University of Navarra

Working Paper
WP no 201
December, 1990

ADJUSTING TO A GLOBAL ENVIRONMENT: COMMERCIAL BANKS' INTERNATIONAL STRATEGIES

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Abstract

The purpose of this paper is to study banks' international strategies in Europe amid the globalization of the industry. In recent years, a large number of international operations have been performed which do not conform to the classic models of cross-border lending.

The first observation worth noting is the considerable importance of the financial environment in shaping the globalization of the banking industry. In particular, international financial instability has led to an increase in capital flows between countries and has triggered an intensive process of financial innovation all over the world. At the same time, the financial deregulation process taking place in the EC has opened domestic markets to foreign competition, thus breaking the monopolies held in certain domestic financial markets.

The second conclusion of interest is that the internationalization processes set in motion in Europe respond to certain patterns, which are scale, attention to the customer and transfer of resources - these differ from the more conventional patterns mentioned in the literature.

Finally, some of the means by which this internationalization process is put into effect (particularly alliances and acquisitions) are markedly different from those used traditionally in international business.

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Introduction and Description of Methodology

The purpose of this paper is to perform an empirical study of international strategies and patterns of globalization of the commercial banking industry. The geographical area specifically analyzed is Western Europe. The reason for this is very clear: in the last ten years, particularly since the approval of the Single Act - which will have as its final consequence the creation of the Single European Market - the main internationalization movements have taken place in this part of the world (Walter, 1988; Canals, 1990).

Thus, the changes caused by disintermediation and the new conditions resulting from a more unstable and fluctuating economic environment (Pecchioli, 1983) are compounded by those brought about by the process of deregulation of the industry undertaken by the governments of most of the world's industrialized nations, not to mention those caused by the construction of the Single European Market in 1992. While deregulation and increased financial instability are two forces that are also present in other financial systems such as the North American and Japanese systems, the construction of a single financial market within the European Communities is a factor that solely effects European banking and those branches of international banking with a strong presence in the EC. The progressive integration of the East European countries in the economic life of the Twelve adds a further factor of interest to this process.

As a result of these trends, the structure of the industry is currently undergoing enormous changes. Thus, a group of major financial institutions have decided to compete directly with the big American and Japanese banks. In line with this foreseeable trend, some banks have started to acquire interests in other banks. Thus, for example, Deutsche Bank – one of the big three German banks – has purchased other banks in a number of European countries over the last few years: the subsidiary of Bank of America in Italy, Sociedad de Investimentos in Portugal or Morgan Grenfell in Great Britain; at the same time, it has acquired controlling interests in banks in other European countries. Other banks, however, have preferred to swap shares or acquire mutual interests in each other's banks, as is the case of Commerzbank and Banco Hispano Americano or San Paolo and Compagnie Financière de Suez.

This phenomenon not only affects commercial banks but also savings banks. In countries such as Spain, the traditional restrictions have recently been lifted. This will enable savings banks to effectively compete with banks in the financial services industry and will induce those savings banks aspiring to serve a wide market to increase the number of branches at their disposal. At the same time, the insufficient scale of some institutions has sparked off a mergers and acquisitions process, precisely with a view to being able to operate in geographically broader markets.

Furthermore, this phenomenon is also affecting banks in countries outside the EC. Thus, Kansallis-Osake-Pankhi, Finland's largest bank, has recently come to an agreement with Gö tabanken, the sixth largest bank in Sweden in terms of volume of assets, to form a Scandinavian group of sufficient size to compete with other large EC banks. These countries' legislation is very restrictive and it has therefore not been possible for these banks to merge. However, the agreement will enable them to offer financial services as if they were a single unit. On the other hand, the American banks wish to exploit to the utmost their strong presence in Europe and it is nighly unlikely that the Japanese turn their backs on this important market which, with the disappearance of many frontiers, has become particularly enticing.

The direction that the banking industry will follow in Europe is by no means clear. In the EC as a whole, the industry is heavily fragmented and, in many countries, there is still a significant distinction between commercial banks, investment banks and savings banks as regards the type of operations they can perform. Also, as has happened in the case of the two Scandinavian banks mentioned above, the formation of supranational banks is not an easy task, not only due to legislation on mergers or the involvement of foreign companies, but also for the simple reason that in certain countries, such as France or Italy, the government still holds considerable interests in the capital of financial institutions. Another significant difficulty results from the variations in each country's legislation on the protection of bank shares. Thus, in some German banks, the maximum stake that can be held by a single shareholder is limited to 5%. In Switzerland, the restrictions are even greater: there are several types of shares but those giving the right to vote are limited to Swiss citizens.

It seems clear that the ultimate reason for these strategic moves is to prepare and adapt banks to the reality of a single financial market. These transformations provide a very rich body of empirical evidence for studying the industry's patterns of globalization and the diversity of international strategies.

With this purpose in mind, we have closely studied the behavior of 25 commercial banks in five European countries (France, West Germany[1], Italy, Spain and the United Kingdom) and 27 internationalisation moves. These banks represent the top five domestic commercial banks in each of the countries analyzed. The information used here was obtained through interviews with bank executives, public information provided by these banks, annual reports and press releases in specialized magazines.

When studying each of these organizations, particular attention has been paid to the effect of European financial integration on its strategy and the role of the respective governments and central banks in the industry's globalization process. The results obtained enable us to draw conclusions on the quality and effectiveness of the international strategies and to provide practical recommendations for those banks that may desire to internationalize their activities in the future.

