Why do Banks Internationalize?
The Distinctive Strategy of a Brazilian Retail Bank

Autoria: Sebastião Cunha, Dirk Michael Boehe

Abstract

Drawing on strategic management approaches and case research we develop a novel argument explaining the internationalization of retail banks. We argue that the internationalization of service firms may be motivated by the aim to strengthen their market position on the home market. This is different from previous research which has focused on the host country market and has neglected the possible impacts of internationalization on the home market. The retail bank studied clearly combined a differentiation with a market niche (or focus) strategy in that it offered a set of new value-added services as a "South American Bank". We claim that our competitive advantage argument is conceptually different from existing approaches such as the follow-the-client, internalization or ownership advantage arguments. We further show that the international diversification and the beachhead arguments are a corollary of and to a certain extent compatible with our explanation.

Key words: retail banks, internationalization, competitive advantage, emerging markets

INTRODUCTION

Research on multinational banks (MNB) has been primarily based on the ownership advantage, international diversification, follow-the-client or beachhead arguments (Rugman, 1981; Tschoegl, 1987). However, mentioned arguments do not explain the internationalization of private banks that a) do not have any ownership advantages exploitable abroad, b) do not have any MNE clients whom they might follow abroad. This study's purpose is to understand internationalization of retail banks as a proactive differentiation strategy triggered by home country and regional institutional and market drivers. Thus, we intend to extend international business literature, in particular, literature on the motives of internationalization of banks and other service firms.

The remainder of this paper is structured as follows: in the next section, we review the main arguments found in the extant literature which explain why banks go international. Then follows the method section which provides details about the case study design; data has been obtained from senior executives who were working with Banco Real, a large Brazilian retail bank which initiated its internationalization process in the 1970s, a process which was interrupted (and reversed) when the bank was acquired by ABN Amro in 1998. The case description starts off with the context, i.e. the institutional and the market environment in vigor from the 1970s to the 1990s. On this background, we explain the bank's internationalization strategy and, more importantly, the driving forces and motivations which made its top management adopt a particular internationalization strategy. The discussion section confronts case evidence with the arguments explained in the literature review and demonstrates why an alternative argument is needed to explain why Banco Real internationalized. Finally, we evaluate the relevance of our argument in view of the extant internationalization literature and show how it extends and contributes to this literature.

WHY BANKS INTERNATIONALIZE

Extant internationalization literature (see details below) has treated multinational banks (MNB) different from multinational enterprises (MNE), i.e. manufacturing firms, and has come up with several alternative explanations with respect to the internationalization of retail banks. The most prominent ones center on the ownership advantage, international diversification, defensive expansion, beachhead expansion, and offshore banking arguments.

These arguments do not seem to be mutually exclusive. In the remainder of this section, we briefly review these arguments and try to identify possible gaps in literature.

Ownership advantages and internalization

A firm's ownership advantages, developed prior to internationalization, have been considered as one of the most prominent explanations for internationalization. Following Hymer (1976), ownership advantages are necessary preconditions for internationalization, because internationalizing firms need to compensate the costs of entering foreign markets and the liability of foreignness, i.e. their disadvantages compared to host country competitors with respect to local market knowledge, host country regulations as well as different negotiation practices.

While ownership advantages of MNEs are frequently related to capital intensive economies of scale and scope in manufacturing and proprietary technology, possible ownership advantages of MNBs relate mostly to intangible assets such as experience with clients, existing client networks, skilled personnel, differentiated products, unique banking skills, government support (mainly applicable to state-owned banks) as well as financial assets such as a large domestic capital and deposit base, competitive cost of capital or scale economies (Nigh et al., 1986; Tschoegl, 1987).

Most of these assets are highly information and knowledge intensive. Extending internalization theory from manufacturing firms to banks, it has been argued that market imperfections or failures hamper the free flow of intermediate products such as information and knowledge across country and organizational boundaries. Hence, MNBs exist as they are able to overcome these market imperfections creating an internal market for these intermediate products (Buch, 2003; Rugman, 2006).

