
Consortium banks were mainly a feature of the late 1960s and 1970s. With these joint ventures, banks tried to create a platform to service foreign clients and undertake corporate finance activities, while sharing the costs of building such an activity independently. In the beginning of the 1980s, there were a number of banks who relied on the consortium banks to provide an alternative for a foreign branch network. These were Amro and Midland. Subsequently, a number of banks built their foreign networks by buying out the other shareholders in the consortium banks.

During these alliances banks probably also acquired detailed information of the partner banks. This could be concluded from the observation that ING (un)successfully acquired former InterAlpha partners from the mid-1990s for its expansion in Europe. From the 1990s, alliances between banks either had to develop specific skills neither bank could achieve alone, or serve as a defensive move in wake of expected restructuring in the European banking market. This usually was accompanied by share exchanges.

Table 3.3. Selected Alliances between 1980 and 2000

Alliance to acquire or share specific skills	Alliance to ensure (future) market position
• Royal Bank of Scotland – Santander (1990-) • BNP-Dresdner (1988-2000) • Société Générale – BSCH (2000)	• BBVA – UniCredito (2000) • Amro – Generale (1988) • Commerzbank – Banco Hispano Americano (1973, 1990)

The re-appearance of alliances and joint ventures in the 1990s was more specific than in the 1970s and was also accompanied by mutual equity stakes. Banks opted for mutual equity stakes to forge a stronger link with the other bank than an alliance; the mutual equity stake effectively represented an option to a first right to negotiate with the other bank when consolidation in the (European) banking market was considered.

Internet Banks
From the late 1990s, the branchless Internet banks as an organizational form gained importance. Internet banking was initially viewed as a cost saving measure, providing the opportunity to close down branches while retaining the bank's customers. Other banks have developed Internet banking into a low cost distribution form to expand in mature markets, such as ING Direct, Comdirect or DB24. Other activities were less successful though. Aiming to capture the high end of the consumer market, HSBC formed in 2000 a USD 1bn joint venture with US securities firm Merrill Lynch to offer online brokerage services to wealthy clients. HSBC wanted to win new customers by outsourcing research and brokerage services to Merrill. However, the activity was quietly disbanded in 2003.

3.4 Realized internationalization strategies

To gain further insights in the realized internationalization strategies, 44 case studies were developed, spanning 24 years. For each bank the individual internationalization activities were tabulated and clustered to identify phases in activities, the geographical area or region of activity, and additional information about the clients, products and organization form used. The world's largest banks pursued different internationalization strategies between 1980 and 2000. Banks retreated as well as increased their internationalization activities. Roughly one quarter of the banks remained

internationalized, one quarter retreated, while one quarter slowly and one quarter strongly internationalized.

A bank's strategy is determined by a large number of variables which cannot be easily moulded into a framework (Canals, 1997). Walter (1988), Smith and Walter (1997), and Canals (1997) have developed strategic frameworks for banks. Smith and Walter (1997, pp. 401–436) developed a three dimensional matrix, which can be drawn up for each banking organization: a client – arena – product (C-A-P) matrix. The C-A-P classification is useful to analyze the activities of a bank or any firm in general. Smith and Walter do not derive general strategic typologies from their framework, although it builds on the strategy research of Porter (1985). Banking "is a complex web of markets, services and institutions that is not easily subjected to systematic analysis" (Canals, 1997, p. 401). Instead, they state essential attributes to exploit opportunities within the C-A-P framework. These include the adequacy of the institution's capital base, the institutional risk base, quality of human resources, its access to information and markets, its technology base and managerial culture, and the entrepreneurial quality of its people.

Canals (1997, pp. 266–269) investigated internationalization strategies of banks and presented an internationalization model which is based on three main incentives, the combination of which he hypothesizes to be instrumental for the internationalization of banks. In his view scale, customer service and resource transfer are the main incentives for international activity. Canals (1997, p. 250) further linked motives to organizational form of internationalization activity. Alliances are the best way to transfer resources or skills, and acquisitions are a modus operandi for increasing scale. If on the other hand customer service is an important objective, then the development of branches are quite likely. Canals stressed that "the strategic options banks have open to them vary depending on their resources and their home country [...]. The reason for this variety of strategic options is related not only to each bank's starting position, resources, skills, and weaknesses, but also to the financial model in which it operates." (Canals, 1997, p. 329).

The risk of simplifying strategic nuances may weigh up to the analytical advantages of creating a comparative framework to develop general observations. Although each framework has its merits, there is no general framework which can be straightforwardly applied to internationalization strategies for banks. Therefore, the strategic framework for internationalization strategies in this study builds on the determination of strategy phases developed by Fujita and Ishigaki (1986), and De Carmoy

(1990), combining banking strategies with strategic conduct into phases. Within this framework, four major phases for internationalization activities were identified: entry, expansion, consolidation and restructuring. Additionally, we limit ourselves to the identification of realized strategic activities compared to intended strategies (Mintzberg, Quinn, & Ghoshal, 1995): information on realized strategies is publicly available and the measurement of realized strategies allows more comparisons between banks.

Table 3.4 show the phases; based on the case studies additional information has been added in the right columns: the range of TNI during a phase and the change in TNI during the phase.

Grouping banks on the basis of these phases and the resulting TNI development led to five distinct types of realized internationalization strategies. In general, a stylized strategy is bound to ignore specific choices that banks have made, but on the other hand offers the advantage of defining commonalities in internationalization activities more clearly. The five types are:

- *Accelerating internationalization*
  Banks initially develop internationalization activities by setting up branches in major economic and financial centers. As a next step international activities are expanded by increasingly large foreign bank acquisitions. Finally, the bank has to restructure, to consolidate the large foreign acquisitions and to regain or increase its profitability.

- *Moderate internationalization*
  In general, banks with *Moderate* internationalization strategies consider internationalization as a support activity of the total bank organization. They develop a foreign branch network and bank activities in major foreign economic and financial centers; acquisitions and establishment of other international bank activities are a reaction to the internationalization activities of other banks, especially banks with *Accelerating* strategies. Ultimately, restructuring also sets in to consolidate activities and (re)gain profitability.

- *Imploding internationalization*
  Fast increase of internationalization activities, to uphold or increase the bank's relative position compared to other competitors. Because the bank is unable to control the large increase in international activities, a prolonged financial crisis occurs. Finally, internationalization activities are divested to raise capital; bank management (under pressure of regulators) refocuses its activities on the domestic banking market.

Table 3.4. Phases of international organization activity

	Strategy phase		Description	Effect on bank organization	Effect on bank's TNI	
					TNI level	TNI change
1	Entry		Refers to a) a new activity in a new market, b) a new activity in an existing market or c) an existing activity in a new market.	Change/expansion of organizational structure, new strategic goals	0-20%	0-10%
2	Expansion	Broad	Above average growth of capital commitment to activities	Targeting of several markets, combined with several acquisitions	20-60%	0-20%
		Focused	Above average growth of capital commitment to activities, combined with selective disinvestments in activities and/or markets	Specific targeting of one or few markets, perhaps combined with one large acquisitions	20-80%	0-20%
3	Consolidation	Balanced growth	Average growth of capital commitment to activities, aiming to maintain current market position and/or financial targets.	Change in internationalisation dependent on difference home-foreign growth rates	All levels	-5 - +5%
4	Restructuring	Refocus	Period of reformulating strategy or restructuring the organization as a result of a crisis of some sort. Restructuring of activities does not lead to disinvestments and serves to increase profitability and/or lower the cost base	Staff cuts, change of organisational structure and refocusing of strategic goals	20-80%	-5 - +5%
		Refocus & exit	Period of reformulating strategy or restructuring the organization as a result of a crisis of some sort. Average growth of capital commitment to activities, combined with selective disinvestments in activities and/or foreign markets to increase profitability or lower the cost base.	Staff cuts, change of organisational structure and refocusing of strategic goals. Disinvestments in the markets which are no longer targeted. Freed capital is used to invest in remaining activities or to generally shore up solvency	all levels	-10 - 0%
		Exit	Period of reformulating strategy or restructuring the organization as a result of a crisis of some sort. Sale or shut down of activities and markets to raise capital and/or reinvest in other existing activities.	Staff cuts, change of organisational structure and refocusing of strategic goals. Disinvestments in the markets which are no longer targeted. Freed capital is used to increase solvency	40-80%	-20 - 0%

- *Retreating internationalization*
  After a foreign financial or economic crisis, banks reassess their foreign activities and shift their focus from international activities to domestic activities. Foreign activities are divested to raise capital and/or domestic banking activities are expanded, lowering the degree of internationalization.

- *Established internationalization*
  These are banks with a high degree of internationalization; the banks have been historically committed to international activities, usually building up international activities over a long period.

Table 3.5. Banks and their model of internationalization

Accelerating	Moderate	Imploding	Retreating	Established
• HypoVereins bank • BCH • ING bank • ABN/Amro • NMB Bank • BBV • Paribas • Credit Suisse • Deutsche Bank • Dresdner Bank • Santander • UBS • WestLB	• Argentaria • Amro • Fortis • Bayerische Hypobank • Vereinsbank • Agricole • Commerzbank • IBJ • Rabobank • Royal Bank of Scotland	• Midland • Crédit Lyonnais	• Manufacturers Hanovers • Chemical Banking • Mitsubishi Bank • Bank of America • Barclays • Chase Manhattan • Dai Ichi Kangyo • Lloyds TSB • National Westminster • Sumitomo Bank	• Tokyo-Mitsubishi • ABN • HSBC • Tokyo • SBC • JPMorgan • BNP • Citicorp • Société Générale • Standard Chartered

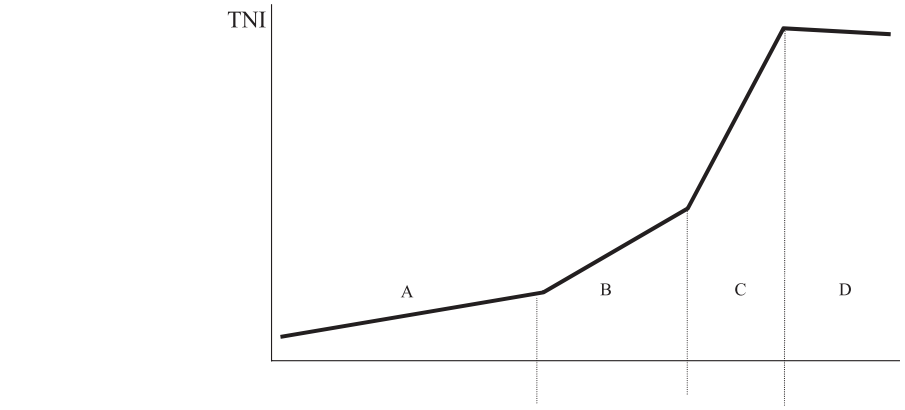
The five types represent the internationalization of all banks in the sample, and are classified in Table 3.5. Besides the two banks representing *Imploding* internationalization, the number banks' models of internationalization is evenly spread between the other four types. Next, the stylized types of realized internationalization strategies are discussed.

3.4.1 Accelerating internationalization

The first model fits banks that started internationalization at a moderate pace, increasing the degree of internationalization in one or more subsequent steps, after which a period of consolidation set in (Figure 3.3). In the first period (stage A in Figure 3.3), the TNI generally moved between 10 and 20%.

Foreign activities comprised a branch network in main financial centers and economic centers. For European banks, activities were set up in centers such as Luxembourg, Switzerland, Paris and London to gain access to the Euromarkets and more advantageous sources of finance than in the domestic market. The bank's objective has been to seek resources, acquire skills and funding. Also, market seeking was an important objective, expanding the existing services to be offered to domestic related clients in foreign countries. This stage also includes banks who have actively participated in consortium banks, building their branch networks in the late 1970s partly on the basis of restructured or dissolved consortium bank networks.

Figure 3.3. Stylized model of accelerating internationalization



	A	B	C	D
Entry	■■■	■		
Expansion, broad	■	■■		
Expansion, focused	■■	■■■	■■■	
Consolidation, balanced growth			■■	■■
Consolidation, restructuring				■
Restructuring, focus & exit			■	■■■
Restructuring, exit				
Average length in years (N)	7.1 (7)	8.3 (10)	5.4 (11)	1.8 (4)

■ Less likely objective; ■■ Likely objective; ■■■ Very likely objective

In the second stage (B), internationalization quickly gathered pace and TNI reached levels between 20 and 40%. Weighing up between domestic and international investments, banks increasingly chose international expansion. Drivers for this change were in Europe the perceived convergence of financial markets, forcing banks to acquire foreign activities to have a European foothold (just in case) and also to re-establish relative domestic positions. The change

from stage A to stage B is consistent with "obtaining a foothold strategy". Information about the foreign market is obtained by making small investments, precursor of larger investments in the following years (Molyneux, 2003).

A number of banks have a third stage (C), accelerating the already strong growth of internationalization activities. Here, the acquisitions get larger in size, pushing TNI levels between 60 and 80%. The acquisitions in the second stage probably have been integrated relatively smoothly. The increase took place for a number of banks between 1995 and 2000 (ABN Amro, UBS, Credit Suisse); the funding opportunities in the stock market might have helped as well.

The strong organizational changes in stages B and C have to be absorbed at some point, signalling a consolidation or restructuring period (D). A trigger for this could be threefold. First a financial crisis could force bank management to reconsider its geography-product portfolio. For example, the Asian crises of 1998 made Barclays and ING (further) downscale their investment banking activities, leaving shareholders with the impression the (geographic) span of risk control was not an optimal one. Second, funding opportunities for further expansion might be limited because the stock market is no longer a viable option, forcing the bank to concentrate more on organic growth opportunities than growth by acquisitions. Third, banks might have hit an internationalization ceiling: raising internationalization above a certain level raises questions like representativeness of the management board, and the validity of the location of headquarters. In other words, raising the TNI above a certain level might in some respects be a threat to sitting management.