A particularly significant conclusion derived from this study is the importance of the role of the financial environment in shaping the internationalization process and in influencing the decisions taken by some banks to adapt themselves to this process and to garner the greatest

[1] Henceforth, Germany.

benefits from it. As we will see in this paper, the flexible exchange rates system and the deregulation process have been decisive for understanding the industry's globalization.

Together with the role of the financial environment, the strategies followed by the big banks have been a complementary factor to the above. Thus, three main types of causes have been observed in the sample of banks studied. The first relates to the achievement of the efficiency goal, through which greater size enables benefits to be obtained from the economies of scale and scope observed in the banking industry. The second cause corresponds to the development of the ability to provide a response to the needs of domestic customers who operate in other foreign countries, in order to thus maintain and enhance the relationships existing between the bank and its domestic customers. The third cause refers to the transfer of financial innovations and the ability to market products in other countries. Each of these generic options offers advantages and disadvantages, both regarding the goal to be chosen and the way to pursue it. The following sections will be concerned with the study of these options.

This paper is structured as follows. In the following section, we will briefly discuss the structure of the industry in Europe, taking into account vital variables such as concentration, dimension and profitability. We will then discuss the main events that have led to the industry's globalization, examining them on two different levels: the globalization of worldwide finance and the globalization of the banking industry in Europe. The last section deals with the causes of this process, studying in detail each bank's underlying motivations. Finally we will assess the procedures used to implement this internationalization strategy, paying particular attention to the acquisition of other banks and the establishment of alliances between banks in different countries.

Structural Characteristics of the Banking Industry in the EC

The specific objective of this section is to provide a brief overview of the state of the banking industry in the five European countries considered in this study: Germany, Spain, France, United Kingdom and Italy. Any study of the structure of the banking industry must include a series of factors, described in the next section (international financial instability, deregulation, etc.), which have had a profound impact on banking operations. The fact that in this section we intend to concentrate on a number of data concerning the industry's structure should not undermine the importance that factors such as those mentioned above have had on this structure.

Commercial banking activity in these countries has configured itself around two possible models. The first is based on the principle of universality, by which any bank can perform any type of bank operation without any special legal formula. German banks are a typical example of this model. By contrast, the specialization model requires that banks concentrate on those financial activities that they are allowed to perform by law, while other types of activities are prohibited to them. British banks are the best example of specialized banks. In actual fact, these two principles are opposite poles between which a number of mixed solutions are admitted, as is shown by banking practice in European countries.

Thus, Great Britain is a prototype of a country with a clear banking specialization. In this country, banks are classified under the two major categories of commercial banking and investment banking, both with clearly differentiated functions. A certain degree of formal specialization can also be seen in Italy, where there are organizations specializing in short-term operations and others specializing in long-term operations. However, in those countries where historically there has been a certain amount of bank specialization, this is gradually being dismantled by the deregulation process and by concentration, so that at present organizations with different fields of activity are operating under a single management body. As we will see in the following chapters Germany, Spain and France , to a greater or lesser extent, follow the principle of universal banking.

In order to help us in our comparison, we will separate the figures concerning banks from those concerning savings banks. The relative size of the banking industry can be measured by the ratio between total bank assets and the GDP. This indicator provides an indirect reference as to the efficiency of the banking system and the banks' weight in the economy[2], as it states the volume of financing necessary to obtain one unit of product (Table 1).

Table 1

Relative weight of deposit-taking institutions (% assets of GDP, 1987)

	Banks	Saving banks	Others	Total
France[1]	84.4	15.7	29.8	129.9
Germany	44.0	70.3	32.3	146.4
Italy	88.5	26.7	2.9	118.1
Spain	87.6	43.7	4.5	135.8
UK	242.2[2]	-	37.6	280.3

[1] 1986 figures.

[2] Includes TSB Group.

Source: Canals (1990).

Upon observing the figures shown in the above table, the data for the United Kingdom clearly stand out from the rest, with total bank assets two and a half times greater than that of the GDP. Lagging far behind, the next country is Italy, with a value of 88.5% of the GDP. This can only be accounted for by London's unique status as a major financial centre in Europe, with a strong foreign banking presence which is highly active in international financing operations.

It is also interesting to consider the weight of each of the types of institution within this financial system. For example, the market share of savings banks in Germany is very high while the value of bank assets is relatively small, considering the strength of the German economy.

What is more, most industrial countries have a high level of bank concentration, so that a small core of banks accumulate a significant proportion of bank assets and liabilities, as can be seen in Table 2. As this table shows, the greatest degree of bank concentration is to be found in France, where 35.1% of total assets are held by the three main banks.

Table 2

Bank concentration: % of total bank assets (1984)

	Three largest institutions	Five largest institutions	Ten largest institutions
France	35.1	53.6	70.5
Germany	15.0	22.0	35.0
Italy	17.5	25.4	40.4
UK	21.3	29.7	37.1
Spain	23.8		

Source: Bank of Spain (1988).

[2] Canals (1990) and Dermine (1990) provide more information on the industry.

Table 3 summarizes a few revealing figures, which reflect the size of the banking industry in the EC, particularly with regard to each bank's branch network.