A variant of this argument has been presented by Tschoegl (1987) who posits that uncompetitive host markets may create incentives for foreign expansion. This argument implies that internationalizing banks have ownership advantages, as firms' competitiveness in a particular market is a function of their ownership advantages compared to the incumbent players in this market.

International diversification and creation of firm specific advantages

A further motivation to internationalize is to add new income sources which permits to diversify income streams. This reason, quite common for exporting firms' efforts to expand into several unrelated markets, applies also to banks. In view of that, MNBs gain advantages over banks which operate exclusively in the domestic market, as they escape systematic risk of any one domestic market, as they avoid to be trapped by the regulations of one particular financial market and as they are able to avoid or reduce market imperfections with respect to international information transfer (Rugman, 2006). As a consequence of this, MNBs tend to have more stable earnings which constitutes a benefit as such and might motivate to go international.

Likewise, MNBs are in a position to exploit mentioned market imperfections accessing international financial information in a privileged manner, while banks operating exclusively on the domestic market have no such opportunities. Recalling Rugman (2006: 74),

> "multinational banks do better than domestic banks (since these miss out on the net benefits of international banking) and multinational enterprises (since they have greater additional costs of subsidiary production than do the banks)."

However, it should be noticed that the information/market imperfection argument has lost in importance in the last two decades as technological revolutions have make information accessible instantly and worldwide at much lower costs.

Furthermore, MNBs have more opportunities to grow and gain scale economies increasing their size. Economies of scale in banking implies, for example, that overhead costs can be

better diluted, which improves the overall cost structure and is likely to increase the profitability of MNBs. Being the generation of profits the main motivation of enterprises, internationalization can be seen as a necessary strategy to achieve that goal. According to Rugman (2006: 74):

> "The real difference between domestic and multinational banks is that the latter have more scope for growth and profitability through international operations."

Thus, when banks internalize their ownership advantages by setting up subsidiaries abroad, they generate new opportunities for the development of firm specific advantages (Rugman, 2006: 72-73). In this sense, the motivations to exploit firm specific ownership advantages or to create these advantages by international diversification are interrelated. Nonetheless, though Rugman envisages several advantages of internationalization of banks, he does not seem to relinquish the premise that banks need to have an ownership specific advantage prior to internationalization.

A variant of above mentioned diversification argument is that banks internalize in order to take advantage of less rigid banking regulations (Aliber, 1976). Offshore banking operations provide tax incentives, free capital flows, among others. Today, however, global banking supervision has reduced the relevance of the offshore argument. However, empirical support for the hypothesis that foreign market opportunities influence the internationalization of retail banks has not been supported by previous research (Nigh, Cho, & Krishnan, 1986).

The defensive expansion argument (follow-the-client)

Banks may go international in order to follow their domestic clients which set up subsidiaries abroad. In this case, bank internationalization is motivated by maintaining the existing client base. The rationale goes as follows: if a bank did not follow its client, foreign banks might take him over and eventually enter the bank's domestic market reducing its market share and profitability.

Previous empirical research using different country data sets has found considerable support for this hypothesis. For instance, Nigh, Cho, & Krishnan (1986) find evidence for the argument that US business presence (MNEs) triggers involvement of US banks in the same countries. The presence of Japanese MNBs in the USA has also been found to be positively associated with the presence of Japanese MNEs in the same country (Hultman & McGee, 1989). Lastly, using firm-level data from Japanese banks, Qian & Delios (2007) corroborated that bank internationalization is triggered by their clients' moves abroad. However, defensive expansion's impact on profits has been found to be small (Williams, 2002).

Several recent contributions have integrated the defensive expansion hypothesis with the internalization theory (Williams, 2002; Qian & Delios, 2007); however, mentioned integration has already been anticipated by Rugman (2006: 79) who considered the defensive expansion hypothesis as

> "a subset of the theory of internalization, since the need for a multinational bank to exist to service the multinational enterprise would not arise in a world of perfect capital markets."

Once having established branches abroad, arises the questions of what comes next? In particular, does international expansion stop there or do banks leverage this position to grasp new opportunities abroad?