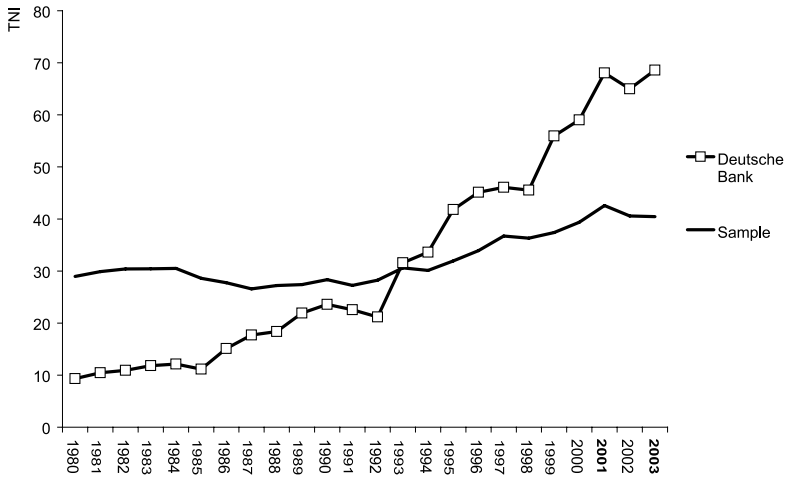
Table 3.6. Major changes in TNI between 1980 and 2000

Bank	Year	TNI Change	TNI	Event
ABN-Amro	1997	18.61	69.85	Acquisition Brazilian Banco Real
Barclays	1989	12.31	43.17	
BBV	1996	11.51	40.46	Acquisition South America fund managers
	1997	11.53	51.99	Acquisition South America fund managers
Credit Suisse	1990	14.28	47.53	Acquisition Swiss Bank Leu
	1997	10.83	62.22	Acquisition Swiss Winterthur, BZW branches from Barclays
Deutsche Bank	1993	10.41	31.58	Acquisition Italian, Spanish subsidiaries and branches
	1999	10.40	55.93	Acquisition Bankers Trust
HypoVereinsbank	2000	17.34	36.11	Acquisition Austrian Bankverein
ING bank	1998	15.75	56.24	Acquisition German BHF Bank
Midland	1981	12.38	33.74	Acquisition American Crocker Bank
	1982	11.93	45.68	Acquisition American Crocker Bank
Royal Bank of Scotland	2001	16.44	34.02	Acquisition of National Westminster
Santander	1997	19.55	53.13	Acquisition several South American banks
SBC	1995	10.77	42.67	Acquisition English Warburg
UBS	2000	12.09	65.51	Acquisition American PaineWebber
Westdeutsche Landesbank	1993	10.87	23.87	Acquisition European branch network Standard Chartered
	1995	14.63	34.54	Acquisition English Cook Travel

Bank management at this stage in general refocused: it redefined the Client-Arena-Product areas (cf. Walter, 1988) it would like to excel, finding that it acquired a number of activities in the previous years that would not fit anymore in the bank organization. Key ratios as solvency, stability of earnings, profitability and loan provisions become more important management drivers, forcing divestments in some activities.

Deutsche Bank: accelerating internationalization strategy

Deutsche Bank fits the stereotype of the European bank in search of a truly global strategy. As one of Europe's largest banks, it has focused on developing a retail bank presence in Europe in the 1980s, shifting to acquiring a leading position in worldwide investments banking in the 1990s.



Initially, Deutsche Bank's *Accelerating* internationalization strategy began by setting up branches in major economic and financial centers. Next, international activities were expanded by increasingly large foreign bank acquisitions. Finally, a restructuring period set in, consolidating the large foreign acquisitions and regain profitability.

1970s–1985: Entry in international banking markets.
Throughout the 1970s, Deutsche Bank systematically set up its branch network world wide. This development was largely over in the early 1980s but Deutsche Bank continued to open branches or convert representative offices to branches, though not with the intensity of the "flag-planting competition" of British banks.

1986–1998: Broad international expansion.
In 1986, Deutsche Bank started a reorganization to increase its market position in securities trading, increase its presence in other high-growth international markets and strengthen bank's position in retail banking. Retail banking networks were acquired in Italy (1986 and 1993), Spain (1993) and Belgium (1998). It was unsuccessful in acquiring a retail network in France, and decided in 1999 to set up 15 branches for wealthy customers. The growth in the capital markets was primarily accomplished in two large steps: the acquisition of Morgan Grenfell in 1989, and the acquisition of Bankers Trust in 1998. Subsequently, the bank's headquarters for its investment banking activities were transferred to Morgan Grenfell in London. Deutsche Bank's aim was to also to become a sizeable participant in the wholesale banking activities in the United States. This was achieved with the sale of Bankers Trust to Deutsche Bank in 1998.

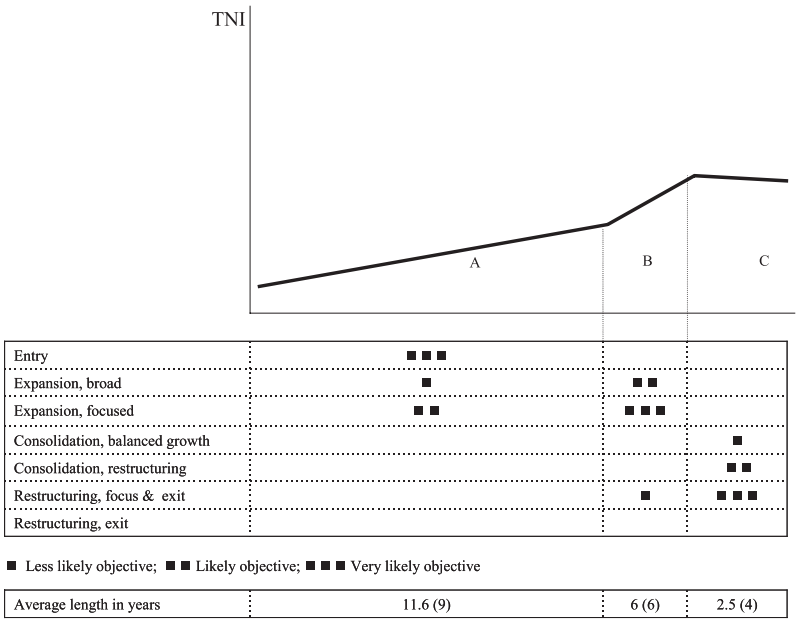
1999–2004: Restructuring.
Increasing its German market share was a permanent issue for Deutsche Bank in the 1990s. It unsuccessfully negotiated a merger with domestic competitor Dresdner Bank in 1999, failing to agree on integrating their investment banking activities. The restructuring of domestic operations had to be done alone, and Deutsche Bank created "Deutsche Bank 24", its retail banking unit, by combining retail and direct bank activities (clicks and bricks) in 1999. After restructuring, profitability increased in 2000, and the bank moved away from the concept that retail banking was a costly but necessary burden for the bank. Further cost reduction was pursued by the intended joint venture with Dresdner's and HVB's backoffices. Opportunities to expand in the domestic market, to counter the volatile investment banking source of income, were often debated (such as the Postbank IPO) but not seized. In the absence of potential partners in Germany's fragmented banking market, Deutsche would have to look to one of its European peers, as indicated by its chairman. Also, management focus was distracted by the Mannesmann trial.

3.4.2 Moderate internationalization

Banks with a stable growth of internationalization activities tend to consistently increase their TNI over time. Here too, the first stage is the build up of a branch network, with levels of TNI remaining between 10 and 20 percent. Where other banks accelerate their growth, mostly by acquisitions, these banks prefer to continue a strategy combining greenfields and/or small acquisitions. In some cases they are simply restricted by earlier actions (Commerzbank internationalization activities lagged behind its domestic

competitors because it had accumulated less reserves in the 1980s) or focus: Argentaria was created as a domestic oriented bank, and Rabobank had a strong domestic base. At some point, usually when the acceleration in internationalization activities took place for the *Accelerating* banks, these banks also attempted to catch up with their competitors and strongly increase their foreign activities. Rabobank set up an investment banking unit in London in 1995, and Commerzbank, previously focused on Europe, set out to buy a Taiwanese bank. At this stage, TNI generally moved between 20 and 40%.

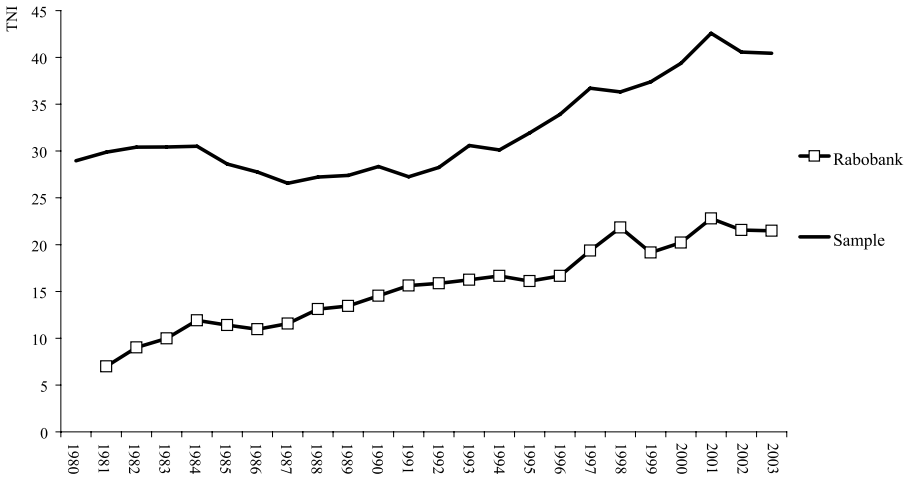
Figure 3.4. Stylized model of moderate internationalization



Reorientation with these banks generally took place ahead of restructuring with *Accelerating* banks: the low degree of internationalization is probably caused by a more risk-averse approach to foreign activities, allowing little room to absorb more volatile results. Also, a relatively late acceleration of internationalization activities might have soon created the awareness that size or infrastructure to effectively compete in markets with other banks could not be achieved without considerable amount of investments. A reorientation takes place (C), focusing on its core activities. Rabobank down-scaled its investment banking activities and focused on agricultural finance as an international niche strategy, aligning its international activities with its domestic strengths. Commerzbank set out to keep a confined geographic scope, maintaining a European branch network to support its German clients.

Rabobank: moderate internationalization strategy

Dutch based Rabobank is a diversified financial services organization with a cooperative status. Founded in 1972, the bank has a strong domestic base, and builds on its agricultural roots in its foreign expansion strategies.



The Rabobank is representative for banks with a moderate internationalization strategy: to a large degree, internationalization is considered as a support activity of the total bank organization.

1980s: broad international expansion.
Foreign activities to serve its domestic clients formed the core of its internationalization strategy in the 1970s and 1980s. To join the international capital market operations, Rabobank set up activities in London and New York. Rabobank actively participated in consortium banks and alliances, with UNICO as a linking pin within this strategy.

1990–1995: broad domestic and international expansion.
In the 1990s, the bank moved towards a bankassurance model acquiring insurer Interpolis and asset manager Robeco. It was the basis for a three pillar strategy: in the home market, Rabobank built its organization into a broad financial service provider, strengthening the retail, corporate finance and asset management side, remaining loyal to the legacy of earlier decades. Rabobank strengthened ties with existing UNICO partners, especially German DG bank and Spanish bank Banco Popular.

1996–1998: Increased international expansion.
The rising costs of the foreign branch network forced a reorientation, and in 1996 the bank decided to provide corporate, investment and private banking services to clients in the agricultural, pharmaceutical and food industries in the major regions, initiating a string of acquisitions worldwide. Somewhat more opportunistic, its London branch was heavily upgraded in 1997 into an investment banking department, trying to reap the fruits of booming securities markets. Investment banking was scaled down in 1999 after disappointing results.

1999–2002: Restructuring.
However, Rabobank suffered a string of setbacks forcing it to reconsider its strategy: two announced large scale mergers fell through and its investment banking activities delivered poor results. In 1998 Rabobank unsuccessfully contemplated a full-fledged merger with Achmea. An alternative, to combine the investment banking activities with DG Bank in a joint venture, fell through. Also, the domestic cost efficiency was lagging in comparison with other competitors. These events signalled a period where management reconsidered the bank's strategy, and in anticipation of a new direction cost cutting measures were announced.

2003– : Refocused expansion
Asset management heralded the continued commitment to international operations when Rabobank bought two American asset managers and a hedge fund boutique in 2001 and 2002, as well as a small Swiss private bank. In 2004 Rabobank agreed to co-operate with pan-European insurer Eureko, in a deal initially restricted to health insurance. In Poland a large financial participation in the leading agricultural banks BGZ was acquired, while in India the bank took an equity stake in an Indian retail bank. The bank faced resistance however when it announced its intention to acquire US based Farm Credit Services. The bank's commitment to further international growth is still unwavering; its chairman predicted early 2005 that in 10 years "our international side will be bigger than our Dutch side".

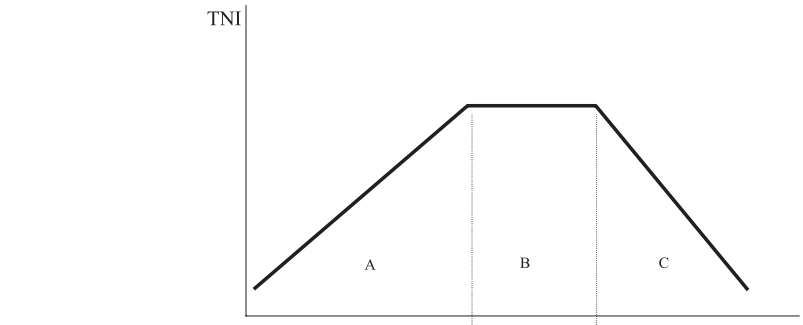
3.4.3 Imploding internationalization

Jean Deflassieux, senior international officer at Crédit Lyonnais in 1980, said that banking internationalization is "a bit like bicycling: if you stop going you fall off" (Lewis, 1980). A strong rise and decline of internationalization between 1980 and 2000 applies to two banks: Crédit Lyonnais and Midland

Bank. Within a short period, foreign activities were acquired to achieve status (stage A): Crédit Lyonnais aimed to achieve a similar market position as Deutsche Bank in the European banking market, while Midland felt it lagged in internationalization activities after years of consortium banking and alliances, and wanted a major foreign acquisition to be at par with the other British banks.

The rise in internationalization and change in market-position came in both cases at a cost: the bank organization became uncontrollable, its problems surfacing in stage B. For example, management of United States Crocker Bank did not give its owner, Midland, full insight in its financial statements (Rogers, 1999). Midland was not able, and perhaps did not press hard, to gain disclosure about how its capital injection was spent. The influx of capital in Crocker created unbalanced loan growth, and poor disclosure meant that risks similar to Crocker and Midland were not controlled for the total organization. Crédit Lyonnais had similar problems: it did not have an administrative organization in place to manage the operational risk that was increasing with each additional foreign acquisition.

Figure 3.5. Stylized model of imploding internationalization



Entry			
Expansion, broad	■ ■ ■		
Expansion, focused	■ ■	■ ■	
Consolidation, balanced growth		■ ■ ■	
Consolidation, restructuring		■	■
Restructuring, focus & exit			■ ■
Restructuring, exit			■ ■ ■

■ Less likely objective; ■ ■ Likely objective; ■ ■ ■ Very likely objective

Average length in years (N)	8.5 (2)	3.5 (2)	4.5 (2)

The decline of internationalization for both banks was a forced exit, as sudden as its entry. Midland had to take large provisions for the losses at Crocker, damaging Midland's solvency which was only stopped when Crocker was sold at a large loss. Crédit Lyonnais had to sell its European subsidiaries in return for state aid. After this, both banks their independence was ended. The restructuring of Midland was undertaken by HSBC from 1992; the French government restructured Crédit Lyonnais from 1998, and redistributed its shares in a public offering in 2000 making it clear it would not object a (domestic) takeover.