Table 3

Sice of EC banks (1986)

	Inhabitants (million)	Number of banks	Number of branches	Number of employees	Loans (million ECU)	Inhabitants per branch	Employees per branch	Loans per branch (thousand ECU)	Loans per employee (thousand ECU)
Germany	61,080	308	6,382	191,300	255,390	9,751	29.97	40,017	1,335
France	55,379	386	9,917	229,197	254,340	5,584	23.11	25,647	1,110
Italy	57,221	162	5,878	191,871	103,190	9,735	32.64	17,555	538
UK	56,900	578	14,300	403,000	908,270	3,979	28.18	63,515	2,254
Spain	38,638	138	16,498	157,595	99,646	2,342	9.55	6,040	632
Total EC	269,218	1,572	52,975	1,172,963	1,620,836	31,211	123.45	152,774	5,869

Source: Bank of Spain (1988).

Spain has the highest total number of branches (15,498) of all the countries included in the study, whilst the country holding second place in this ranking, United Kingdom, with a much more sophisticated financial system, has only 14,300 branches. However, this figure loses its impact if viewed in the context of the number of inhabitants per branch, in which case Spain drops down to the bottom of the list.

In order to analyze the strategic importance of the number of branches, we need look at another statistic. Thus, upon studying the volume of loans granted per branch, it soon becomes clear that the productivity of Spanish banking, when measured on this particular scale, is extraordinarily low: 6.4 million ECUs as opposed to the 17.6 million ECUs generated in Italy, the country immediately above it, and the 63.5 million ECUs in loans granted by bank branches in the United Kingdom in 1986. This provides a further indication of the strength of the English financial system. If instead we analyze the volume of loans granted per employee, the situation does not undergo any substantial changes and only Italy has a lower rating than Spain.

Causes of Globalization of the Banking Industry and Banks' International Strategies

Before describing the globalization process of the banking industry, we must first define what we understand by this concept. According to Porter (1986), a global industry may be defined as an industry in which a company's competitive position within a certain geographical market is influenced by(and in turn influences) its relative position on other markets. Indeed, geographical areas cease to be important in a global industry.

The movement towards globalization has been one of the most significant trends of the international economy in recent years. For companies, this factor has meant a new challenge that they must confront to a greater or lesser extent, depending on the type of industry they operate in.

Although all economic sectors have a common denominator, the globalization patterns vary from one industry to another. However, it is generally agreed that they are particularly prominent in the finance industry and each of its markets.

What consequences does this have for a particular industry with these globality features? It is quite clear that this trend profoundly affects its structure and its long-term behavior. The reason for this is that the global sector is not just the mere sum of national companies but also the competitive or collusive relationships which these companies develop with one another in order to achieve a position of leadership in the international market.

Globalization in this industry has stemmed from a number of causes[3]. On the one hand, it is possible to identify factors associated with the economic and financial environment. On the other hand, specific business factors resulting from strategies followed by commercial banks also play an important part (see Ghoshal, 1987). When analyzing this process, it is useful to make a distinction between the two types of causes. However, it is necessary to consider both types as interdependent as, in actual fact, the internationalization of many banks is a result of the opportunities created by the process guiding the globalization of the industry. This dynamic between the two causes is a specific feature of the banking industry.

[3] See Crane and Hayes (1983) and Walter (1988) for a general study of these issues.

Within the context of the economic environment, there are two main types of cause. The first is the system of flexible exchange rates, which has encouraged a significant growth in international capital flows and has opened the doors to a continual process of financial innovation. The second cause is the financial deregulation process, which has occurred on two different levels: that which has taken place within each EC country and that which has been implemented in the EC as a whole and which is geared towards the creation of a single European financial market.

There are two types of cause related to internationalization-orientated business decisions. Firstly, there are the reasons which are traditionally used to account for internationalization decisions, such as the cost of production factors or attempts by businesses to follow customers or find new local markets. However, our research has revealed a number of other factors influencing commercial banks' internationalization decisions, which stem from the desire to achieve economies of scale and scope, to deliver better and broader services to the customer and to transfer both innovations and managerial capabilities. In one way or another, all these motivations are linked to the internationalization process underlying the growth of multinational companies, although the specific factors involved in this case are different.

In the rest of this section we will describe the deregulation process within the EC, leaving aside the question of the international monetary system since it is not overly relevant to the focus of this paper. In the following section we will analyze firms' explicit internationalization decisions.

The deregulation process in the EC

The universal financial deregulation process carried out by the various industrialized countries has taken a unique turn in the European Communities. In this case, the deregulation process is being implemented in conjunction with another process: the creation of a single financial market, which will have enormous implications for the banking industry and its globalization strategy. This market requires two conditions. The first is the freedom to establish financial organizations and provide financial services in the EC countries. The second is the liberalization of capital flows between the EC countries. As we will see later, the Second Bank Directive attempts to provide an answer to the first aspect. The second aspect has been addressed by the lifting of all restrictions to capital flows, approved by the EC Council of Ministers in June 1988. A third component is the creation of a single European currency, a project which was studied in the Delors report, published in April 1989. Although this is an important aspect, its role is less crucial than that of the previous two components.

According to the studies performed (Cecchini, 1988), the various legal barriers existing in the banking industry (i.e. barriers to trading and the establishment of bank business, barriers to trading of securities and insurances, barriers to trading of financial services) give rise to significant differences in the prices of similar financial services in different EC countries. In a hypothetical situation, it is estimated that the price reduction in financial services that would be achieved as a result of a lesser degree of regulation and a greater degree of competition within the industry would be very substantial in countries such as Spain, Italy, France and Germany and less so in the United Kingdom.

The potential benefits of this reduction are considerable (Cecchini 1988) and may be even greater if significant positive effects are obtained from a greater integration of the member countries' capital markets as this would help create a greater price competition and would consequently lead to a further price reduction.