The beachhead argument and autonomous international expansion

The beachhead argument claims that banks with branch offices abroad may take advantage of their presence in foreign markets to learn about the host country business environment, gain experience and identify new business opportunities which go beyond merely serving their existing clients from their home country. Thus, MNBs can use their beachhead to gain access to new clients in their host country or to acquire host country bank operations from local competitors.

This argument, originally crafted by Fieleke (1977), is compatible with the behavioral approach to internationalization (Qian & Delios, 2007). The latter approach asserts that entering and expanding in foreign markets constitutes a risky activity. Therefore, firms need to acquire information and knowledge about the markets they are entering in order to reduce their risk of failure. Being the acquisition of knowledge an incremental activity, firms tend to increase their commitment in foreign markets incrementally as well (Johanson & Vahlne, 1977). Accordingly, following a client can be considered as less risky than going abroad without having clients in the host country. Once being established abroad, the bank is in a position to learn incrementally about its host country market and increase market commitment as it learns and reduces its risk of failure. However, longitudinal studies which support this view have been scarce. Also, it has been argued that the costs of bank internationalization have been decreasing due to advances in communications and information technology and financial market integration (Tschoegl, 1987).

<center>*   *   *</center>

All of these arguments are based on the notion that the drivers of bank internationalization reside abroad. Conversely, none of these arguments takes into account the possibility that the home country market and institutional environment may influence the internationalization decision. Though Qian & Delios (2007) consider a bank's internationalization as a reaction to peer banks' already initiated internationalization (oligopolistic reaction), no study to our knowledge investigates internationalization as a proactive strategy triggered by home country (domestic) and regional institutional and market drivers. In an attempt to better understand such driving forces and to develop a novel argument, we describe and discuss the internationalization case of a major Brazilian retail bank.

METHOD
Research design and context
This study adopts a single case design, concentrating on the internationalization of Banco Real. The selection of one single case is due to the fact that this bank's internationalization has been unique in Brazil's banking history and can be seen as an extreme or rare case for Brazil which justifies a single case study (Yin, 2001). Yet, this does not necessarily mean that it is too extreme to be theoretically relevant as similar situations might have occurred in other countries and in other companies within the broader service sector. More importantly, a single case may be sufficient when the aim is to identify new concepts or to challenge existing views of the world. According to Yin (2001, p. 62), a single case is reasonable when a well-formulated theory is to be tested, particularly, to "determine whether the propositions of a theory are correct or whether another alternative set of explications could be more relevant". A final raison d'être for a single case study is the revealing study in which the researcher gains access to a situation previously inaccessible for research, which applies to this case study as well (see data collection section below).

The Brazilian banking sector provides interesting research opportunities being one of the technologically most advanced markets in the world. A highly unstable environment, with one of the world's severest inflation records up to the beginning of the 1990s is in part responsible for Brazilian banks' continuous efforts to sophisticate its banking operations. Several institutional improvements since the creation of the Central Bank in 1964 have contributed to a stable and well-regulated banking system with advanced, strict corporate governance standards. Despite several recent incursions of foreign multinational banks, such as the take-over of Bamerindus by HSBC in 1995, of Banco Real by ABN Amro in 1998 and of Banespa by Banco Santander in 2000 and, again, of Banco Real ABN Amro by Barkley's in 2007, the

domestic market continues to be strongly dominated by state-owned (Banco do Brazil, Caixa Econômica Federal) and Brazilian private banks (Bradesco, Itaú, Unibanco). All of them are considered highly profitable, benefiting of elevated spreads and interest rates.

Nevertheless, even today, only a small group of Brazilian banks is present abroad, though some recent movement, such as the acquisition of Bank Boston's Latin American branch by Banco Itaú, could suggest that a new wave of Latin industrialization is looming. Before this background, the internationalization of Banco Real, initiated already in the 1970s, can be considered the most prominent case, particularly, as its international presence was, according to an industry insider, approximately 15 years ahead of its domestic private competitors in the beginning of the 1990s.