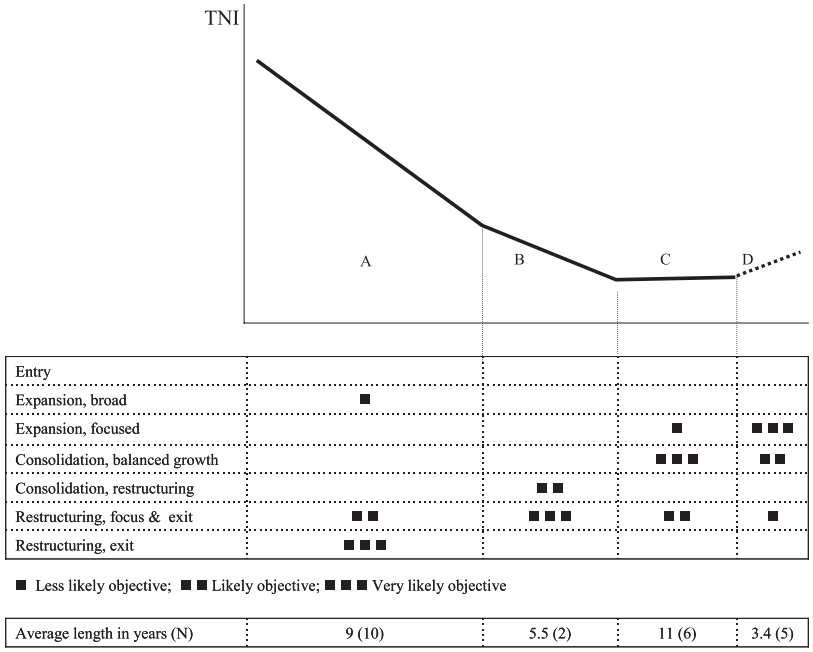
3.4.4 Retreating internationalization

Retreating banks have already acquired high levels of internationalization in an earlier period. They have built a branch network supporting their domestic clients, but also other activities like commercial bank networks. The decline of internationalization is triggered by a crisis; for American and British banks in the early 1980s this was the LDC crises.

Banks then began a period of reorientation: their main concern is to stop the loss making activities, depressing their profitability, solvency as well as their market value. American banks reduced their LDC exposure throughout the 1980s, while playing an active role in the loan restructuring committees until 1985 to salvage some of the loans. Regulatory authorities tended to play an active role, stimulating the decrease in foreign activities because they more domestic mergers and acquisitions to achieve scale and more cost-cutting opportunities.

This hastened the decline in TNI in stage B (see Figure 3.6). This also suggests that internationalization was not the preferred growth strategy for these banks in the first place. This is especially the case for American banks, when the regulation on interstate banking was lifted, allowing domestic mergers.

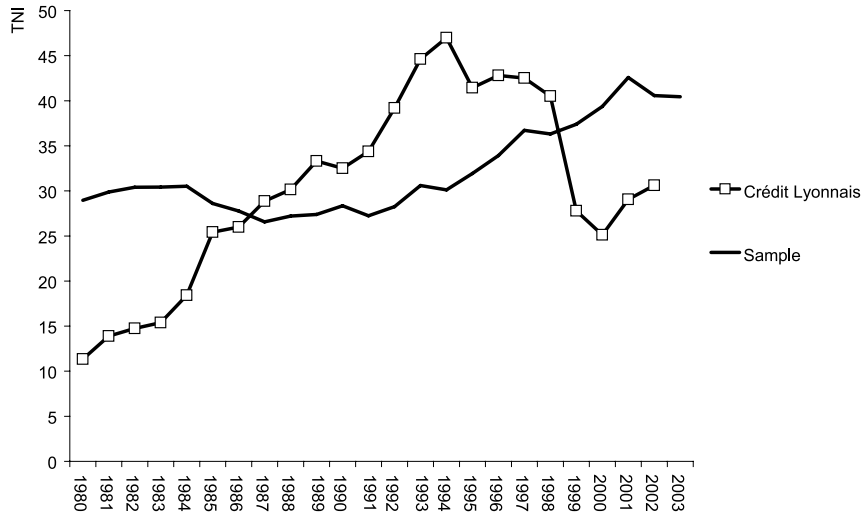
Figure 3.6. Stylized model of retreating internationalization



After a period of consolidation, working through the domestic merger, bank management became interested again in internationalization. Chase Manhattan bought J.P. Morgan in 2000 to this end, Bank of America set up investment banking activities in London from 1999 onwards, and domestic oriented banks like Lloyds announced that it might once again reconsider international activities in 2000.

Crédit Lyonnais: imploding internationalization strategy

Crédit Lyonnais, a state owned bank, dramatically increased its internationalization efforts in the 1980s, aiming to become the largest diversified European bank and overtaking Deutsche Bank's role. A financial crisis eventually emerged because of poor management. The bank restructured with state aid, and eventually was acquired by Crédit Agricole.



Crédit Lyonnais experienced an *Imploding* internationalization strategy. After a financial crisis in the early 1990s, the bank reassessed its foreign activities and had to shift its focus from international activities to domestic activities. Foreign activities were divested to raise capital, lowering the degree of internationalization.

1980–1984: Broad international expansion.
The internationalization of Crédit Lyonnais was well underway since the 1970s, establishing a network in Latin America, Africa and for a short while the Middle East. Branches in the major financial centers were created, and capital market activities expanded.

1985–1993: Increased international expansion.
Crédit Lyonnais embraced a universal banking concept: while the bank aimed for an important role in the financing as well as control of industrial companies. It believed in the need to be present in European countries, either

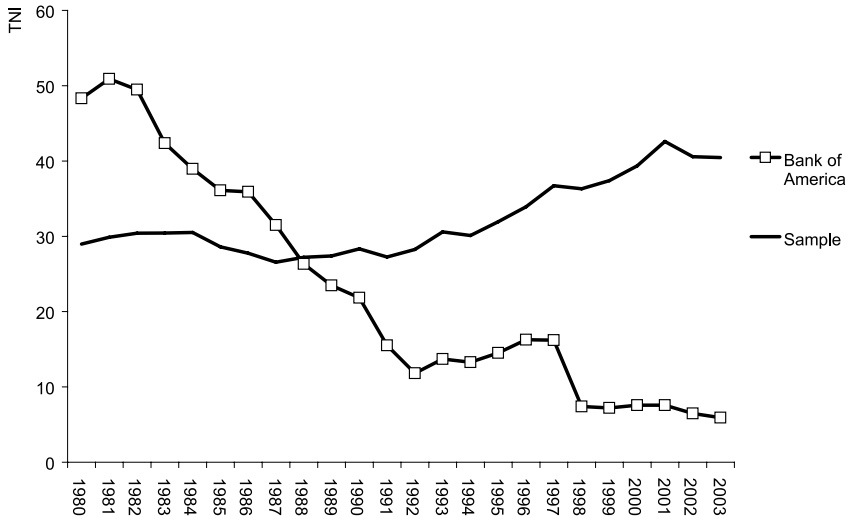
through internal growth or by buying foreign banks. The expansion of Crédit Lyonnais was directed by government; the bank expanded abroad to assist state-owned industrial firms as they sought to compete outside France. It acquired a score of banks and industrial holdings between 1989 and 1992 in Europe; this aggressive strategy proved to be a risky one after the economic slowdown in 1992. Industrial holdings and property loans generated heavy losses. Insufficiently controlled subsidiaries caused serious setbacks both in France and abroad. After a change of management, staff was cut, operations streamlined and assets sold. Mounting heavy losses forced the French government to rescue the bank, first in early 1994 and then in April 1995.

1994–2000: Restructuring, refocus and international exit.
The government provided financial assistance which probably worsened the situation, and the bank ran into further trouble in 1996. A financial restructuring plan was finally agreed on with the French government and approved by the European Commission in 1998. This plan included scheduling major sales of foreign assets as well as the privatization of the bank by October 1999. In subsequent years however Crédit Lyonnais still had to cope with the aftermath of its ill fated acquisition strategy, such as the disputed acquisition of insurer Executive Life.

The public offering of shares took place in 1999, with Crédit Agricole controlling a 10% equity stake. In 2003 Crédit Lyonnais was fully acquired by Crédit Agricole in a domestic consolidation move, ahead of BNP Paribas who also had built up an equity stake and shown interest to acquire the whole bank. The Agricole-Lyonnais combination controls about a third of the country's retail bank business.

Bank of America: retreating internationalization strategy

The initially California based Bank of America was in the 1970s a bank with a large worldwide presence. In 20 years, the bank transformed into broad financial service provider, with a predominant domestic focus caused by foreign divestitures and large domestic mergers with Nationsbank (1998) and recently FleetBoston (2003).



The internationalization strategy of Bank of America has been *retreating*: after the foreign loan crises in the emerging markets in the early 1980s, the bank reassessed its foreign activities and shifted its focus from international activities to domestic activities. Foreign activities were divested to raise capital and/or domestic banking activities expanded, lowering the degree of internationalization.

1980: Financial crisis.
The asset seeking strategy of the 1970s and early 1980s had major flaws: operating expenses were hard to control, management had difficulties coping with the organization, and the foreign expansion turned out to be over-ambitious, having lent considerably to LDCs.

1980s: Foreign retreat, domestic restructuring.
Large losses between 1985 and 1987 forced a restructuring program with three goals. First, the retail and commercial banking units were strengthened,

since BankAmerica had an extensive distribution network. Second, poorly performing lending activities were divested or cut back. Third, international activities were cut back. The number of European staff decreased from 7,500 to 1,700 in 1994, the number of Latin American countries it was active in decreased from 20 to 6. After cutting costs and restructuring bad loans, the bank returned to profit in 1988 and steadily increased its financial performance.

1992–2000: Increasing domestic expansion.
In 1990 the operations of Bank of America were expanded into seven other states by acquiring thrifts. In acquiring Security Pacific, Bank of America increased its position in California, increasing total assets by 56%. The bank acquired additional banks and mortgage businesses, and in 1994 Continental Bank was bought. Bank of America and Nationsbank announced their merger in 1998.

2000: Renewed international orientation?
The Russian crisis and the merger activities between Nationsbank and BankAmerica led the bank in early 1999 to restructure its foreign activities, selling its private banking operations in Europe and Asia to UBS, and its consumer banking business in Asia to ABN Amro. Simultaneously, it announced that it planned to expand its securities activities in at home as well as in the United Kingdom, attempting to build it up internally.

2003: Continued domestic expansion and foreign retreat
Instead of re-expanding internationally, the bank anticipated on further regional integration with Mexico, buying part of Serfin, Mexico's third largest bank from Spanish SCH. Its commitment to other foreign activities such as in Japan was reassessed a few months later, scaling back its capital market operations there. Finally, in 2003 Bank of America acquired FleetBoston, making it the third largest banks by assets (and deposits) in the United States. The share of foreign operations dropped under 8% compared from almost 50% in 1980, evidence of the strong transformation the bank has experienced.

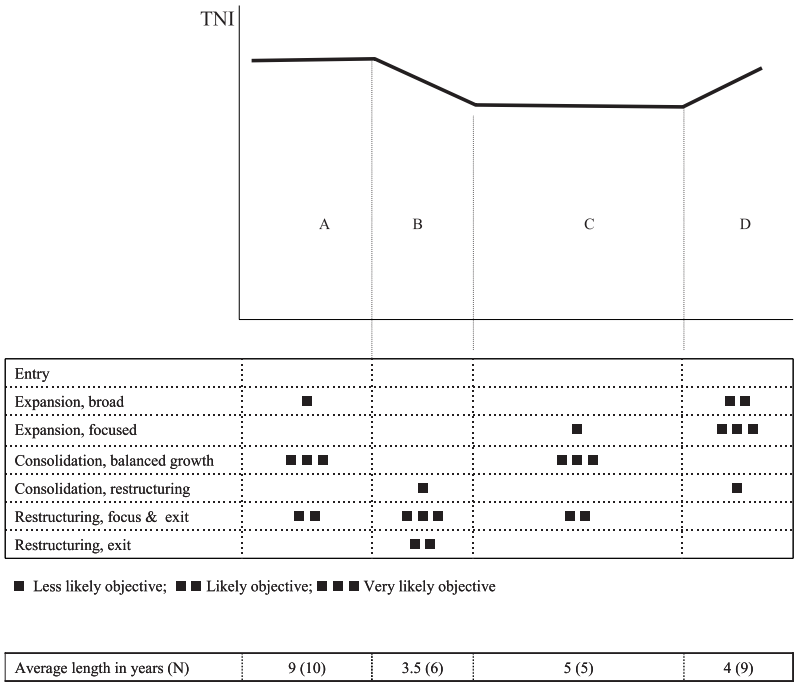
3.4.5 Established internationalization

Accelerating, *Moderate* and *Imploding* internationalization have in common that initially the level of TNI was low: the bank had to acquire a market position in international banking, and had three routes to choose from. For

Retreating and *Established* internationalization, the bank's initial position was different. The level of TNI was high, and while *Retreating* banks chose to focus on domestic activities, *Established* banks continued their commitment to international activities, maintaining a TNI level between 30 and 50%. This was the case for J.P. Morgan, Citicorp and HSBC in the 1980s and 1990s, or ABN in the 1980s.

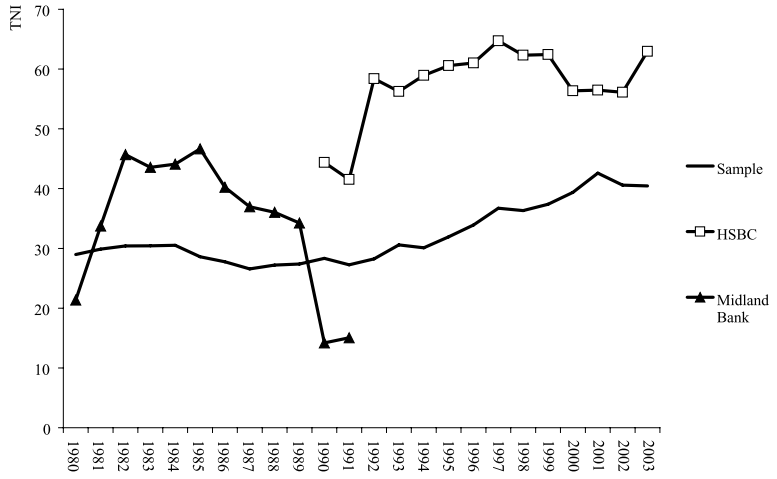
Established banks were not immune to change: economic and financial crises, and shifting focus on international banking activities led at time to restructuring activities. However, the banks typically did not decrease their TNI by more than 10 percent, illustrating their commitment to foreign banking activities. This also indicates that the banks have in general balanced international and domestic growth of banking activities.

Figure 3.7. Stylized model of established internationalization



HSBC: established internationalization strategy

HSBC began its internationalization strategy as a HongKong based bank with close ties to the United Kingdom. Expanding in several countries, the bank moved its headquarters to the United Kingdom in 1991 by acquiring Midland Bank. Its worldwide presence as a large diversified banking organization was enhanced in the 1990s by buying banking activities in Brazil and in the United States.



HSBC, a bank with an *Established* internationalization strategy, has historically upheld a high degree of internationalization. Historically committed to international activities, HSBC has built up international activities over a long period.

1980–1992: Broad expansion.
In the late 1970s and into the 1980s, China began to open up for foreign business. The bank bought operations in the United States (notably Marine Midland) and Canada, initially to capitalize on business between China and the United States and Canada, much of which was transacted through Hong Kong since China lacked financial infrastructure until the 1980s. HSBC was located in HongKong, uncertainty about its return to China led HSBC to gain a major foothold in the United Kingdom. In 1987, pressed to reduce its independence on Hong Kong, it took an equity stake in Midland. Midland Bank was purchased in 1992 and – as part of the agreement to buy Midland – in 1993 HSBC formed HSBC holdings, transferring its headquarters from Hong Kong to London.