It is therefore clear that this process of financial integration in Europe will lead towards increasingly competitive markets, which will force banks to reformulate their strategies in order to survive in this new, much more aggressive environment.

In the White Paper, the European Commission used a new criterion to address the single financial market: the principle of mutual recognition, by which it will no longer be necessary to standardize the various national legislations. All non-matching legislation will be mutually recognized, a principle which will be supplemented by that of the above-mentioned home country control. This means that from the time of its acceptance in a particular country, it will become the responsibility of the appropriate authorities in this country to monitor banks' activities.

This principle is included in the Second Directive, which was approved by the Council of Ministers in June 1989, in the form of the so-called single bank license issued by the home country authorities. This will enable any bank to establish itself and offer a wide range of financial services in other EC countries on the sole basis of the initial license. This is a very significant step as it will enable progress to be made in European financial integration without increasing the general burden of regulations.

There is no doubt that the principle of reciprocity may enable rapid progress to be made towards establishing the single financial market but it is by no means free of difficulties or potential drawbacks, not to mention the considerable increase in the bureaucratic workload that this might involve. Let us consider an example. According to this criterion, a French bank, authorized by the French financial authorities, could have offered leasing services in Spain as leasing is one of the activities included in the Second Directive. However, until the beginning of 1988, Spanish banks could not undertake leasing activities and consequently would have been at a disadvantage with respect to their French colleagues.

This simple example shows that the Second Bank Directive will provide considerable momentum towards the standardization of the various national legislations so that the banks from each country do not find themselves at a disadvantage with respect to their counterparts in other countries.

The Second Directive also aims to establish patterns of behavior in two particular areas linked to the creation of banking institutions. The first of these refers to the establishment of a minimum capital, fixed at 5 million ECUs for each bank. Therefore, any branches of a bank opening in another EU country will no longer have to fulfill this requirement. The EC has delegated to the Bank of International Settlements the question of the ratio between total investment and total equity. Compliance with the new, highly exacting regulation proposed by the BIS may cause problems for some Italian and French banks, which generally have a weak capital base.

The second area refers to the application of the reciprocity principle to countries from outside the EC. In accordance with the single banking license principle, a bank from an outside country could open a subsidiary company in any EC country and from there open branches in other countries. However, some of these EC countries could raise objections to this on the grounds that the bank's home country does not provide equal facilities for its banks. In these cases, before allowing a bank from a non-EC country to establish itself in an EC country, the

Commission will study whether the home country provides reciprocal treatment to each and every one of the member countries.

Another interesting issue concerning the banks of non-member countries is the distinction made by legislation between a foreign bank's subsidiaries and branches. The subsidiaries must comply with the requirements of the EC country in which they are based but from there they may expand to other EC countries as if they were actually EC banks. On the other hand, branches from non-EC countries, by not having any independent legal status themselves, must comply with the regulations of each country. Among other things, this implies that each of the branches in different countries would have to comply with minimum capital requirements, which will increase these branches' capital cost in comparison with banks acting through a subsidiary.

As can be seen, the banking industry will undergo considerable changes in its legal structure over the next few years, with the result that the impact of the creation of the single market on this industry will be much greater than on most other industries.

Together with these changes being implemented under the auspices of the Second Bank Directive, other complementary changes are also taking place within the European Communities which stem from the liberalization of capital movements. This liberalization will have major consequences on the provision of financial services in Europe.

Indeed, the creation of the single European market is inconceivable without the free provision of financial services and the free movement of capital. The free circulation of goods and services, which is the goal of a true internal market, requires that individuals and corporations have free access to whichever financial services they may require.

Dismantling barriers to the free circulation of capital between member countries will improve allocation of resources from savings, providing greater investment opportunities for savers and additional financing possibilities -at lower cost- for companies. Furthermore, the free circulation of capital is a necessary condition without which one of the aspects of the single market, the provision of financial services, will not become practicable.

The financial deregulation process currently taking effect in Europe is leading towards the creation of a single financial market in which, although national differences in consumer behavior will continue for a certain period of time yet, three major goals will be achieved: the opening of domestic markets to foreign banks, the liberalization of capital movement and the standardization of regulations governing the various national systems. All this will no doubt create new business opportunities for banks to further internationalize their activities and carry out operations in other countries. The Banks' response to these opportunities is described in the next section.

Commercial Banks' International Strategies

1. The Conventional Reasons

In the literature on the internationalization of the firm (Caves, 1982; Dunning, 1983; Wells, 1972), a series of causes have been stressed which seem to be decisive in setting these processes in motion and which will be briefly discussed here. However, we will state at this point that they do not exactly correspond to what we have found in our research, which will form the main focus of the next section.

The reason traditionally given for banks' overseas expansion is their determination to follow the customer (Walter 1988; Dunning 1983). According to this motive, banks' international expansion is following in the wake of direct foreign investment and foreign trade. The international strategies of the North American, English and Japanese banks seem to be following this path: to utilize in other countries the business relations built up with companies in the home country. In this manner, they are able to offer the customers (companies) the same financial products as in the home country, on the basis of a relationship developed beforehand. This phenomenon may be related to oligopolistic reactions (Caves 1982), which implies that some banks invest abroad as a strategic reaction to actions by other banks and out of fear of losing customers. The great advantage of this pattern is that it enables the bank to make use of the customers' knowledge and of the bank's own reputation. On the other hand, the weakness is that national governments are usually unwilling to open their frontiers to foreign banks.