Data collection

Data collection faced several difficulties as the internationalization process of Banco Real pertains to history. Therefore, many of the bank's former executives are no longer reachable and historic internal documents inaccessible due to mentioned changes in ownership. Even secondary information on the internationalization of Banco Real seems to be virtually nonexistent as an Internet-based search makes plain. Generally, research about banking in Latin America covers FDI by MNBs from Europe or the U.S. but not FDI by Latin American banks (see for instance, CEPAL, 2002; Freitas, 1999).

Besides, retrospective interview data may suffer from ex-post rationalization or the difficulty of remembering important details. For mentioned reasons, we had to take particular care during data collection, elaboration of research reports and analysis in order to provide reliable and valid information. Conversely, the fact that the internationalization of Banco Real is an historic event has some advantages as well, because formerly highly sensible information such as the bank's strategy, the main concern of our study, is now obsolete and does no longer have to be protected. This should have helped us to gain "purer" insights into the bank's history.

Moreover, one of the authors has actively participated in the bank's internationalization and in the formation of Banco Real's international department. He served the bank as a senior executive in the international area for almost 25 years and gained invaluable insights as a global executive, setting up new branch offices abroad and finally, coordinating the bank's foreign exchange and foreign commerce business.

In addition, senior executives from Banco Real and its business context (competitors, Central Bank, Finance Ministry) were asked to revise drafts of the case study and to provide us with written statements with respect to the main arguments presented in our analysis. The resulting exchange of arguments lead to a refinement of case relevant information and helped to corroborate our insights.

Particularly, we asked questions which reflected our hypothesis and the main alternative hypotheses covering questions such as:

- Why Banco Real went international in the 1970s?
- Explain why the internationalization was good or bad for the bank.
- What were the main competitive advantages (or differentials) of Banco Real compared to its main rivals (Itaú, Bradesco, Unibanco, etc.) in the Brazilian market during the 1970s (before the internationalization)?
- What were the main competitive advantages (or differentials) of Banco Real compared to its main rivals (Itaú, Bradesco, Unibanco, etc.) in the Brazilian market during the 1990s (after the internationalization)?
- What factors influenced Banco Real's decision to internationalize in the 1970s? (open question complementing a ranking question with pre-formulated answers representing several alternative hypotheses)

- What were the main impacts of the internationalization of Banco Real all along the 1980 and until the take-over in 1998? (open question complementing an agreement / disagreement question with pre-formulated answers representing several alternative hypotheses).

Multiple sources of information from inside and outside the bank as well as different techniques such as the verification of our arguments and drafts are recommendable in order to evaluate the construct validity (Yin, 2001, p. 55). Complementing these approaches, similar questions were asked repeatedly in order to check whether answers remained consistent.

A further issue was reliability of the information provided: in brief, data is reliable when different researchers arrive at the same conclusions. We tried to take account of reliability issues using the following technique: one of the authors revised several different drafts of the study elaborated by the other author and former bank executive, questioned and discussed the conclusions and asked for more detailed explications. After the final draft in Portuguese language, one of the authors wrote a new version of the paper in English which included his own interpretations as well as the statements of further respondents and the questionnaire. The final version in English was then verified by the other author (and former executive of the bank). During this process, questioning with respect to several of the case's details helped to clarify previously ambivalent issues.

Data analysis

During the data analysis we were concerned with two issues: 1) whether the statements from different respondents converged and 2) whether our explanation of Banco Real's internationalization holds against alternative hypotheses or not. To do this, we compared the statements from different respondents and continuously revisited our data in order to check whether our interpretation continued to be consistent with the information obtained.

Additionally, one of the researchers confronted the fellow researcher and ex-executive with the alternative arguments derived from the literature review asking for written statements. A similar procedure was used vis-à-vis other respondents (see above-mentioned questionnaire). Finally, it is noteworthy that the comparison of the bank's internationalization trajectory with the domestic and regional institutional and market context permits to evaluate whether our and the alternative arguments make sense against that context. This seems to be a most valuable procedure as objective information about the context is available. This is also one of the reasons why we give considerable weight to the analysis of the research context.