1993–: Broad expansion.
The strategy of HSBC in the mid 1990s has been to build the world's biggest financial services group, presenting itself as a contender of Citigroup. HSBC took a different approach to investment banking than competitors like J.P. Morgan, and Deutsche Bank, building a far more modest investment banking unit, emulating Barclays Capital Market activities. HSBC began to expand further in Asia, expanding in Malaysia and China. In 1997 it expanded in South America, buying banks in Argentina, Brazil, Mexico and Peru. In 1999 it bought a controlling stake in South Korea's government-owned Seoulbank.

It also bought Republic New York and Safra Republic Holdings, doubling HSBC's private banking business and adding 426 branches in New York State. In 2000, HSBC bought Credit Commercial de France for 11 billion euros, adding 1 million French customers and completing Europe's largest ever cross-border banking acquisition. Also in 2000, HSBC formed a USD 1 billion US dollar joint venture with US securities firm Merrill Lynch to offer online brokerage services to wealthy clients.

The bank further increased its foothold in the United States with the acquisition in 2002 of Household, the consumer finance group, for about 15 billion US dollar – HSBC's largest purchase until then. Further acquisitions were eyed, especially in China and South East Asia, the traditional stronghold of HSBC. Early 2005, the bank expanded its global branding strategy by renaming French CCF.

3.5 Characteristics of realized internationalization strategies

The typologies are based on observations about realized strategies. In other words, the observation of what a bank actually has done has been the basis for identifying the different realized internationalization types. The different strategy types have a long time period in common spanning twenty years, which might be considered a long time for a strategy. Such a long time period is not uncommon. One of the path breaking management studies in the 1980s by Peters and Waterman, "In search of Excellence", examined American (non-financial) companies between 1961 and 1980 (Peters & Waterman, 1982). Another example is Collins and Portas (1993), who in 1989 studied a sample of American companies founded before 1945 to analyse their long term performance. A long term horizon also has some implications: the bank is in the analyses treated as an organization with a sense of historical memory; changes or events in the past bear their mark on strategic thinking today.

Figure 3.8. TNI per strategy type, unweighted average

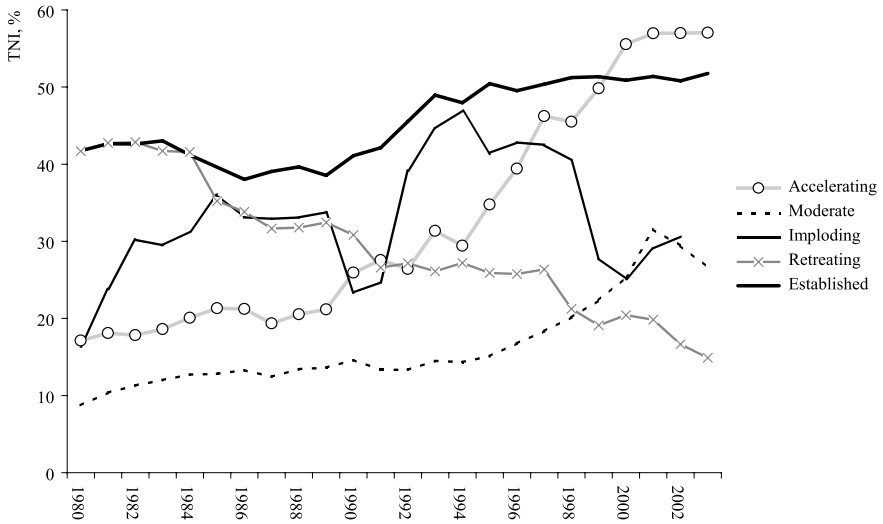


Figure 3.8 shows the unweighted TNI averages per strategic type. *Established* banks show the highest TNI throughout the period, only to be surpassed by *Accelerating* banks in 2000. On the lower end are the *Moderate* banks, showing the lowest average TNI throughout the period to be surpassed by the *Retreated* banks in 1998. *Accelerating* and *Retreated* banks are negatively related: for the *Accelerating* banks TNI increased, especially after 1989. *Retreated* banks show steadily declining levels of TNI, from 1983 onwards.

Table 3.7 presents a number of key figures per strategy and per five year period. Although *Accelerating* and *Retreated* banks are different strategies, they seem to have had similar growth targets: the average asset size in 1995–2000 is similar for *Accelerating*, *Retreated* and *Established* banks.

For the 1990s, *Retreated* and *Established* banks have been better capitalized, but also had higher loan provisions than *Accelerating* banks. *Moderate* banks have had a relatively high degree of provisions in 1981–1985, probably leading to the relatively low capitalization of the banks during that period. This may be partly responsible for the low degree of internationalization: these banks did not have the financial cushions (anymore) in the early 1980s to engage in international activities. If herding has taken place in the 1990s, then it surely was a risk-controlled one: exits were more swiftly decided on than with other bank types.

Table 3.7. Descriptives of realized internationalization strategy types

	1980-84			1985-89			1990-94			1995-99			2000-03		
	Mean	Standard deviation	N	Mean	Standard deviation	N	Mean	Standard deviation	N	Mean	Standard deviation	N	Mean	Standard deviation	N
TNI															
Accelerating	18.36	8.78	35	20.70	9.93	43	28.19	12.60	53	43.07	13.93	55	56.62	12.71	38
Moderate	11.10	7.26	34	13.11	9.29	35	14.01	8.96	39	18.19	6.85	40	27.62	10.28	21
Imploding	26.22	13.99	10	33.79	6.59	10	32.41	13.19	7	37.15	7.29	6	28.27	2.53	6
Retreating	42.12	7.62	50	32.98	5.54	50	27.64	7.35	46	23.80	8.07	37	18.05	8.14	25
Established	42.25	16.09	40	38.98	15.87	40	45.24	16.10	39	50.54	16.51	38	51.20	16.31	24
Total assets, mln U$															
Accelerating	48,697.52	19,910.73	37	86,399.91	43,126.20	43	175,661.42	80,295.12	55	342,125.03	171,082.65	55	572,218.08	216,234.14	35
Moderate	54,473.98	22,346.42	35	113,387.77	67,895.12	35	181,809.16	104,272.34	39	265,178.73	124,895.36	40	507,602.63	160,872.85	21
Imploding	82,991.75	12,167.73	10	123,524.84	44,651.64	10	261,316.73	103,785.13	7	248,066.48	66,972.90	6	204,038.04	41,083.60	6
Retreating	83,616.67	24,959.15	50	166,497.32	114,172.53	50	267,226.53	168,379.87	46	364,927.70	126,056.66	37	678,385.38	269,857.51	25
Established	73,009.69	31,133.93	40	123,095.59	60,733.80	40	193,846.32	82,635.31	39	348,155.55	173,437.01	38	662,753.90	326,944.76	24
Profitability, % capital															
Accelerating	12.14	7.00	40	16.68	8.41	43	13.60	7.51	55	12.52	6.72	55	8.25	12.48	38
Moderate	14.69	5.65	32	15.57	4.36	35	12.89	3.66	39	13.26	9.48	40	10.81	8.62	21
Imploding	16.63	7.10	10	9.77	13.19	10	-0.56	13.21	7	7.53	2.17	6	11.99	1.99	6
Retreating	18.88	4.91	50	13.93	19.80	50	12.96	10.37	46	14.87	19.78	37	12.87	26.57	25
Established	20.12	6.72	40	14.37	12.34	40	14.56	7.87	39	14.09	15.49	38	17.48	9.18	24
Capital ratio															
Accelerating	4.21	1.34	37	4.60	1.27	43	5.05	1.20	55	4.47	1.48	55	4.29	1.64	35
Moderate	3.23	1.20	35	3.64	1.32	35	4.63	2.52	39	4.20	1.08	40	5.07	1.44	21
Imploding	2.86	1.71	10	3.65	1.37	10	3.26	0.74	7	3.40	0.97	6	4.43	0.26	6
Retreating	3.90	1.22	50	4.13	1.30	50	4.90	1.48	46	5.45	1.86	37	4.70	1.80	25
Established	3.41	1.62	40	4.17	1.62	40	5.00	1.50	39	5.17	1.39	38	5.39	2.06	24
Total provisions, % capital															
Accelerating	12.17	7.98	40	14.20	6.72	42	11.65	6.16	53	8.85	6.94	55	8.96	7.34	38
Moderate	20.35	16.34	31	12.12	9.49	35	11.42	6.77	38	10.25	11.29	40	5.46	5.04	21
Imploding	33.08	23.32	10	25.76	12.95	10	25.41	8.87	7	15.58	4.12	6	8.94	3.21	6
Retreating	7.69	4.58	39	19.35	21.19	50	14.12	10.02	46	12.51	14.73	37	16.43	17.33	25
Established	18.26	17.58	36	17.32	16.55	40	11.78	8.89	38	10.12	10.51	38	7.63	6.78	24
Asset growth, yearly, U$, %															
Accelerating	-1.00	8.23	29	23.44	17.70	42	16.20	20.61	52	14.14	17.89	54	9.43	14.68	35
Moderate	-2.73	6.43	28	22.29	15.85	35	16.17	23.23	37	10.61	24.56	39	24.66	51.84	21
Imploding	1.71	11.84	8	11.86	10.98	10	10.65	17.50	7	-9.09	12.43	6	7.72	17.14	6
Retreating	5.29	10.46	40	14.30	18.20	50	9.43	16.72	46	13.37	38.38	37	12.95	19.52	24
Established	2.58	7.10	32	13.65	13.64	40	9.05	15.96	39	12.39	16.78	37	15.78	20.58	24

Finally, we examined whether herding applies to the five different realized internationalization strategy types. An incentive identified in chapter 3 to internationalize was herding. Herding takes place when a bank imitates the actions of other banks; the bank must be aware of and be influenced by other banks' actions (Bikhchandani & Sharma, 2000). A herding incentive might exist if other banks may know something about the return of foreign bank activities that the bank does not know; the bank may also have an intrinsic preference for conformity and follow (domestic) competitors.

To see whether the realized internationalization strategies are concentrated, Table 3.8 shows banks in the sample, grouped per country and per realized internationalization strategy. *Established* and *Retreating* internationalization strategies tend to be concentrated with American, British and Japanese banks, while *Moderate* and *Accelerating* realized strategies tend to be clustered around German, Dutch, Spanish and Swiss banks. This supports the notion that herding on a country level might exist.

Table 3.8. Realized internationalization strategies, per country

	United States	United Kingdom	Japan	France	Germany	Netherlands	Spain	Switzerland
Accelerating				Paribas	Deutsche Bank Dresdner Bank Hypo-Vereinsbank Westdeutsche Landesbank	ING Bank ABN/Amro NMB Bank	BCH BBV Santander	Credit Suisse UBS
Moderate			IBJ	Agricole	Vereinsbank Commerzbank Bayerische Hypobank	Rabobank Fortis Amro	Argentaria	
Imploding		Midland		Cr dit Lyonnais				
Retreating	Chemical Banking Manufacturers Hanovers Bank of America Chase Manhattan	Barclays LloydsTSB National Westminster	Mitsubishi Bank Dai Ichi Kangyo Sumitomo Bank					
Established	J.P.Morgan Citicorp	Standard Chartered HSBC	Tokyo-Mitsubishi Tokyo	BNP Soci t G n rale		ABN		SBC

4 Profitability and shareholder value

4.1 Introduction

Through internationalization, a bank might aim to improve its profitability, or realize more stable profitability through geographical diversification. The goal of this chapter is to determine if international activities have delivered a better performance than home country activities, and what relationships exist between performance measures of banks and TNI. There are several performance measures which can be evaluated, leading to the presentation of a number of analyses. First, the relationship between profitability and internationalization is tested, after shareholder return is included in the analyses.

4.2 Relationship between profitability and internationalization

Have banks become more profitable through internationalization, and have shareholders gained by it? To get an answer to this question, the relationship between the degree of internationalization and performance was analyzed.

4.2.1 Hypothetical relationships

The relationship between internationalization and performance has been extensively investigated, focusing on two research questions. Is there a relationship, and if so, what is the shape of that relationship? Organizations might show learning effects when their commitment and involvement in foreign activities increase, resulting in different benefit-cost trade off pay-offs for the organization.[4] In the last decade, researchers have developed different scenarios for explanation, hypothesizing two primary non-linear curve types: quadratic (J, U, inverted J, inverted U) and cubic.

The J curve assumes that over time banks can learn to minimize the additional costs associated with foreign expansion. (cf. Ruigrok and Wagner, 2003). This means that internationalization costs outweigh benefits until banks gain experience and learn to deal with them. Consequently, banks will reach an

[4] The following paragraphs about the shape of internationalisation lean heavily on Ruigrok and Wagner (2003).

inflexion point along the expansion path at which incremental benefits start to outweigh incremental costs. This is visualized as a J- or U-curve. This scenario implies that bank undergo a period of performance deterioration before experimental knowledge can lead to higher performance levels.

On the other hand, an opposite J- or U-curve can be hypothesized, arguing that banks do not need to explicitly address initial internationalization costs through organizational learning, but deploy their home based skills and resources to achieve economies of scale and/or scope, without large cost increases. Thus, at the start of internationalization, the incremental benefits of internationalization should outweigh the incremental costs. However, as banks intensify their foreign expansion, not only do coordination and monitoring costs increase exponentially and become difficult to address through organizational learning, but learning costs may outweigh value generated. In other words, an internationalization threshold is identified at the point where incremental costs of internationalization start to outweigh incremental benefits, implying that banks should not overstep this (degree of) foreign expansion.

Besides a J or U curve, a horizontal S shape has also been proposed to explain the link between performance and internationalization, aiming to reconcile the conflicting quadratic curve types. Here, two types of costs associated with internationalization are identified. Type I costs are fixed and modest costs at low degrees of internationalization, stemming from the liabilities of foreignness and newness: unfamiliarity with trade laws, consumer ethnocentricity, new consumer tastes and cross-cultural communication costs. Type 2 costs, visible at high degrees of internationalization stem from the significant coordination and monitoring demands caused by intense market complexity, dynamism and uncertainty. The horizontal S logic argues that learning to address the Type I costs is necessary and cost effective, but learning to successfully manage extreme levels of internationalization (Type 2 costs) is not. Banks should aim at learning to deal with initial costs of foreign expansion but avoid extreme levels of foreign market dependence.

Ruigrok and Wagner (2003) conducted a meta analysis of the relationship between performance and internationalization. Using data from 62 studies, covering 174 samples, they found empirical support for a non-zero, positive impact at the aggregate level. As to the form of that relationship, no clear conclusions could be drawn.

4.2.2 Internationalization of banks and performance

On a basic level, we can define the relationship between internationalization and performance as

$$p_T = f(w, p_F, p_H) \quad (1)$$

Where p is profit before tax as a percentage of total assets, the subscripts denote (T)otal, (F)oreign, and (H)ome. w is defined as foreign assets as a percentage of total assets. Whether w, p_F, p_H are related or not, the accounting definition holds by definition, stating that total profits before tax is an asset weighted average of foreign, and domestic profits before tax:

$$p_T = w \cdot p_F + (1–w) \cdot p_H \quad (2)$$

Equation (2) is a simple test for the linear relationship between profitability and internationalization. If $p_F > p_H$ we should observe a linear, upward sloping relationship between total profitability (p_T) and the degree of internationalization (w). The opposite holds for $p_F < p_H$. In other words, not assuming any learning effects or economies of scale exploitation leads to a hypothesized linear relationship between internationalization and performance. Theoretically, we could observe 4 different combinations of relationships. These are shown in Table 4.1.