The second reason why banks expand their overseas operations is to look for foreign markets (Murray 1984), seeking direct access to local consumers in each country. Normally this reason occurs either because a bank has a number of products that are superior to those of its competitors or because it perceives a lack of competition in certain foreign financial market segments, and the consequent high profit potential. Normally, the means of entry into foreign markets consists of differentiating products (Grubel 1977), thereby exploiting the lack of competition and innovation in the respective national markets. In general, entry is usually preceded by a careful segmentation of the market that the bank is intending to penetrate, concentrating its focus on large corporations, the public sector or high income segments. In general, once foreign banks have penetrated a particular country, rivalry in the industry increases considerably. A good example of this is provided by the banking industry in Spain: after the entry of foreign banking after 1977, the rivalry within the industry grew significantly, as did also its market share.

The cost factor is the third reason used to account for the expansion of banks abroad (Aliber 1984; Ramsler, 1982). In actual fact, the factor identified here is capital cost. Internationalization of bank activities enables banks to gain direct access to the cheapest sources of capital, leading to a transfer of these resources to areas where the return on the investment will be much higher. The international expansion of certain Japanese banks is an example of this criterion.

The final factor we will consider here is that of financial and political risk diversification (Lessard, 1986). Thus, internationalization tends to be self-sustaining as penetration into certain markets tends to compensate for possible risks in other markets, balancing out the various prospects in a particular bank's business portfolio.

Each one of these factors explains in part the reasons for banking expansion overseas in the past. However, some of these arguments, such as capital cost and risk dispersion, are unconvincing as explanations for the internationalization process of banking in Europe. On the other hand, factors such as following the customer and oligopolistic reactions in local markets may have more significance, as we will see in the next section.

2. An Explanatory Model of Bank Internationalization

The 27 cases that have been studied in this analysis of bank internationalization actions in the EC in recent years seem to bring to light a behavior pattern somewhat different from that stated in the previous section, although they do share certain points in common. These cases may be grouped under three main categories: alliances (eight cases), alliances with strategic interest (four cases) and acquisition (fifteen cases). In Table 4, we have distributed these cases in accordance with two criteria: the number of countries in which the bank is present and the breadth of product range. One initial observation is that universal banking tends to be more international than specialized banking, which may be indicative of the importance of dimension for commercial banks. Table 5 shows a typology of international strategies according to the number of available products and the number of foreign countries involved.

Table 4

Positioning of banks observed

Number of products				
	Universal banking	9	6	5
	Specialized banking	6	1	-
		0	1-2	>2
		Number of foreign countries with significant banking presence		

Table 5

International strategy typology

Number of products		Few	Several	Many
	Universal banking	National	Plurinational	Global
	Specialized banking	National focus	National and product focus	Product focus
		Number of foreign countries with significant banking presence		

The most connonly given motivation for the internationalization of bank activities is the desire to achieve economies of scale and scope. (Kogut 1985; Tschoegel 1984). The procedure most frequently used to achieve this has been cross-border acquisitions of other banks. Table 6 shows the most significant operations of this type that have recently taken place within the EC.

Table 6

Alliances and Acquisition Activity in Key European Banking Markets

Category/Investor	Target Country	Year	Transaction
Alliances/Interests			
San Paolo Bank (Italy)	U.K.	1986	Acquired 6% of Hambros Bank
Deutsche Bank (West Germany)	U.K.	1984	Acquired 5% of Morgan Grenfell
San Paolo Bank (Italy)	France	1987	Acquired 1% of Compagnie Financiere de Suez
General de Banque (Belgium)	France	1987	Acquired 1.5% of Compagnie Financiere de Suez
Cariplo (Italy)	Spain	1988	Acquired 1% of Banco Santander
Commerzbank (West Germany)	Spain	1984	Acquired 10% of Banco Hispano-Americano
Banco de Bilbao (Spain)	U.K.	1987	Acquired 5% of Hambros Bank
Banco Santander (Spain)	U.K.	1988	Swapped initial 5% shareholding with Royal Bank of Scotland
Blocking/Strategic Minority Interests			
Hongkong Bank (Hong Kong)	U.K.	1987	Acquired 15% of Midland Bank
Cariplo (Italy)	Spain	1988	Acquired 30% of Banco Jover from Banco Santander
Banco Santander (Spain)	Italy	1988	Purchased 30% of I.B.I. from Cariplo
Skandinaviska Enskilda Bank (Sweden)	Denmark	1986	As part of Scandinavian Bank partnership, S.E. Banken acquired 5% of Privatbanken, 6% of Bergen bank and 3% of Union Bank of Finland
Cross-Border Acquisitions			
Banca Popolare di Novara (Italy)	France	1988	Acquired 80% of Banque de l'Union Maritime from CCF
National Australia Bank (Australia)	U.K.	1987	Purchased Clydesdale Bank and other interests from Midland Bank
Bank of Ireland (Ireland)	Ireland		
	U.K.	1987	Acquired Bank of America's UK mortgage loan subsidiary
Banque Nationale de Paris (France)	U.K.	1988	Purchased Chemical Bank's UK mortgage loan subsidiary
Dresdner Bank (West Germany)	U.K.	1988	Acquired 70% of Thornton Fund Management Group
Deutsche Bank (West Germany)	Italy	1986	Purchased Banca d'America e d'Italia from Bank of America
Banco Santander (Spain)	West Germany	1987	Purchased CC Bank from Bank of America
Citicorp (U.S.)	Spain	1983	Acquired Banco de Levante
Citicorp (U.S.)	Italy	1984	Acquired Banco Centrosud from Banco di Roma
Chase Manhattan (U.S.)	Spain		Purchased Banco de Finanzas from regulatory authories
Barclays (U.K.)	Spain	1981	Acquired Banco de Valladolid from regulatory authorities
Credit Lyonnais (France)	ND	1987	Purchased Nederlandse Credietbank from Chase Manhattan
Banco Santander (Spain)	Belgium	1988	Acquired Belgiam subsidiary of Credit du Nord
San Paolo Bank (Italy)	France	1987	Acquired control of Banque Vernes from Suez group
Lloyds Bank (U.K.)	West Germany	1984	Acquired failed Schroeder, Muenchmeyer Hengst merchant bank

Source: Salomon Brothers and own data.