EMPIRICAL EVIDENCE

To begin, we cast some light on the context of the focal bank as recommended by Yin (2001); in particular, we briefly look at the home country domestic institutional and market environment as well as the regional institutional and market environment during the 1970s through 1990s. In light of the context, we will then provide some evidence regarding the motives of the focal bank's internationalization strategies.

Contextual factors

Domestic institutional environment. Due to extensive, state-financed investment programs in hydro and nuclear energy, petroleum and heavy industries, the government needed continuously be financed both by state-owned and private banks (national and foreign). This development model resulted in increasing inflationary pressure up to a point that banks perfectly adapted themselves to an inflationary economy. While rising confidence in the Brazilian financial system suggested that banks were using sophisticated planning and control systems, inflation concealed the real efficiency of the financial intermediaries. In this context,

banks were focusing primarily on attracting deposits and lending to the government or state-run companies. Banks avoided medium or long-term loans and concentrated on the money and overnight market. Private lending constituted an almost negligible activity, with an emphasis on foreign trade financing. Only in 1986, after the implementation of the first formal stabilization program, it became evident that banking operations required a high inflation rate in order to remain profitable. Therefore, this first economic shock program forced Brazilian banks to initiate a strategic change and develop the lending business directed to private households and firms. Yet, inflation came back and rendered the loan business unprofitable. The inflation cycles from 1987 to 1990 helped banks to recover within the logic of the inflation economy. However, executives from the banking sector had become more sensible regarding the fragility of the system to which they had been accustomed and recognized that they would have to increase the client base considerably in order to achieve critical mass in deposits.

As the international loan market dried up, banks needed to focus on existing domestic clients and tried to enlarge its domestic client base in order to access fresh money. Hence, competition among Brazilians banks for domestic clients' deposits increased.

According to a former director of the Brazilian Central Bank, mentioned situation provided additional incentives for the development of foreign trade:

> (…) On the other hand, given the restrictions regarding access to external financial resources, as a result of the moratorium of the sovereign debt, in the Brazilian case, there were incentives to develop trade between the countries of Latin America and Africa.

From this perspective, regional trade happened to be an outlet for an alternative growth strategy, in a situation where competition among domestic banks has become fierce and the domestic credit market underdeveloped (due to inflation). This rationale has become even more important once the government's credibility as debtor was hurt and international debt financing intermediation dried up.

Regional institutional environment. From the 1970s onwards, four interrelated movements characterized the Brazilian government's external policy: first, foreign trade development (exports and imports) were a main concern of governmental development policy and industry. In particular, a shift in the export profile from commodities towards semi-manufactured and manufactured exports was a major goal. Second, the Brazilian government searched to increase its influence beyond its frontiers, mainly as a regional, South American economic and diplomatic leader. The strengthened Brazilian financial system could play a key role in this process as Brazilian banks were in a position to finance the international expansion of Brazilian companies. Third, South American countries undertook first associative initiatives which would eventually result in the formation of free trade zones and a common position in trade negotiations with the U.S. and the European Common Market. According to a former director of the Brazilian Central Bank, "the most effective and brilliant instrument at that time was the CCR", an agreement among South American countries which Central Banks guaranteed the payment of foreign trade debts of the signing governments. Consequently,