Table 4.1. Hypothesized relationship between profitability and internationalization

	Foreign vs. domestic profitability	Relationship total profitability and internationalization	Support for
1.	$p_F > p_H$	$p_T = f(\overset{+}{w})$	Positive internationalization effects. Resource based asset seeking, or seeking new clients/markets. Geographic diversification advantages might apply.
2.	$p_F > p_H$	$p_T = f(\overset{-}{w})$	While foreign activities are more profitable, managerial and overhead costs of integrating them in the organization outweigh internationalization benefits.
3.	$p_F < p_H$	$p_T = f(\overset{+}{w})$	Support strategy. Foreign activities are loss making, but support total profitability. Resource based asset seeking, or seeking new clients/markets. Geographic diversification advantages might apply.
4.	$p_F < p_H$	$p_T = f(\overset{-}{w})$	Other motives to internationalize: gaining market share fast, having a long term acquisition horizon.

We first examine in 5.2 whether foreign profitability is higher than domestic profitability – in other words, is $p_F > p_H$. We do not assume, or test for specific J, S or U curve relationships between internationalization and performance. We examine in 5.3 the relationship between total profitability and the degree of internationalization, and identify a possible shape.

4.3 Is foreign profitability higher than domestic?

To test whether $p_F > p_H$, the following analysis focuses on differences in profitability based on reported data by banks (actual figures for a smaller number of banks). Banks have published this information to a limited degree. In 1980, 15 out of 44 banks reported such information, increasing to 20 out of 44 in 2000. Incidental reporting by for example Deutsche Bank has been left out, as have incidental reporting for Rabobank, NMB Bank and Tokyo Bank. A second analysis is then set up to analyze differences in performance for the whole sample with estimated figures for the whole sample. An alternative measures is developed here for foreign and domestic profitability, using benchmark profitability data and asset weightings.

Table 4.2. Data availability of domestic and foreign profitability

Country	Bank, period of data availability
France	Crédit Agricole (1992-2003), BNP (1982-2003), Crédit Lyonnais (1983-2002), Société Générale (1983, 1987-2003)
Germany	Commerzbank (1995-2003), Deutsche Bank (na), Bayerische Hypobank (na), Dresdner Bank (1997-2003), Hypovereinsbank (1998-2003), Vereinsbank (1992-1997), Westdeutsche Landesbank (na)
Spain	Argentaria (na), BBV (na), BBVA (na), BCH (na), Santander (na), BSCH (na)
Switzerland	Credit Suisse (1995-2003), UBS (na), SBC (na)
United Kingdom	Barclays (1980-2003), HSBC (1992-2003), Lloyds/TSB (1980-2003), Midland (1980-1991), National Westminster (1980-2003), Standard Chartered (1980-2003)
Netherlands	ABN (1980-1989), ABN Amro (1990-2003), Amro (na), Fortis (1996-2003), ING Bank (1992-2003), NMB (na), Rabobank (na)
United States	Bank of America (1980-1997), Chase Manhattan (1980-2003), Chemical Banking (1984-1995), Citicorp (1980-2003), J.P. Morgan (1980-1999), Manufacturers Hanover (1980-1990)
Japan	Dai Ichi Kangyo (1994-2003), IBJ (1994-2003), Mitsubishi Bank (1987-1995), Sumitomo Bank (1997-2003), Tokyo Mitsubishi (1996-2003), Tokyo Bank (na)

na: not available

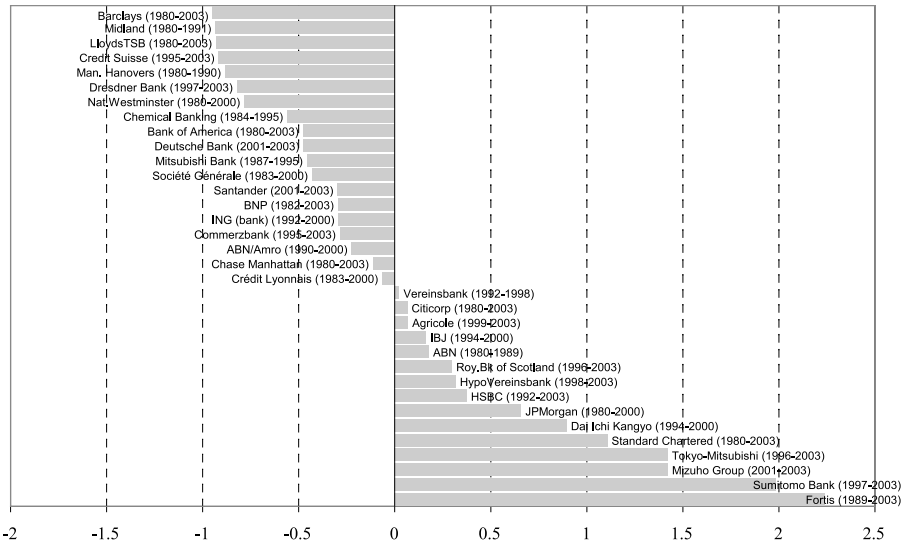
The best disclosed performance measure between for the banks in the sample with a geographic dimension is profit before tax as a share of total assets; Table 4.2 presents the banks that have reported longer series of foreign and domestic profitability. Information before 1990 leans strongly on the information provided by British and American banks, and to a lesser extent on French banks. It cannot be stated that when internationalization became more important for banks, they started to report more internationalization-related information in their financial reports. Banks like SBC, UBS or Deutsche Bank did not report this information although they progressed significantly with their internationalization activities. A general remark is usually found in the financial report stating something like "due to the integrated nature of our activities worldwide a geographical breakdown does not provide additional information"; the information provided by British and American banks in the 1980s proves otherwise. Difference in profitability between foreign and home activities (p_D) is calculated as:

$$p_D = p_F - p_H \tag{3}$$

The relative size of foreign activities does not influence the value of p_D; the difference in profitability does not change if the bank has 1% or 10% foreign assets.

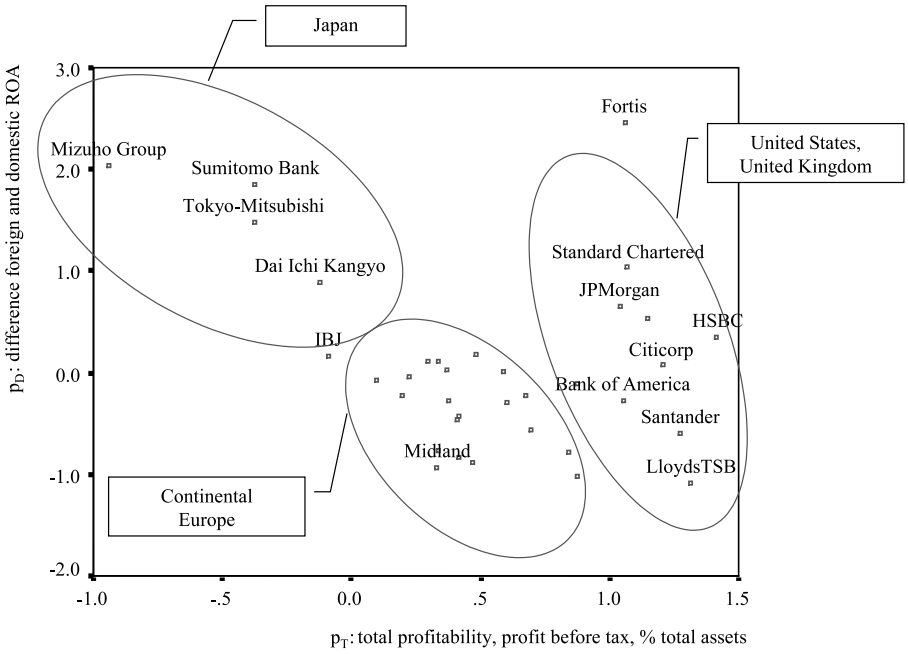
In total 34 out of 44 banks have reported at some time foreign and domestic profitability figures for three or more years between 1980 and 2003; 10 banks have not reported such figures. Of these 34 banks, 19 have shown a negative difference in profitability (Figure 4.1). When banks show a negative difference in profitability, is this caused by a relatively lower profitability of foreign activities or a relatively higher profitability of domestic activities? To answer this, a scatter plot is presented in Figure 4.2. On the vertical axis, the difference between foreign and domestic profitability is shown (p_D), and on the horizontal axis the total profitability is shown.

Figure 4.1. Differences in reported foreign and domestic profitability, for variable time periods



Note: Average difference foreign and domestic profit before tax, % total assets. Time period between brackets

Figure 4.2: Scatter diagram between difference in foreign and domestic profitability, and difference in domestic and average domestic profitability



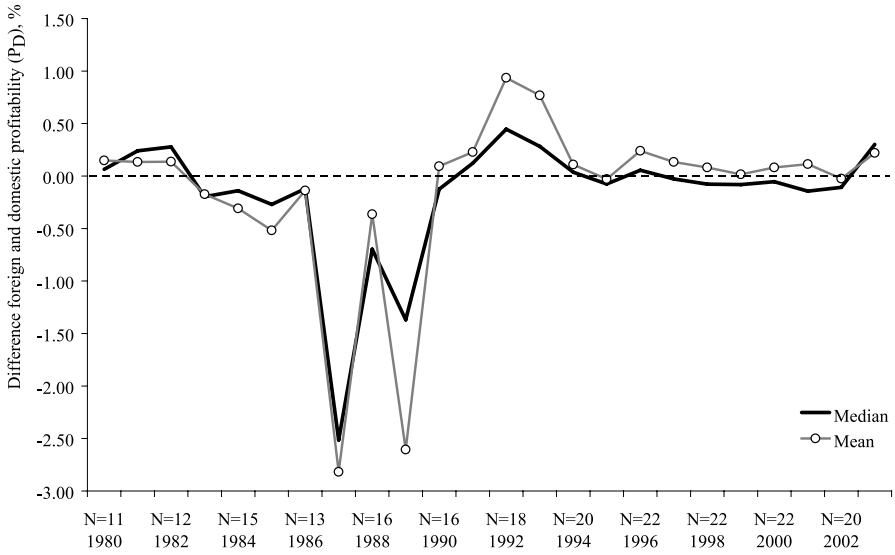
The relationship presented in Figure 4.2 is negatively sloped with a correlation of –.59 ($p<.01$, $n=30$). There is one outlier, Fortis, reporting a relatively higher difference between foreign and domestic profitability than would have been expected given the general negative relationship. An explanation for this might be the relatively favorable period of reporting for Fortis, between 1996 and 2003. The scatter plot indicates that in general p_D is negatively related to total profitability, if we cluster the results we find different relationships for countries. For Japanese banks, p_D is on average positive while p_T is negative. This suggests that Japanese banks need foreign activities to support their total profitability. On the other hand, for continental European banks p_D is on average negative while p_T is positive: foreign banking activities seem to have depressed total profitability for European banks. Mixed results are found for – mostly – American and British banks: their total profitability is high, but the variance of p_D is also high.

The negative relationship suggests that a relative positive domestic performance is not necessarily related to a relatively successful foreign performance. It suggests that lagging domestic performance might have been an incentive for some banks to internationalize since additional performance is relatively more easy to achieve outside the home country than within.[5] It can also be interpreted another way: some banks with relatively high domestic performance (Credit Suisse, Barclays) perhaps have the buffers and reserves to sustain relatively lower foreign performance.

The observed negative relationship between p_D and the relative domestic performance is difficult to generalize, due to differences between time periods of banks. Banks who reported on average a negative p_D did this during an average length of 13.6 years compared to 8.6 for banks reporting a positive p_D: the difference in years is a combination of not reporting the figures, and the higher number of mergers in the 1990s, limiting the maximum reporting period for some banks. A better approach would be to consider the information per year for the sample. Figure 4.3 shows the mean and median difference in foreign and domestic profitability between 1980 and 2000.

[5] This explanation is partly included in the small home market incentive: due to a small home market, growth opportunities and opportunites to exploit economies are limited decreasing profitability and increasing the incentive to internationalise.

Figure 4.3. Difference foreign and home profitability



Of the 21 years, the median value is negative for 11 years. The representativeness of the banks who reported foreign and domestic profitability compared to the sample increased throughout the period: before 1990 not more than 16 banks reported these figures, increasing to 22 in 2000. The highly negative values for p_D between 1987 and 1989 are followed by a short period of high p_D values between 1990 and 1994. The values from 1980 to 1987 and 1994 to 2000 remain closer to zero. p_D does not differ significantly from zero for the whole sample.

Figure 4.3 shows that p_D in 1987 or 1989 differs substantially from the other p_D values. This can be explained by the large provisions banks had to take in 1987 and 1989, since securities activities were mainly concentrated in financial centers (outside the home country for a number of banks). Another explanation is the large provisioning in 1987 banks booked to write off LDC loans, led by Citibank after six years of unresolved negotiations to reschedule LDC debt. Two years later, LDC write offs were once again large when the Baker plan led to a final agreement to end the LDC crisis for banks.

To determine in which years p_D showed values significantly different from zero, a regression model has been estimated with p_D as the independent variable, and the year dummies as independent variables. The estimated model is $p_{Dijt} = \gamma_t T_t + \varepsilon_{ijt}$. Dependent variables are the year dummies (T_t). The results are shown in the following table:

Table 4.3. Estimated Dummy Regression model, p_D as dependent variable

Dummy	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
Coefficient	0.1480	0.1340	0.1370	-0.1730	-0.3080	-0.5180	-0.1380	-2.818**	-0.3640	-2.605**	0.2950	0.5170
N	11	11	12	14	15	13	13	16	16	16	16	15

Dummy	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Coefficient	1.129**	0.854**	0.2460	0.1030	0.2790	0.1660	0.1090	0.0384	0.0944	0.1140	-0.0247	0.2200
N	18	18	20	22	22	23	22	23	22	22	20	21

F(24,410) = 6.761**, adjusted R Square = .242.
**: p value < .01; *: p value < .05

Estimated coefficients with p values < .05 were 1987, 1989, 1992 and 1993. From 1983 to 1989, foreign activities were on average less profitable, especially since 1987. A financial recovery period was visible in the early 1990s, especially in 1992 and 1993. This suggests that timing has been important: banks that have increased their international activities significantly in the early 1990s should have enjoyed above average returns, while banks who established international activities in the 1980s will have experienced rebounding foreign profitability. On the same note, an exit from international banking in the early 1990s will have meant that "recovery advantages" were not reaped, while exiting or expanding from 1995 will not on average have changed performance for better or for worse. The conclusion is then that for the banks who have reported geographic distribution of profits:

- Performance of foreign activities is lower than domestic, but does not differ significantly from zero.
- The negative performance difference is concentrated around 1987 and 1989.
- Entry and exit moments matter for the total profitability of the international activities.

4.4 Relationship between internationalization and total profitability?

The previous test focused on the relationship between foreign and domestic profitability where the relative weight of foreign or domestic activities exerted no influence. The next test determines if internationalization is positively related to a higher performance. This is tested in two steps: does such a relationship exit for the individual banks in the sample between 1980 and 2000. Next, does such a relationship exist for the whole sample? A straightforward approach is to evaluate one variable regression model per bank

$$Y_{it} = \alpha_i + \beta_i TNI_{it} + \varepsilon_{it} \quad (4)$$

The dependent variable is profit before tax as percentage of capital and reserves; TNI is the independent variable. The constant in the model represents the level of profitability if the bank would not have internationalized (TNI=0). This test focuses on the direction of coefficient β. If β is negative (positive), then a higher degree of internationalization is associated with lower (higher) profitability. The number of observations varies per bank, so the significance of β provides less information and is ignored here. At the most, 21 observations per bank can be found, while on the lower side at most 3 observations per bank can be observed. Table 4.4 presents the estimated coefficient β per bank, in combination with the adjusted R-Square and the p value for β.