Strategies followed by some European banks, such as Barclays Bank, Natwest Bank or Dresdner Bank, aimed at achieving a greater scale in order to compete more effectively in the single European market, suggest that the question of dimension is important, or at least that is what banking executives think, and they should know.

From a theoretical viewpoint, scale may help to achieve two types of very important economies in any company: economies of scale and economies of scope[4]. At the same time, dimension enables greater technological innovation or the achievement of a certain degree of market power.

What are the real sources of the economies of scale or scope in a bank? It is fairly evident that the major source of this type of economy's the investments made in computers and telecommunications equipment. Only large financial organizations can gain access to the huge computers able to process enormous volumes of information at a minutely small additional cost per transaction.

Furthermore, the capacity available in this type of computer system can be used at low cost to process other types of accounts, new products and even different banks that could be acquired by the larger bank. In all these cases, this would lead to economies of scope. Closely linked to this argument is the type of strategy that we have previously called differentiation. This could be performed at a lower cost if, for example, a product can share the information on other financial products provided by the computer. When the cost of repeatedly using the same information is less than the cost of obtaining this information separately each time, cost savings for the organization concerned can be very substantial.

Finally, we must not forget that the progressive spread of the influence of computer technology within a bank will enable a greater part of the resources to be devoted to service marketing, which for a distribution-orientated company is of extreme importance.

A second major aspect of the economies of scale described above is the risk of diversification that can be assumed by a large organization, which means a proportionally lower cost in terms of provisions (and solvency) than that for a smaller institution. In this case, the advantages are provided by asset investments, as by increasing the number of customers and the range of industrial and geographical diversification, the risk is diluted among a greater number of accounts. But the advantages may also appear on the liabilities side as, by increasing the number of deposits, the variability decreases in keeping with the large numbers law, thus reducing the risk of lack of liquidity.

Distribution-related activities open up another field for economies of scale or scope. A large organization's brand image will enable it to penetrate other national or foreign markets more easily. In addition, the cost of distributing loans or attracting deposits may decrease if the same bank branch is able to offer its customers treasury bonds or pension funds, by which it is able to attain exceptional economies of scope. Finally, one must not underestimate the role played by advertising (and the growing importance of advertising expenditure in income statements) in the bank service marketing process. The greater an organization's volume, the smaller the impact a particular advertising campaign will have on the cost of a given product line; what is more, advertising by an organization above a certain size supports the sale of all the services offered by this organization.

It seems to be fairly clear from the above arguments that economies of scale and scope may play a significant role in banking and should therefore be attained in order to achieve sustainable competitive advantages. In this case, the achievement of a minimum scale seems to be a prerequisite for a bank to be competitive. However, let us remember that this was only one

[4] See Gilligan et al. (1984), Berger et al. (1987), Clark (1988) and Lawrence (1989) for a full discussion of these concepts in the banking industry.

possible way of achieving competitive advantages and that added to this, retail banks do not necessarily have to seek this type of advantage. Furthermore, empirical evidence of the efficacy of economies of scale and scope in the banking industry is not as patent as might appear from the theoretical arguments that we have used (Gilligan et al., 1984; Clark, 1988; these reasons should therefore be used with caution.

What is more, as we have stated previously, economies of scale and scope are not the only arguments in favor of achieving a greater scale of banks and this aspect can also be considered from other viewpoints. The first of these alternative factors, which we have already mentioned in a previous paragraph, is the argument of market power, which can be defined as the ability that certain companies in the market have to increase prices above those that would be obtained in conditions of perfect competition. Market power usually -although not exclusively- occurs in highly concentrated markets with high entry barriers. This situation enables larger-sized companies to set monopolistic price policies.

Another reason for justifying greater scale is that of activity diversification. The spectacular development of certain financial markets has reduced the banks' volume in relative terms. This fact is of particular importance for banks at a time when it seems that there will be no going back on financial disintermediation.

Faced with this tendency, European banks have reacted by increasing their presence on the stock markets either as brokers or at their own risk, as detected by the various regulations in the countries concerned. Logically, this has led to a considerable increase in the degree of rivalry in the industry, as we have stated previously.

The liberalization of capital movements within EC countries may turn the less profitable smaller or medium-sized banks into possible takeover targets by larger foreign banks. Consequently, the achievement of a greater dimension may enable these banks to protect their independence more effectively against possible takeovers by other organizations. A larger dimension does not prevent them from happening altogether (as has been seen in several industrial sectors in recent years) but it makes them a lot more difficult.

By way of summary of these arguments, we can say that size will be an important variable for the growth of banking institutions over the next few years. This is not so much due to the existence of economies of scale or scope as to the advantages obtained on the basis of a wide range of criteria, from the attainment of a certain degree of market power to improved protection against takeovers and the possible tax advantages obtained, for example, from a merger.

However, greater size raises one serious problem: how to achieve it. Both mergers and alliances pose significant operational obstacles which only an exceptional management team is able to overcome. We will look at some of these questions in the next section.