> the financing bank's commercial risk of this concentrated intra-South American trade was minimal (…) the CCR, together with the foundation of the Latin American Export Bank (BLADEX) constituted the most important instruments available for the economic agents hit by the heaviest and, in that time, recent external debt crisis.
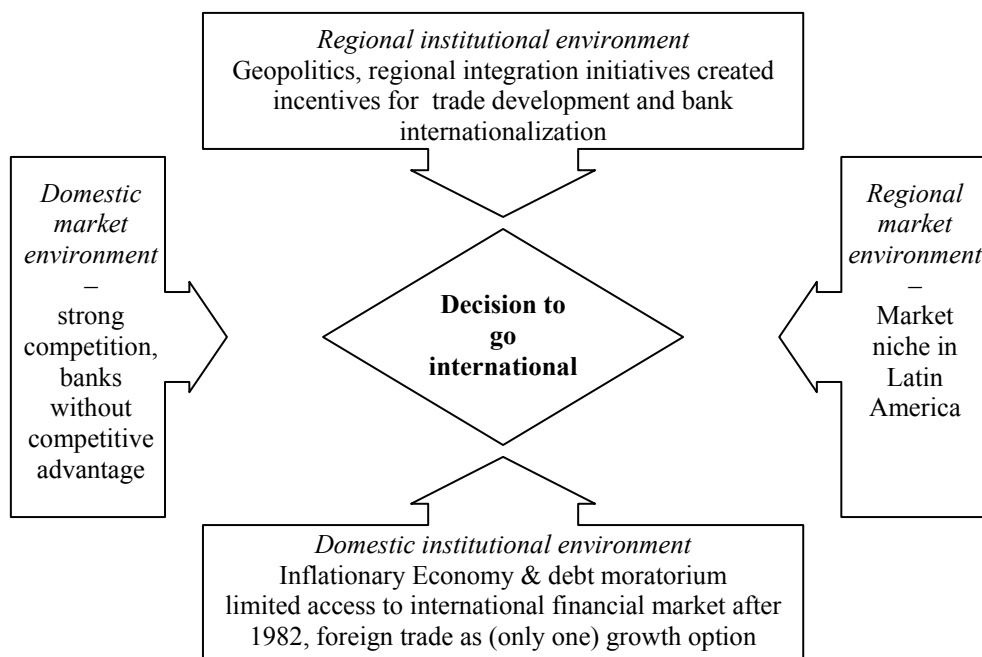
Figure 1 – Contextual factors of retail bank interanationalization

Finally, in the 1970s the Ministry of Foreign Affairs initiates its Africa-Policy aiming at strengthening diplomatic and commercial relationships between Brazil and African countries. The relationship with Nigeria constituted an initial success of this policy. In the light of this external setting, the former executive of the bank's international area comments that "in such a scenario, the internationalization of a Brazilian bank could support the internationalization of Brazilian firms".

We may conclude that in the 1970s both geopolitical and international trade related factors were encouraging the internationalization of Brazilian firms. However, adequate instruments and supportive infrastructures were missing as no private local bank owned an international presence. Furthermore, the South American subcontinent was a priority both in political and economic respect.

Domestic market environment. In the absence of any competitive advantage, Brazilian banks competed fiercely for domestic clients as banking products and services were similar. A former senior executive noted,

> In this moment, the [Brazilian] banks had to adopt formal strategies which resulted in a controlled and conscious process aiming at achieving fixed deposit targets. Bank executives' responsibilities were to design programs and plans (…) regarding the size, layout and strategic localization of their own bank agencies intending to attract potential clients.

This account underscores, once again, the predominant logic of Brazilian banking in the 1970s and 1980s. Local clients were the principal source of money which could then be used to finance the government and state-owned companies. As a result of this, maintaining and attracting new clients were crucial to a bank's survival and growth perspective. However, above-mentioned statement also implies that the main form of differentiation seemed to be the strategic localization, size and layout of bank agencies and, probably, less so, the banking products.

Thus, the main problem was that all major private banks were looking for the same, an increase in their client base, while none of them was offering anything different or unique to its clients. In this vein, a former Brazilian economist and finance minister (working as assessor of Brazilian ministers during the 1970s and 1980s) commented that

> (…) in this era, there was a sort of commoditization of the financial intermediation process, during which the products created by the banks differentiated themselves scarcely or in no respect. (…) the banks were offering the same product to their clients.

We may characterize this market structure as an oligopoly, consisting of a few major private banks (in order of size in the 1970s): Bradesco (largest), Banco Itaú, Banco Real (acquired by ABN Amro in 1998), Unibanco, Banco Nacional (today Unibanco) and Bamerindus (today HSBC). In addition, there were two major state-owned banks: Banco do Brasil and the São Paulo state bank, Banespa (acquired by Banco Santander in 2000). Apart from them, there were many smaller, often regionally focused banks in addition to smaller public banks owned by the governments of federal states. Until the 1970s only two state banks were internationally active, Banco do Brasil and Banespa, basically as an extension of their governments and often playing a political role as a tie between the Brazilian (federal and São Paulo state) government and the host country's governmental agencies.