There are 44 banks in the sample, of which 25 show a negative relationship between TNI and profit before tax as a percentage of capital and reserves. In other words, there is no tendency towards a positive or negative relationship for the whole sample. For 12 banks, the adjusted R Square is negative indicating absence of any relationship. This is not due to the number of observations for the regression; 7 of these 12 banks have the longest possible period of data availability (21 years). Also, most of the banks showing no relationship between performance and TNI have pursued strategies increasing their TNI: *Accelerating* strategies (UBS, Dresdner Bank, Credit Suisse, BBV, Argentaria) or *Moderate* (Commerzbank, BCH, Hypovereinsbank).

A stronger relationship is observed for 15 banks in the sample, showing a relationship between TNI and performance is shown with an adjusted R-Square higher than .25. Of these banks, 10 out of 15 show a negative relationship between the level of TNI and profit before tax. In short, the estimated signs of relationship between TNI and performance for the banks are equally distributed for the positive and negative direction. For almost a quarter of the sample, there is no relationship observable. Similar results are yielded if profit before tax as a percentage of total assets is taken as a measure for performance, or if performance is corrected for domestic performance or the performance of the sample.

Table 4.4. Relation between performance and TNI per bank, 1980–2000

Bank	Constant	TNI	Adjusted R Square	n
Mitsubishi Bank	-41.3455 **	1.7494 **	0.7555	16
NMB Bank	25.0550 **	-0.8623 **	0.7405	10
HSBC	19.5547 **	-0.0415 **	0.6550	14
Crédit Lyonnais	41.4417 **	-0.6693 **	0.6482	24
Tokyo-Mitsubishi	38.8505 **	-0.7705 **	0.5921	13
Vereinsbank	21.0973 **	-0.7008 **	0.5342	18
ABN/Amro	6.2651 **	0.0921 **	0.5099	14
HypoVereinsbank	-21.6256 *	0.7142 *	0.4643	14
Rabobank	16.1435 **	-0.2597 **	0.4211	21
Deutsche Bank	-14.3680	0.7911	0.4100	21
Tokyo	147.5924 *	-3.9174 *	0.3920	8
SBC	44.1174 **	-0.8996 **	0.3228	18
ABN	25.2715 **	-0.4415 **	0.2520	10
Agricole	13.4394 **	-0.1646 **	0.2447	21
Dresdner Bank	25.8692 **	-0.2173 **	0.2300	22
Santander	30.7243 **	-0.2006 **	0.1935	20
Amro	17.0726 *	-0.4890 *	0.1840	7
Bay. Hypobank	19.5109 **	-0.6484 **	0.1797	18
Bank of America	28.4871 **	-0.4414 **	0.1752	24
Citicorp	-5.6162	0.5579	0.1467	24
LloydsTSB	-62.8698	1.7589	0.1405	20
Sumitomo Bank	-22.4133	0.9918	0.1325	24
BBV	26.0055 **	-0.1135 **	0.1259	18
Paribas	30.3054 **	-0.4572 **	0.1244	19
Standard Chartered	-96.3675	1.4752	0.1019	24
UBS	5.2613	0.1632	0.0976	22
National Westminster	1.9070	0.4297	0.0828	21
Dai Ichi Kangyo	12.5835 **	-0.0575 **	0.0766	24
JPMorgan	10.9245 **	-0.0202 **	0.0608	12
BNP	3.7072	0.2916	0.0289	24
Chemical Banking	0.0026	0.4739	0.0268	16
Westdeutsche Landesbank	7.1014 **	-0.1036 **	0.0213	24
Manufacturers Hanovers	-26.3991	0.9058	0.0091	11
IBJ	26.2216	-0.6968	-0.0249	6
Credit Suisse	35.7957 **	-0.8437 **	-0.0271	27
Royal Bank of Scotland	38.6488	-0.7795	-0.0372	8
Societe Generale	20.8171 *	-0.1054 *	-0.0378	24
Commerzbank	13.4649	-0.0519	-0.0449	24
Chase Manhattan	16.2375	-0.0144	-0.0453	24
Barclays	20.0161 **	-0.0081 **	-0.0453	24
Midland	-0.1983	0.2295	-0.0493	12
Fortis	20.2979 **	-0.4799 **	-0.0754	24
ING (bank)	19.4219	-0.3579	-0.0827	21
BCH	13.1710 *	-0.1586 *	-0.0891	7
Argentaria	13.0154 *	0.1917 *	-0.1118	9
Mizuho Group	89.7522	-5.7455	-0.3796	3

**: p value < .01, *: p value < .05

A limitation of the analysis is that different and overlapping time periods are covered. For example, data for Midland Bank is available from 1980 to 1991 while data for Bank of America covers the full 21 years between 1980 and 2000. The regression results for Midland might have less explanatory power than Bank of America's due to the shorter time period. On the other hand the estimation for Bank of America might yield insignificant results because over the long time period, a "V-shaped" recovery is in general poorly estimated by a single linear measure. To counter this problem, different time periods were considered by calculating average TNI and profitability for five year period, further grouping the TNI in steps of 20%.

Table 4.5. Change of TNI between 20% brackets per five year period

		Change TNI from				
		0-20	20-40	40-60	60-80	80-100
	0-20	29	3			
	20-40	3	43	7		
To	40-60	1	6	14		
	60-80			3	5	
	80-100					2
	Total	33	52	24	5	2

In Table 4.5, the numbers represent the number of occurrences of the TNI values for full five year periods, moving from one TNI-bracket to another. Condensing the total number of 737 yearly observations to full five year periods produces 116 observations; the largest group has a TNI of 20–40%. The table further shows that observations for TNI larger than 60% should be ignored when drawing general conclusions; the 7 observations constitute 6% of the total number of observations.

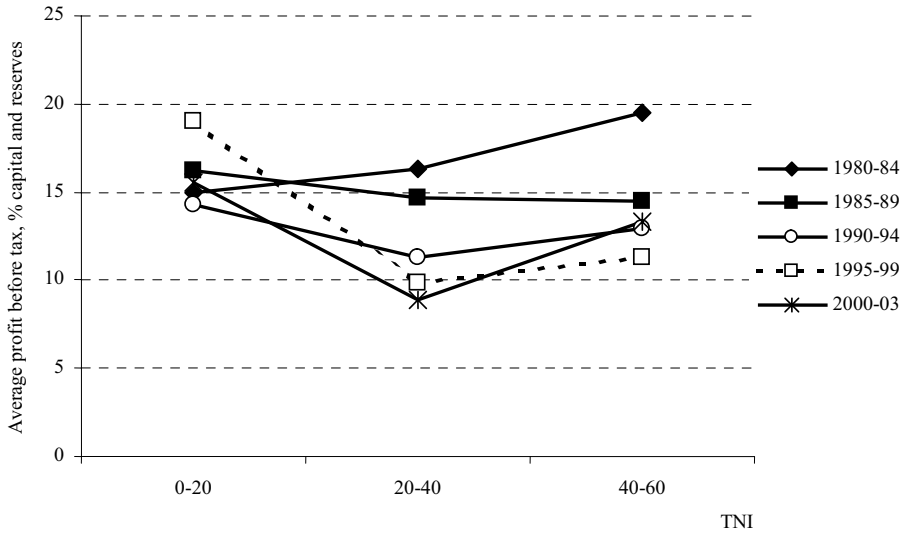
The next question is then to see what the dynamics are: how many banks shift from one TNI-bracket to another? Changes take place between the 20–40% TNI-bracket, and the 40–60% TNI-bracket. There are relatively few banks that have moved from one bracket to a higher one: Credit Suisse, Deutsche Bank while Bank of America did the opposite. The average profitability per TNI bracket, excluding TNI higher than 60%, for the different five year periods is shown in Figure 4.4.

For the sample as a whole this suggests that between 1981 and 1985 there was a linear and positive relationship between TNI and performance, and between

1986 and 1990 the relationship became negative but still was linear. Between 1991 and 2000 the relationship turned out to be V-shaped: profitability for banks with TNI level of 20–40% was lower than for banks with TNI levels of 0–20%. The means of the first three brackets have significantly different levels of means.[6]

Summarizing, for most banks and most time periods there is a negative relationship between performance and TNI. This suggests that a degree of internationalization lower than 20% would have yielded the best performance. Also, for most banks an increase in internationalization correlates with a decrease in profitability, but this result is valid cross-section, not longitudinal.

Figure 4.4. Relation between TNI and performance, five year periods

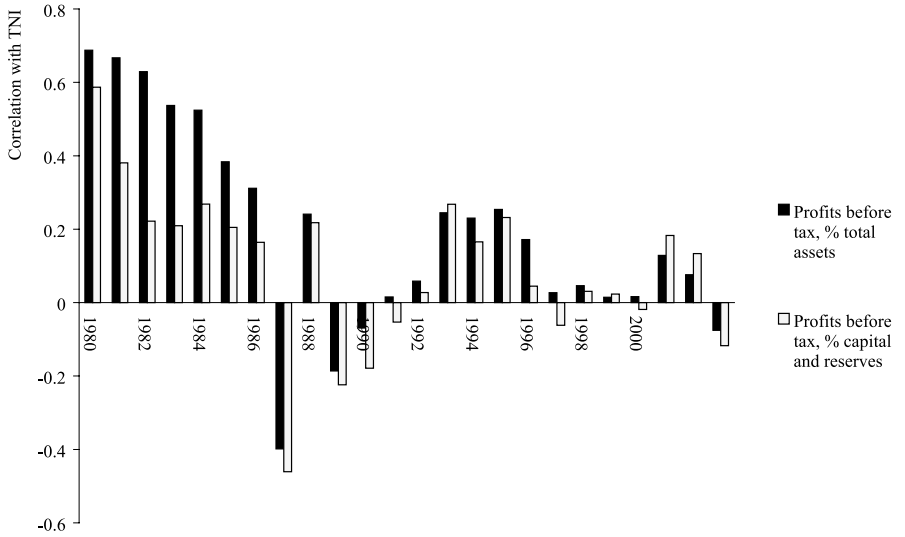


A closer look warrants the positive linear relationship between TNI in 1981–1985 in Figure 4.4, changing to a negative one in 1986 to 1990. The relation between total performance and TNI is determined by calculating the bivariate correlations between TNI and profit before tax per year. Figure 4.5 shows that the relationship between the two measures steadily breaks down: the correlation was almost .6 in 1980, steadily declining to under .2 in 1986.

[6] Using T test with p values < .05. There are 7 observations not shown in this graph, because they are not representative compared to the other observations. 4 out of 7 are Standard Chartered (2 observations for TNI 60–80%, 2 for higher than 80%. The other three are ABN Amro, HSBC, and Credit Suisse, all with TNIs between 60–80%.

Negative correlations can be observed for 1987, 1989 and 1990; from 1991 onwards the relationship between TNI and profitability has broken down completely.[7] Correlations between TNI and profitability as a percentage of assets remain more persistent, suggesting an asset driven approach to TNI until 1985. After a restructuring period in 1987–1990, similar values for the correlations indicate that both performance measures have been synchronized.

Figure 4.5. Bivariate correlations between TNI and profit before tax, per year



Summarizing, a positive relationship between profitability and the degree of internationalization cannot be found on a bank level. For almost a quarter of the banks in the sample no such relationship has existed between 1980 and 2000; for the other half no tendency towards a positive or negative relationship can be observed. For the total sample, there is only a positive relationship between 1981 and 1985. For the other periods up to 2000, there is a negative relationship between profitability and the degree of internationalization. The negative relationship in 1986–90 is determined by the years 1987 and 1989. After 1990 a weak form of a negative and V-shaped relationship exists. Banks with the lowest levels of TNI in the sample, 0–20%, have shown the highest performance. Banks with TNI levels of 40–60% have shown a higher performance than banks with a TNI of 20–40%, but both reported lower performance levels than banks with TNI of 0–20%. Overall do the results not support the hypothesis that a higher degree of internationalization is positively related to a higher performance of the total bank?

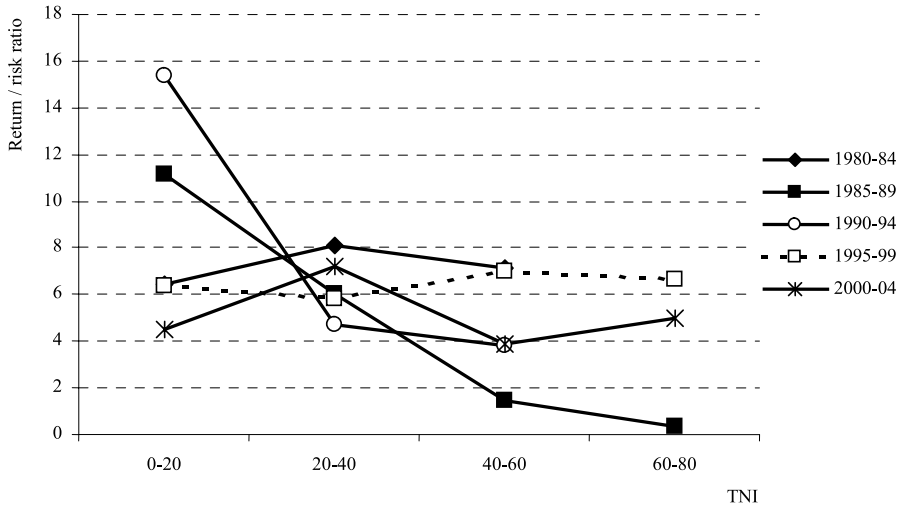
[7] For 1980–1985 and 1987 significance is below a .05 level.

4.5 Internationalization and risk/return diversification

While internationalization might not on improve overall profitability, another argument is that internationalization leads to more stable profitability through geographical diversification. Rugman (1976) found that a higher ratio of foreign to total operations is positively related to a lower variability of earnings to book value, concluding that internationalization is risk reducing. Literature on commercial banks in the United States generally finds that larger, more geographically diversified institutions tend to have better risk-return trade off (Berger et al., 2000, Goldberg 2001). Buch et al. (2004) calculated efficient country-allocation portfolios, and compared these with the actual allocations reported by banks. Overall, it was found that banks tend to over-invest domestically, leading to suboptimal risk/return diversification advantages.

In this study, risk/return diversification advantages were examined by the ratio of variability of profitability and average profitability. The variability of profitability was measured as the five year standard deviation of profit before tax as a percentage of capital and reserves. A finding was that variability of profitability increased with a higher degree of internationalization. This suggests that the banks in the sample were on average not able to generate additional profitability (reaping internalization advantages) and neither to generate more stable earnings (profit from geographical diversification).

Figure 4.6: Relationship between return/risk of profitability and internationalization.