The second phenomenon observed is that some banks have expanded their business overseas in order to improve their service to the customer, following him or her in his or her operations abroad (direct investment abroad or export operations) and creating new ways of distributing products or attempting to exploit local market deficiencies by offering suitable financial products and services to potential customers. In some sense, the reason explained before, that of following the competitors, could be considered a particular aspect of customer service.

These two reasons are important in certain cases. The first is more applicable to German, Belgian and Italian banks, who try to follow their home country customers in their operations abroad in order to provide them the same services as in the home country. Commerzbank, San Paolo di Torino and Societe Generale de la Banque are good examples of this. In the next section, we will discuss the method they have used to implement this strategy.

The second case refers to the entry of American (Citicorp, Chase Manhattan) and British (Natwest, Barclays) banks in the Spanish market, in an attempt to exploit the financial innovation deficiencies and defects existing in that market. If this has occurred to a particularly large extent in Spain, it is due to the opportunities provided by the Bank of Spain and the government for the entry of foreign banks into Spain. A particularly interesting result of this is that competition in this market has increased substantially within just a few years.

The application of computer technology to this industry has resulted in this factor having a special significance in one particular aspect: cash management. The reason for this is that centralized cash management offers significant benefits in terms of profitability and efficiency. This cause adds a differentiating factor to the classical explanation of following the customer. In this case, the purpose is to increase a bank's responsiveness to its customers' international needs.

In some cases, certain banks, in this situation, such as Chase Manhattan or Barclays, have increased their responsiveness by acquiring other banks in an effort to achieve a greater service capacity by attaining greater dimension. In other cases, banks have made agreements with foreign banks to achieve the same goal. These aspects will be discussed in greater detail in the next section.

The third reason found for this movement towards internationalization is the ability it creates to transfer resources to banks in other countries. These resources may be tangible (cash) or intangible (mainly financial innovations, human resources and management talent). In the final analysis, this provides one of the main explanations for the existence of multinational companies (Cave, 1982). However, in the case of the banking industry, this explanation is particularly important. We must also emphasize the importance in many cases of the role of the general manager in triggering the internationalization process.

There are many examples of this type of operation. Deutsche Bank, with its policy of acquiring other smaller banks, such as Morgan Grenfell or Bank of America in Italy, not only pursues a greater dimension in order to benefit from economies of scale but also the possibility of transferring resources, mainly those which are intangible, such as management ability, to organizations which are perhaps not so well managed. Another typical case is that of Banco de Santander, which has acquired small banks, such as the Belgian subsidiary of Crédit du Nork or the CC Bank.

Obviously, the two previously mentioned factors (achievement of a certain dimension or attention to the customer) may influence some of these purchase decisions. However, in some of these cases, the specific reason is to be found in resource transfer.

One argument that lies halfway between resource transfer and attention to the customer is financial product distribution capacity. In short, some of the alliances made between banks are aimed at transferring to other countries the capacity to distribute financial products in the home country, for which a distribution agreement is of considerable use.

As we will see in the next section, the problem that arises is that the bank providing distribution capacity for innovation may find it more attractive to copy it than to sell it to its customers on behalf of another bank. This may generate problems within the alliances. The lack of experience in this field prevents us from giving a more authoritative opinion and we will have to wait until a certain amount of time has passed before judging its validity.

However, the number of such agreements has grown considerably in recent years, which may induce us to conclude hat its advantages are indeed attractive. For example, the agreements made by San Paolo (Italy) or Banco Bilbao-Vizcaya (Spain) seem to have this view in mind.

We have found in our research that some banks pay particular attention to one of these three patterns, as is shown in Table 7. This does not mean that these banks neglect the other two aspects; however, it does indicate that their international activity revolves around the aspect highlighted here.

Table 7

Drivers of internationalization

		Goal		
		Scale	Attention to the customer	Transfer of resources
Number of products	Large	Deutsche	Crédit Lyonnais	Barclays Bank
	Small	Banco Bilbao Vizcaya	San Paolo	Génerale de la Banque (Belgium)

One finding of interest obtained from this research is that the three main causes of bank internationalization in recent years (achievement of a particular dimension, attention to the customer and transfer of resources) show certain parallels with the three factors that, according to the research recently performed by Bartlett and Ghoshal (1989), are to be found in shaping the international strategies of three manufacturing sectors: branded packaged goods, consumer electronics and telecommunications. These authors stress the following strategic capabilities in determining international rivalry in these sectors: efficiency, responsiveness and transfer of knowledge.

Efficiency may be directly related to scale. Responsiveness has a lot in common with attention to the customer. Finally, transfer of knowledge is a specific example of the more general transfer of resources.

The fact that the same internationalization patterns are found in four different industries leads one to assume that they could perform a role of genuine levers in the companies carrying out international business.

The empirical evidence also points to a conclusion similar to that reached by Bartlett and Ghoshal (1989). This evidence suggests that the banks with superior strategic international positions are those whose operations strike an ideal balance between dimension, attention to the customer and transfer of resources. To a certain extent, the transnational solution proposed by Bartlett and Ghoshal could also be applied to the banking industry.

Commercial Banks' International Strategies

In the previous section, we discussed the causes of the commercial banks' internationalization process in the EC. We will now look at the specific means used to initiate and maintain this process.

A distinction has been made in the literature (Pecchioli, 1983; Walter, 1988) between the various means of entry into international operations, the most important of which are the representative office, shell branch, affiliate, subsidiary and branch; each of these has their own advantages and disadvantages.