Regional market environment. Only foreign banks, mainly from the U.S., Bank Boston, Chase and Citibank, were present in almost all Latin American countries. There are two explanations for this; first, strong presence of U.S. MNEs in Latin America, may have triggered U.S. Bank presence in the same countries, which is in line with the follow-the-client argument (see literature review). Second, abundance of petrodollars, a result of the oil price boom in the 1970s, deposited in U.S. and European banks, had to earn profits on the international credit market. Agencies of U.S. and some European banks in Latin America constituted channels for these international credit operations until 1982. Trade finance of Latin American companies simply could also be carried out by foreign banks. However, the Latin American scenario implies that there was a market niche, poorly explored by Brazilian competitors: trade-finance for Latin American companies.

Banco Real's internationalization strategy

Having said this, Banco Real envisioned, already in the early 1970s, a new business opportunity, which emerged at the crossroads of above-mentioned domestic and regional market and institutional environment (see figure 1): Banco Real decided to go international. Asked about the reasons why he thinks that Banco Real internationalized the past head of the international department of Bamerindus (today, HSBC), a former competitor of Banco Real, commented:

> Above all, in order to gain competitive advantages over its main competitors, given that the national financial system, in that moment, was highly inclined towards the domestic market due to strongly inflationary periods. This took a lot of time of the banks, always trying to update themselves with new systems, 'engineering' new products with the intention to keep its clientele and also trying to gain a share of the competitors' clientele. Banco Real innovated with its internationalization.

This quote underscores what has been said before about the contextual factors: the domestic institutional environment (inflation) and the domestic market environment (high competition) virtually compelled a bank which was pursuing a growth strategy to explore new markets abroad. Besides, the quote also suggests that no one of the banks had a competitive advantage over other banks. Asked about the main difference of Banco Real compared to its competitors, he adds:

> I think that the most important difference was the expansionary vision of Banco Real all over Brazil. This perhaps explains that Banco Real was the first one which envisioned the international market as a great alternative looking for the creation of competitive advantages over its rivals.

Putting it in another way, Banco Real was unlikely to have any tangible or intangible competitive advantages over its rivals such as financial resources, superior technology, know-

how, products or services. Even if it had had, almost all of them would have been straightforward to imitate.

How could the bank realize its expansionary vision, given the then existing institutional and market environment? The former head of the international department pointed out:

> The internationalization process constituted a growth strategy (…) modifying the supply of services to our existing clients and, more importantly, to potential clients. The [bank's] trajectory shows that we were successful gaining new corporate clients, multinational enterprises, many of them gazing at South America and [located] in São Paulo where the representatives of the bank and the representatives of its clients could meet and establish credit policies for various South American countries. The model of the South American Bank worked.

Several aspects of this statement have to be stressed: first, the notion that the bank internationalized in order to realize a *growth strategy* which may be seen both as a reaction to limited growth opportunities within the domestic market and as a proactive step, taking advantage of a conjunction of favorable institutional variables. Second, the bank *modified its services* implying that the bank innovated, possibly looking for a form of differentiation vis-à-vis its competitors on the domestic market. Third, this strategic change was not just focusing existing clients but "*more importantly, to potential clients*" suggesting that the bank did not just follow its clients but rather intended to be ahead of them using this strategy to gain access to new corporate clients. Fourth, the goal and vision seemed to be the creation of a "South American Bank" thus, filling a market niche not previously occupied by Brazilian or foreign bank.

A former director of Central Bank, readily acknowledged that "the differentiation of the financial institution was obtained by expanding in South America and not necessarily in the developed financial markets of that time". This makes sense as a few major Brazilian banks were already present in the major financial centers. He noted that:

> as a result of this, was established the largest network of external agencies, or even creating local banks, in South America and thus, the largest private player in regional trade, leveraging, on the other hand, the clients in the country [Brazil] and, consequently, making grow his internal deposits.