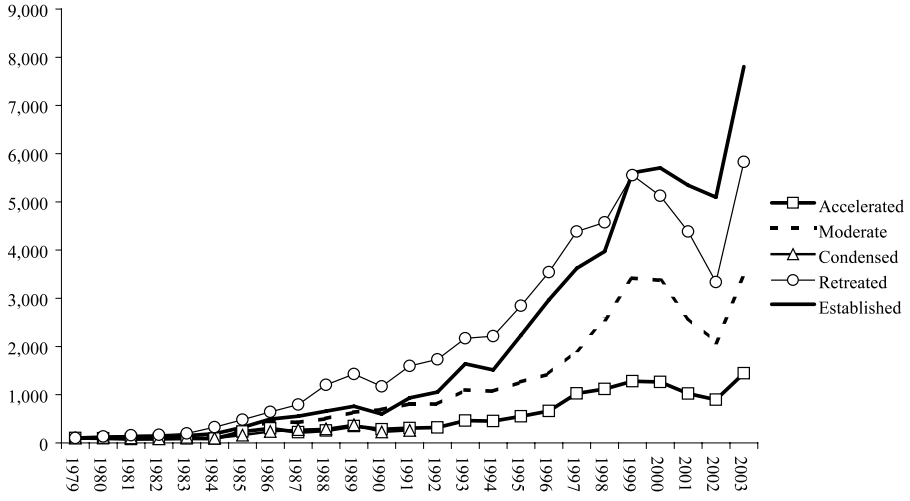
Similarly, another hypothesis was that geographical diversification advantages should allow a bank to generate more stable results and improve its return-to-risk ratio, i.e. average profitability (return) as a ratio of the standard deviation of profitability (risk). Having established that foreign activities do not structurally generate more return, the burden of proof lies with the reduction of risk. However, no relationship exists between TNI and risk. Combining the results for risk and return, internationalization in general is negatively related to the level of the return-risk ratio.

4.6 Do shareholders gain by internationalization?

To analyze the relationship between total shareholder return (TSR) and degree of internationalization (TNI) for the whole sample, a simple model was developed and estimated. TNI, and change in TNI were found to have a positive relationship with shareholder return in line with the hypothesis, especially between 1990 and 2000. But the estimates are in general non-significant.

If shareholders – with hindsight – had made baskets for the different strategic types, what would have been the result? Figure 4.7 presents the cumulative return in US dollar per strategic type re-based at 100 in 1979. The yearly return is weighted by market value; results do not change when banks are equally weighted. A substantial difference over time emerges between two groups: the *Established* (25.2% yearly return) and the *Retreating* (23.2%) on the one hand and the *Moderate* (15.9%) and the *Accelerating* (14.3%) on the other hand. An investment in banks with *Established* internationalization compared to banks with *Accelerating* internationalization over a period of 20 years would have resulted in a total return 6 times as large, or an additional 9.5% per year.

Figure 4.7. Total shareholder return per strategic type



Note: Total return in US dollar, rebased at 31 december 1979=100, return weighted by market value in US dollar
Source: Datastream, own calculations

The large differences in total return urge a closer examination of the underlying data. The differences might simply be caused by a country bias: most banks classified as *Retreating* and *Established* are American or British; banks in these countries have in general shown higher shareholder returns than other countries. To correct for this, the cumulative shareholder return adjusted for the country's bank index needs to be calculated. Another point of examination is the Japanese banks. Since 1990, their equity prices have been steadily falling, and classifying them all into one category might give biased results. Table 4.6 presents the bank per strategic type, and shows the number of banks that are American/British, Continental European, and Japanese. Most of the Japanese banks fall either in the *Retreating* or *Established* category, more likely dampening the results for the *Accelerating* and *Moderate* type banks which were already substantially higher.

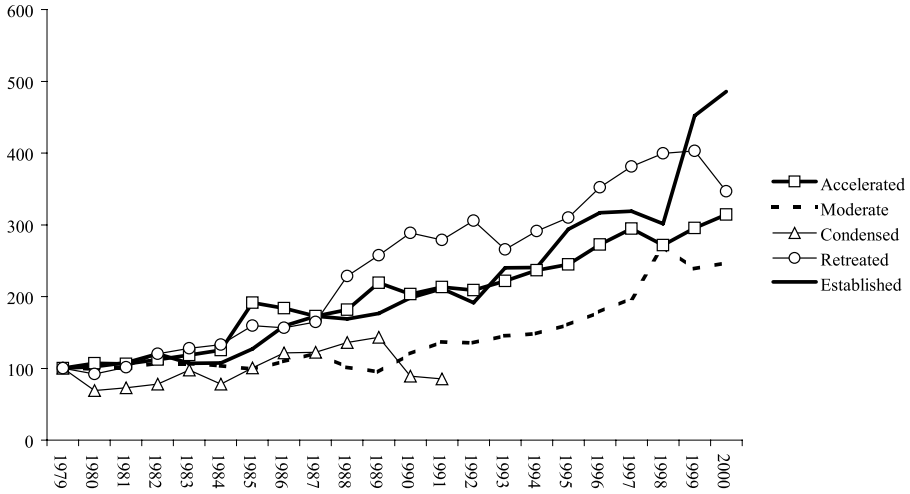
Table 4.6. Classification banks per region and strategic type

Type	United States, United Kingdom	Continental Europe	Japan	Banks
Accelerating	0	9	0	ABN Amro, BBV, Credit Suisse, Deutsche Bank, Dresdner Bank, HypoVereinsbank, Paribas, Santander, UBS
Moderate	0	6	1	Amro, Argentaria, BayerischevHypobank, Commerzbank, Fortis, IBJ, Vereinsbank
Imploding	0	2	0	Crédit Lyonnais, Midland
Retreating	7	0	3	Bank of America, Barclays, Chase Manhattan, Chemical Banking, Dai Ichi Kangyo, Lloyds TSB, Manufacturers Hanovers, Mitsubishi Bank, National Westminster, Sumitomo Bank
Established	4	3	2	ABN, BNP, Citicorp, HSBC, J.P. Morgan, Société Générale, Standard Chartered, Tokyo-Mitsubishi, Bank of Tokyo

The yearly returns are recalculated, adjusting the yearly bank return for the country return represented by the DataStream country bank index in US dollar. The cumulative figure then represents the additional return one would have achieved by investing in the individual banks instead of the country index. This is shown in Figure 4.8.

The substantial differences in returns per strategy are mitigated to a large extent. Adjusting for country shows that retreating banks had most to gain between 1987 and 1998. *Accelerating* banks fared consistently worse than retreating banks between 1987 and 2000, while in turn *Accelerating* banks showed lower returns than *Moderate* banks. Overall, the division in returns between *Accelerating* and *Moderate* banks on the one hand and retreated and *Accelerating* banks on the other hand is upheld.

Figure 4.8. Total shareholder return adjusted for country return per strategic type



Note. Total return in US dollar -/- total return Datastream country bank index (TSR5), rebased at december 31 1979=100, weighted by market value in US dollar. Source. Datastream, own calculations

In short, if indices are created for the different strategy types, then *Established* and retreating banks would have generated the highest return 1980 and 2000, if this is measured in absolute returns, or adjusted for country averages. *Moderate* and *Accelerating* banks would have generated the least returns, in spite of *Accelerating* banks having attracted relatively large amounts of capital to fund their activities.

5 The future of international banking

This study has primarily provided a contemporary analysis of realized internationalization strategies of banks in the 1980–2000 period. In this section possible implications for internationalization of banks in the near future are considered: can something be said of future internationalization developments, and what consequences might this have for shareholders? Three future developments are considered. First, which banks are most likely to gain in the near future from internationalization? Next, what effects would the further European integration have on the internationalization of banks. Finally, what role will financial systems play?

5.1 Summary of findings

- The different analyses support the conclusion that foreign profitability on average has been lower than domestic profitability for banks in the sample between 1980 and 2000. An objection usually raised by banks in their annual reports is that for reported figures, the allocation of foreign and domestic profitability is to some extent arbitrary because some financial services generated are consumed in more than one place. Examining the relation between the degree of internationalization and total profitability took this objection into consideration, but here too an overall negative relationship between the degree of internationalization and total profitability was found.

- The V-Shape of the relationship between profitability and internationalization is reminiscent to the research debate in the international business literature, where organizations might show learning effects when their commitment and involvement in foreign activities increase, resulting in different benefit-cost trade off pay-offs for the organization. Our findings come close to a "J-curve", assuming that over time banks can learn to minimize the additional costs associated with foreign expansion. This means that internationalization costs outweigh benefits until banks gain experience and learn to deal with them (Ruigrok & Wagner). Consequently, banks will reach an inflexion point along the expansion path at which incremental benefits start to outweigh incremental costs. This scenario implies that bank undergo a period of

performance deterioration before experimental knowledge can lead to higher performance levels. However, we find that a) the period of performance deterioration is considerable and b) banks have to substantially increase their international commitments before the inflexion point is reached.

- Furthermore, internationalization patterns change over time. Internationalization should not be looked at as a single process, but as a chain of separate but linked processes. The end of one chain represents the point of departure for the next. Internationalization can be described as a "sedimentation" process, where different phases are stratified upon each other (Nilsson, Dicken, & Peck, 1996). Since a large number of banks have substantially increased their international activities over time, this sedimentation process may hide positive effects of individual foreign banking activities that should emerge after a period were banks show few foreign acquisitions. This agrees with the recent upsurge in foreign versus domestic profitability in 2001–2003, a period where merger and acquisition activities was subdued (see Figure 2.1 on page 19).

- Shareholders clearly attached different valuations for different realized internationalization strategies. *Retreating* and *Established* banks generated the highest total shareholder return, whether this is measured in absolute returns or adjusted for country averages. These groups include relatively many American and British banks. *Moderate* and *Accelerating* banks generated the least shareholder return, in spite of *Accelerating* banks having attracted relatively large amounts of capital to fund their (foreign) activities. The high TSR for *Retreating* banks supports research that for example shareholders in the United States experienced negative abnormal returns when foreign acquisitions were announced; with this type of realized internationalization strategy on average more foreign divestments than acquisitions have been announced.

- Additional analyses considered the relationship between risk, return and the degree of internationalization. No support was found that the level of internationalization is a predictor for out- or underperformance in the consecutive periods. In general, a higher degree of internationalization is negatively related to additional shareholder return, albeit non significant. On the other hand, performance had significant explanatory power for shareholder return.

5.2 Future internationalization

Internationalization activities of banks changed considerably between 1980 and 2000. In 1980, American and British banks were at the helm of internationalization. Japanese banks dominated the international scene in 1990. By 2000 many European banks had raised internationalization to new, unprecedented heights, perhaps only matched by the internationalization of banks in the colonial system at the start of the 20th century. The average degree of internationalization for the sample did increase, but not dramatically: the degree of internationalization (measured by TNI) moved around 30% in the 1980s, and increased to 40% at the end of the 1990s.

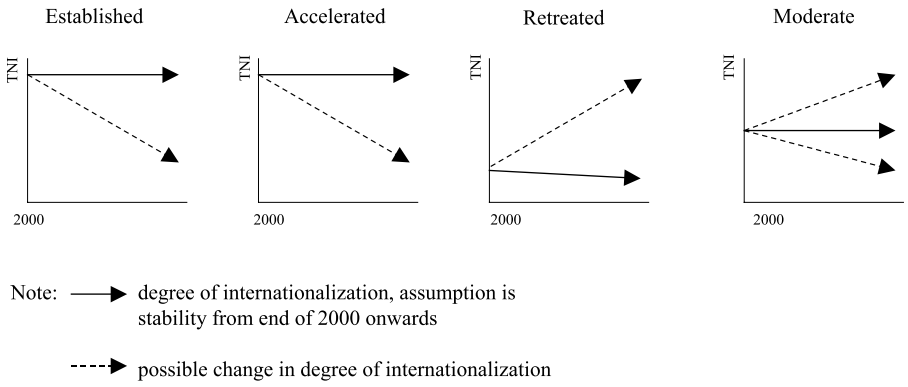
There are similarities observable between the early 1980s and the late 1990s. In the early 1980s, American and British banks had to make strategic choices with regard to their internationalization activities just as Dutch, German, Spanish and Swiss banks had to reconsider the role of their foreign banking activities at the end of the 1990s. In the early 1980s, banks were confronted with the decline of a smooth source of foreign income, the LDC loans; by the late 1990s banks were confronted with the decline of stock markets reducing both fee income and the attractiveness of the stock markets as a source of foreign acquisition financing. A large number of banks in the sample undertook some form of restructuring in 1999 and 2000, and continued this in the years after. While the decrease in stock markets from 2000 onwards might be alleviated, other triggers of strategic change are bound to follow, such as financial crises.

Ultimately, internationalization of banks has been a mixed blessing for shareholders over a longer period. Banks with long established foreign bank activities (the *Established* banks) generated in the long run as a group the highest shareholder return, similar to banks who substantially decreased the role of foreign bank activities (the *Retreating* banks). On the other hand, banks who either increased their internationalization activities steadily (the *Moderate* banks) or with increasing pace (the *Accelerating* banks) have generated the lowest shareholder return.

From the shareholder point of view, which banks' internationalization strategies are best positioned for the near future? Specifically, *Accelerating* banks have increased their foreign bank activities at the end of the 1990s to such an extent that these banks have become comparable in their degree of internationalization to *Established* banks throughout the 1980s and 1990s. Given the relative successful (shareholder) performance of *Established*

banks, what banks with *Accelerating* strategies are likely to emulate the success of *Established* banks? To answer these questions the possible future courses of realized internationalization strategies (*Moderate, Established, Accelerating, Retreating*)[8] are projected in Figure 5.1. For example, *Established* banks have a relatively high degree of internationalization; the solid line in the figure projects the current degree of internationalization into the future, assuming no fundamental change in the role of foreign activities in the bank. On the other hand, the dotted arrow shows a possible change in the degree of internationalization.

Figure 5.1. Future directions of internationalization



If past experience provides any guidance, then an investment in banks with realized *Established* and *Accelerating* strategies for the coming decade might be worthwhile, while investments in banks with *Retreating* and *Moderate* strategies should be considered with more caution.

- *Established internationalization strategies*
  Established banks (such as Citicorp, HSBC) have found a durable balance in the 1980s and 1990s between foreign and domestic bank activities. These banks have in common that their foreign bank activities are broadly based, branching out in investment banking, corporate finance as well as retail banking (consumer finance) and asset management. Also, their foreign activities are geographically well diversified. *Established* banks have to maintain the right configuration to keep internationalization a relative profitable activity, or the bank might divest activities that do not contribute to the total profitability of the bank.

[8] The realized *Imploding* internationalization strategies are ignored here, this strategic type applies to only two banks and is therefore difficult to generalize.