However, in recent years, some procedures have taken precedence over others. The first of these has been the creation of a network of branches in the host country under the bank's own name. This has been the case with the entry of North American and English banks, such as Citicorp or Barclays Bank, in other EC countries.

Normally, the underlying motivations for this type of international expansion are to provide better attention to the customer and to transfer resources (e. g., financial products) from one market to another. In the second case, the products chosen are usually those related to professional advice on mergers and acquisitions, risk tools, swaps, fund investment and LBO. Normally, the success enjoyed by these instruments and services depends upon whether there exists a certain lack of efficiency and innovation in the respective national market.

There are two problems that must be considered when establishing a network of branches. First, they are very expensive to set up and imply a heavy level of commitment in the respective country. The second problem is that of defining the role of this network of branches in the bank's global strategy. Over-centralization could give rise to a lack of responsiveness to the host country's needs. However, over-decentralization could work against the achievement of maximum efficiency or the stimulation of financial innovation. It is vital to find the balance between both extremes for the bank to be successful in a global context.

A second type of procedure observed is the establishment of alliances. Alliances have been extensively studied in their application to international business and have been used considerably in recent years in the European banking industry. Table 4 lists the most significant operations performed in the last few years.

Two types of alliance may be distinguished. The first is geared towards achieving a greater attention to the customer An example of this was the swapping of shares between the Commerzbank and the Banco Hispano Americano, or between the Banco de Santander and the Royal Bank of Scotland.

The participants in these alliances seek to profit from the closeness to the customer that the other bank provides it with and from the access to distribution channels or the possibility of distributing interesting financial products.

The second type of alliance consists of achieving a strategic minority interest in a bank in order to prevent the hostile entry of a minority shareholder in the bank, or in order to control the bank itself. An example of the first case would be the entry of Cariplo (Italy) in Banco Jover (Spain) with the acquisition of 30% of its capital stock; an example of the second case would be the acquisition in 1987 of 15% of Midland Bank by Hong Kong Bank.

Although this kind of alliance is certainly entered into with the purpose of transferring resources and providing attention to the customer, the primary motivation is the achievement of a strategic stake in another bank. In this context, internationalization as a strategy takes on a role that is more defensive than offensive.

Finally, there are cross-border acquisitions. Normally, the purchasing bank seeks to gain a controlling interest in the bank it has bought, with the purpose of including it in its area of influence, restructuring it, changing the management team and attempting to increase its profitability.

A large number of cross-border acquisitions have been performed in recent years, as can be seen in the table. Their primary goal has normally been to achieve a certain scale, as is the case of Citibank or Deutsche Bank. However, in some cases it has been argued that the main motivation of the acquisition is the transfer of resources, such as information systems or management, as has been the case of certain acquisitions by San Paolo, Credit Lyonnais and Banco de Santander.

The main advantages acquisitions have over alliances are that the purpose of the acquisition is very clear and that the buying bank calls the shots in the operation. By contrast, in the case of alliances, the goals are usually less clear and there is no dominant party in the operation, which may cause it to fail. However, it is true that the level of commitment in an alliance is lower than in an acquisition and consequently its flexibility is greater.

Alliances are a recent phenomenon in the banking industry and their purpose, in some cases, differs from that of the more traditional modes typical of other sectors. However, their efficacy is not guaranteed, in part because the banks' pretensions in this area are more ambitious. It will be necessary to wait until a greater body of evidence and experience has been acquired before giving a final opinion on this matter.

Table 8 shows the correlation between international strategic moves and drivers of internationalization in the banking industry, according to the sample of banks described earlier. What stands out from this information is that the same strategic move (e. g. direct investment or alliance) might be a result of two different underlying motivations. But the result that most baffles the observer is that some drivers can be articulated with two different strategic moves; therefore, there is no single relationship between drivers and strategic move, and only recent experience will determine what the best strategic move is to achieve a certain goal in the internationalization process of banks.

Table 8

Correlation between drivers of internationalization and strategic moves

		Drivers of internationalization			
		Scale	Attention to the customer	Transfer of resources	Others
Strategic moves	Direct investment		X	X	
	Alliances		X		X[1]
	Acquisition	X		X	X[2]

1 This includes preventing hostile takeovers, or shareholders, and achieving an international outlook-
2 This includes preventing hostile takeovers or hostile shareholders.

Some conclusions

In this paper, we have studied the banking industry's globalization patterns in Europe and banks' international strategies. In recent years, a large number of international operations have taken place which mark a departure from the traditional forms of cross-border lending.

The first conclusion observed is the considerable importance of the financial environment in the globalization of the banking industry. In particular, international financial instability has led to an increase in capital flows between countries and has sparked off an intensive process of international financial innovation. Furthermore, a consequence of the financial deregulation process in the EC has been to open the national markets to foreign competition, breaking the monopoly held in certain national financial markets.

The second important conclusion is that the internationalization processes started in Europe seem to respond to certain patterns, which are scale, attention to the customer and transfer of resources, which vary from the more conventional patterns discussed in the literature. However, they are consistent with certain findings relating to the manufacturing industries. This implies that the banks that have followed this internationalization process have used a different strategic approach.

Finally, some of the procedures used in this internationalization process (particularly alliances and acquisitions) are somewhat different from those traditionally considered in international business. In any case, their formulation is ambitious and, although the risk is enormous, the parties involved have expressed their confidence in the formula's success. Nevertheless, we will have to wait and see how events turn out before drawing final conclusions.

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