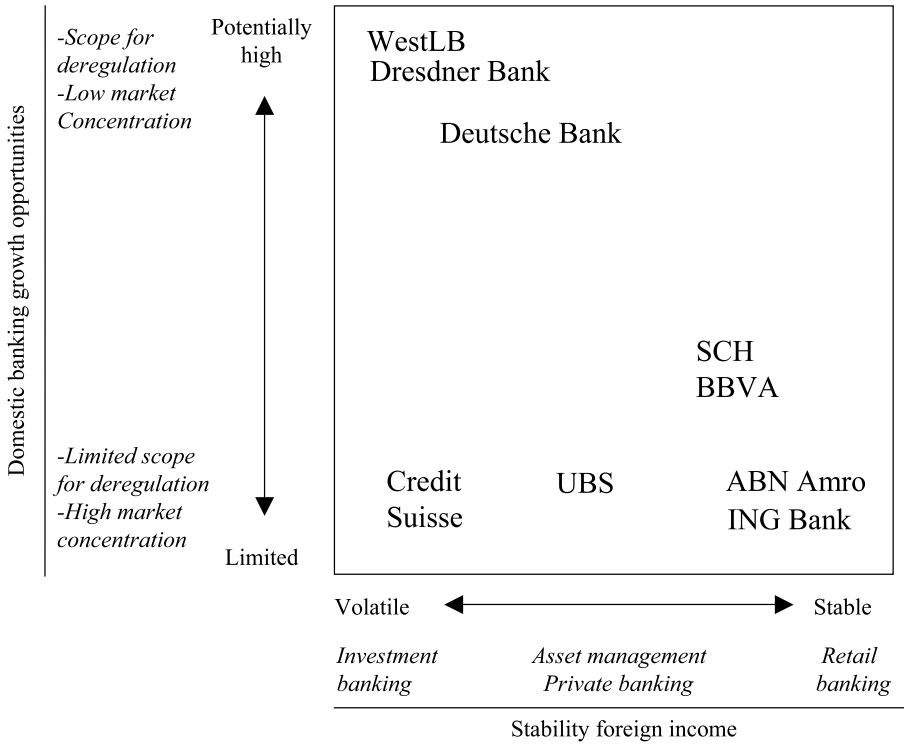
- *Accelerating internationalization strategies*
  Accelerating banks (examples are Deutsche Bank, ABN Amro, Credit Suisse, UBS, Santander) have increased their internationalization activities significantly during the 1990s and are at a position in the early years of the new millennium similar to *Established* and *Retreating* banks in the early 1980s. Either they have to find the right configuration to make internationalization a relative profitable activity, or the bank will divest activities because it has not found an opportunity for sustainable foreign profitability and refocus on domestic activities. In other words, *Accelerating* banks have to determine whether they soon will reach the stage of *Established* banks, or they have to reconsider their portfolio of foreign activities and become *Retreating* banks. In the past, both scenarios were rewarded by shareholders. This suggests a paradox: banks with *Accelerating* internationalization strategies have on average delivered the least shareholder return in the past but are best positioned to generate the most shareholder return in the near future.

  The strategic choice banks with *Accelerating* strategies have between developing either *Established* or *Retreating* strategies leads to the question which banks with *Accelerating* strategies have characteristics more similar to banks with *Established* strategies or more similar to *Retreating* strategies. In other words, what banks with *Accelerating* strategies are likely to evolve into *Retreating* strategies and what banks are likely to develop *Established* strategies?

  Naturally any future scenario is highly conjectural but to answer this, two criterions are introduced. The case studies first indicate that when domestic growth opportunities increase, banks favor domestic growth over foreign bank growth. For most banks, the first priority is to maintain the (relative) domestic market position, as well as seizing the best opportunities to achieve profitability growth or efficiencies. Expansion of domestic banking markets (mostly triggered by regulatory changes) led to a decrease in internationalization of banks; this applied for American banks, British banks and also Japanese banks. Naturally, this criterion does not apply for banks with small and/or highly concentrated domestic banking markets, such as the Netherlands and Switzerland. Future domestic growth opportunities are however relevant for French and German banks where de-mutualisation, and (further) abolishment of separation between different banking types in the country might be future events.

Second, all major retreats from internationalization have been triggered by a financial crisis. While the timing of financial crises cannot be predicted as such, the banks that retreated the strongest or earliest were on average banks with large capital market/investment banking operations. In short, banks with more stable foreign funding bases such as foreign retail banks or banks with more stable foreign fee income base such as asset management and private banking are probably more likely to whither economic and financial adverse conditions than banks with volatile foreign activities in capital market/investment banking. This will be used as the second criterion; both criterions suggest the following categorization of future development (Figure 5.2).

Figure 5.2. Accelerating banks' sensitivity to domestic market developments, stability of foreign income



German banks with *Accelerating* strategies (Dresdner Bank, WestDeutsche Landesbank and Deutsche Bank) are more likely to retreat from foreign bank activities and eventually develop *Retreating*

internationalization strategies. Their potential domestic growth opportunities are relatively large; when regulation permits these banks might prefer domestic banking growth opportunities over foreign banking growth opportunities. Also, these banks are more sensitive to external shocks such as financial crises due to their high dependency on (foreign) capital market activities. On the other hand, the Swiss, Dutch and Spanish banks have no domestic growth opportunities; the Dutch banks ING and ABN Amro have acquired large stable funding bases (retail banking operations) outside the Netherlands. Credit Suisse and UBS have not acquired retail networks outside Switzerland; UBS has created a relatively stable source of foreign income through asset management and private banking while Credit Suisse has more focused on expanding in investment banking. In other words, ING, ABN Amro, UBS, Santander and BBVA may be the banks who have developed and expanded internationalization activities closest to banks with *Established* internationalization strategies.

- *Retreating internationalization strategies*
  Similar to *Accelerating* banks, Banks with *Retreating* internationalization have two strategic alternatives: either to maintain or further decrease internationalization activities, or to increase them again (*re-internationalization)*. Lloyds TSB, Barclays and JP Morgan Chase have re-internationalized or planned to do so. Lloyds TSB has publicly contemplated increasing their internationalization activities in 2000, while Barclays has re-internationalized in Spain but on a more subdued scale than its European and American expansion activities in the 1980s. Chase decreased its foreign bank activities since the mid 1980s but effectively re-internationalized when it acquired J.P. Morgan in 2000 which had more than half its operations outside the United States. Royal Bank of Scotland also (re-) internationalized by acquiring National Westminster. National Westminster decreased its foreign bank activities in the 1990s; after the acquisition in March 2000 Royal Bank of Scotland developed a specialized internationalization strategy, expanding its United States retail branch network with a series of modest acquisitions and developing foreign distribution channels for motor insurance activities.

  The re-internationalization of Barclays or J.P.MorganChase is probably not a repetition of the internationalization activities in the 1980s. Compared to earlier periods, the banks have shown a strong focus on domestic banking activities. Also, bank capital has become scarcer than in the 1980s. At the end of 2003 the proposed structure and implementation of Basle II introduced a more sophisticated regulatory framework for

banks and their capital. Whichever structure or implementation route is chosen, the allocation of capital to foreign bank activities is bound to be more closely monitored and evaluated than in the 1980s. Some internationalization incentives remain the same; the announced re-internationalization of Lloyds TSB could be interpreted as seeking growth opportunities after domestic expansion activities failed, when Lloyds TSB was not allowed to acquire Abbey National in 2000. The other *Retreating* banks have not re-internationalized; Bank of America autonomously expanded investment banking operations in London but substantially reduced the relative role of its foreign operations when it acquired FleetBoston in 2003. For the retreated Japanese banks, the climate for re-internationalization has become more favorable but the banks have largely been engaged in domestic mergers to absorb the large write off of bad loans, increase profitability and regain solvency.

- *Moderate internationalization strategies*
  Finally, question marks surround the future shareholder returns of *Moderate* banks: they have the widest range of strategic options available to them, and are probably the most diverse bank group of realized strategies. However, most of the *Moderate* banks have as yet sought to increase their degree of internationalization. Fortis for example has essentially stayed focused on the Benelux and Spain, consolidating and integrating its bank operations and striving for autonomous growth. Crédit Agricole on the other boosted its foreign activities since its acquisition of wholesale bank Indosuez in 1994 but strengthened its domestic focus by acquiring Crédit Agricole in 2002.

Table 5.1. Possible changes in future internationalization of banks

Change to \ Change from	Established	Accelerating	Retreating	Moderate
Established	Tokyo-Mitsubishi HSBC Standard Chartered Citicorp BNP Paribas Société Générale	ABN Amro ING Bank UBS Santander(1) BBVA		
Accelerating				
Retreating		Credit Suisse(2) Deutsche Bank Dresdner Bank West LB HypoVereins Bank	Bank of America Mizuho(3) Lloyds TSB(4)	
Moderate			JPMorgan Chase Barclays Royal Bank of Scotland(5)	Fortis Rabobank Commerzbank Crédit Agricole

Note 1: The bank has been renamed SCH. Note 2: Credit Suisse could also be classified as retreating. Note 3: Mizuho incorporates IBJ and Dai Ichi Kangyo. Note 4: Lloyds TSB announced a re-internationalization in 2000, this has not materialized between 2000 and 2003. Note 5: Royal Bank of Scotland acquired National Westminster in 2000, and continued its foreign banking activities.

What road leads to a sustainable and equal profitability development of foreign and domestic banking activities? Table 5.1 summarizes the hypothesized changes in realized internationalization strategies for the near future. The number of banks with *Established* strategies will increase, so will the number of banks with *Retreating* internationalization strategies.

5.3 Regional integration: extension of the home market?

A large degree of foreign activities of European banks (as well as American banks) have taken place within European banking markets. Another implication to consider is then the consequence of regional integration such as the European Union, representing an economic and political extension of

the home market and a regional uniformization of the regulatory regime. The European integration process accelerated in two periods, between 1988 and 1991 (in preparation of the Single Market) and between 1996 and 1999 (in preparation of the Eurozone). The economic integration programs liberalized capital markets, and the introduction of the Euro led to a convergence of monetary policies between the major EU countries. With European integration, will the extension of the home market imply similar high profitability as domestically, or should expansion in the Eurozone still be considered internationalization to a foreign country, with lower foreign performance than domestic as this study found?

Banks have dealt with European integration in several ways: pan-European strategies were formulated by National Westminster, Barclays, Deutsche Bank and Crédit Lyonnais in the 1980s. They built up a branch network in the major European cities, and acquired retail or private banks in European countries, mainly in Germany, France and Spain. In the 1990s, a new concept was introduced: the "second home market" in Europe. These were acquisitions of foreign banking activities with the expected benefits enjoyed domestically (such as a large depositor base). Banks who followed this strategy were ING with its 1997 acquisition of Belgian BBL or HSBC who acquired French CCF in 2000. If banks view Europe as an extension of their home market, then the findings of this study would suggest that this extension in general lowers overall profitability. Is this finding also valid for European banks internationalizing in the (integrated) European banking market?

Supporting the assumption that European integration extends the concept of home market are convergence of net interest margins in the Eurozone, the structural removal of regulatory barriers, and reduction of fluctuations in GDP growth because economic cycles in the Eurozone converge. These developments have in common those differences between "domestic" and "foreign" economies within the Eurozone decrease.

Outwardly, one might interpret the process of European integration for the banking markets as following the path taken by American banks since the mid 1990s, where ongoing deregulation of interstate banking has led to a natural extension of the home market. Deregulation of interstate banking in basically has created new markets with similar customers, introducing opportunities for increased efficiency and higher profitability. However, European integration cannot be compared to the banking deregulation in the United States.

There are two arguments that do not support the concept of an extension of the home market within Europe. First, potential efficiency advantages may be difficult to exploit. Consolidation of the banking market moves at different paces in different countries; European labor market are considered to be rigid implying that part of the cost-to-income ratio levels for banks in a country are structural, especially for labor intensive retail banking. In other words, efficiencies might be difficult to gain by foreign banking acquisitions in Europe. Second, fiscal policies with regard to savings and pensions are not harmonized. They determine to a large extent the growth of the savings pool and the opportunities to be had. A scenario could be that further European banking consolidation follows along these lines: Capital market activities in Europe are to a large extent consolidated; dominated by a few American and European banks for the region, with complementary dominant positions for country based banks. Consolidation in the European banking market is then directed at acquiring foreign retail banks. Capital markets are less influenced by local tastes than retail banks, whether this is by a branch network or a virtual network.

5.4 Limitations and further avenues for research

There are several limitations with this research that might also be interpreted as future research avenues. A novel element of this study has been the application of the TNI as internationalisation indicator, to analyse the internationalisations strategies. Using one indicator is a strong simplification of realized strategies. Increasing the number of strategic variables in a framework of multidimensional clustering (cf. Abraham & Van Dijcke, (2002)) is a promising avenue. Another indicator which has not been addressed explicitly is the role of foreign acquisitions. Ideally, a separation in the analysis should be sought after distinguishing between the operational profitability of "daily" foreign banking activities, and the disproportional effects of occasional foreign mergers and acquisitions.

Second, the discussion was about internationalization while the geographical component (such as which country or region) has been not been to the forefront. Adding geographical information, such as similarity and dynamics of actual banking networks, in combination with the internationalization indicator, would enhance the quality of clustering strategic types, as well as providing more body to the herding argument, another explanatory variable which has not been to the forefront.

Third, the focus has been on the largest banks in the world. While they have taken up the major part of internationalization, it needs to be researched whether these findings can be replicated in a broader setting, increasing the size of the sample. In addition, measuring the degree of internationalization is challenging. The calculation of the DOI has been based on pragmatic reasons; other alternatives including organizational must also be considered. For example, if the internationalisation experience of the management board would be taken into account, would this change results?

Finally, this analysis has neglected the complex interplay between financial systems, economic growth and internationalization. While an individual bank may not increased profitability through internationalisation, foreign banking tends to increase competition and increase efficiency of foreign banking systems, which stimulates economic growth. In other words, is there a trade off between individual bank efficiency, and financial system efficiency?

Appendix: TNI in 1980, 1990 and 2000

Country	Bank	TNI		
		1980	1990	2000
France	Agricole	2.3	4.0	17.9
	BNP	27.6	30.5	47.7
	Crédit Lyonnais	11.3	32.5	25.1
	Paribas	28.1	39.4	-
	Société Générale	29.2	27.4	34.9
Germany	Bayerische Hypobank	4.8	4.4	-
	Bayerische Vereinsbank	4.9	6.5	-
	HypoVereinsbank	-	-	36.1
	Commerzbank	14.8	17.8	26.4
	Deutsche Bank	9.3	23.6	59.0
	Dresdner Bank	8.3	8.4	32.5
	Westdeutsche Landesbank	8.6	12.3	41.2
Spain	BBVA	na	11.5	56.0
	BCH	na	-	-
	Santander	na	29.3	59.5
	Argentaria	na	-	
Switzerland	Credit Suisse	26.7	47.5	69.3
	SBC	41.2	38.6	-
	UBS	27.9	37.8	65.5
UK	Barclays	51.5	44.3	28.5
	HSBC	.	44.4	56.4
	LloydsTSB	40.9	18.9	15.1
	Midland Bank	21.4	14.2	.
	National Westminster	34.7	29.2	24.2
	Standard Chartered	72.6	77.0	79.7
Netherlands	ABN	30.5	-	-
	ABN/Amro	-	32.7	72.0
	Amro	13.5	-	-
	Fortis (bank)	-	28.8	33.6
	ING (bank)	11.0	16.8	61.6
	Rabobank	na	14.5	20.2
USA	Bank of America	48.3	21.8	7.6
	Chase Manhattan	51.7	31.9	28.0
	Chemical Banking	38.4	15.3	-
	Citicorp	53.6	41.3	46.1
	J.P. Morgan	47.7	41.7	-
	Manufacturers Hanovers	54.6	38.6	-
Japan	Dai Ichi Kangyo	29.0	39.6	19.1
	IBJ	12.1	26.3	28.6
	Mitsubishi Bank	31.5	33.5	-
	Sumitomo Bank	36.4	35.0	20.5
	Tokyo-Mitsubishi	-	-	40.6
	Bank of Tokyo	31.4	31.3	-

-: bank not in sample. na: not available.

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