He further confirmed that the idea was to "add clients which would be better served", which is in line with the strategy to expand the base of corporate clients rather than to follow existing ones. Moreover, the notion of "clients (…) better served" alludes to a package of differentiated banking services focusing foreign trade, such as:

- Financing Brazilian exports, initially using the system FINEX and later on PROEX, the Brazilian export financing programs;
- Financing South American importers, i.e. the clients of Brazilian firms abroad, as well as the final clients of those South American importers.
  For instance, Banco Real financed the production of Brazilian buses which where then exported to a Chilean representative of the bus manufacturer. The Chilean branch of Banco Real financed then the Chilean representative who sold the the buses to the final client, a Chilean bus line. In short, without branches abroad, Banco Real could only finance pre-exports.
- Offering a broader spectrum of operations to its existing and potential clients, for instance, international trade intermediation on demand of existing clients, i.e. searching for new clients for Brazilian exporters and vice-versa. As noted by the former head of the international area:

> The goal of the internationalization, serving the existent client in Brazil, in a specific case, is contacting the other side of the business in the host country, be it his importer and/or his exporter and linking both points of the operation, thus serving him already implies winning over, almost in a spontaneous manner, the part of the host country. This means even to discover and to bring into contact with the Brazilian client other clients of the host country with whom he does not have any relationship yet and try to develop new business; this is serving the existent client in Brazil.

- Adding value, accompanying the Brazilian client and / or his product abroad.
  Regarding this point, the former head of the international area explained:
  > Being in direct contact both with the importer and the exporter, one could serve [the client] better, discuss better and understand [the client] better and, as a consequence of this, offer a better solution to the clients facilitating the transition.

  Adding value seems to imply that Banco Real offered a differentiated service which resulted from its position as a kind of broker with in-depth knowledge of both trading partners (importer and exporter) in both countries.
- Owning a large set of branch offices abroad, Banco Real could experience an upgrade, improving its image also in the eyes of the international financial community. In particular, the presence in the world's main financial centers had important signaling effects as approval of the host countries' Central Banks was compulsory. Thus it could access a larger amount of external credit lines as soon as liquidity on international financial markets increased. These credit lines were then used to finance the foreign trade of South American clients.

These points confirm that the bank's branches in South America and the main financial centers served for entirely different purposes: while the former were focused on foreign trade finance and related services, the latter were focused on capturing the financial resources to make these services possible. This highlights the concept of a regional, South American Bank. Again, this internationalization concept was completely distinct from that of other Brazilian banks (Banco do Brasil, Banespa) with branch offices in the main financial centers since they were not so much involved on the commercial side with the private sector at that time. Later, Banco do Brazil become also very active in trade finance, while Banespa faced serious difficulties resulting in its sell off to Banco Santander.

In short, the bank clearly combined a differentiation with a market niche (or focus) strategy in that it offered a set of new value-added services focusing regional trade.

Besides, right from the beginning, Banco Real analyzed additional growth options abroad as the bank could use its presence in a wide range of South American countries (in addition to its presence in all major financial centers) as a "beachhead" this is to identify and explore new growth opportunities beyond their existing or potential domestic client base.

The most important business opportunity was the cross selling of services among the foreign branch offices which changed the very essence of the set of branch office from a star (dyads Brazilian - foreign branch office) to a fully connected network (links among foreign branch offices independent of operations in Brazil). The former head of the international area pointed out:
> (…) in order to obtain an additional value (…) a coordination was required that provoked cross selling between several units created in various countries in order to increase the scale of business, more profit, as it happened indeed with our institution.

The high relevance of cross selling becomes even more evident remembering that branch offices in several African countries have been closed down later on (in 1987 and 1994) as expected synergies between African subsidiaries and Latin American subsidiaries could not be realized. As he further noted this possibility has been considered right from the beginning of the internationalization process:
> During the meetings of the internationalization committee, we did not just analyze the economic resources for the definition of the opening of branch offices, but also (…) for the capacity to create added value for situations which we would come across and which would exist in the future, always the possibility of cross selling.

This statement also underscores that the bank's strategy had indeed proactive character as the executives' view had been directed towards to future of the bank. This suggests that a long-

term strategy was in place. This notion of a long-term strategy seems to be re-enforced by the following comment:

> Given the difficulty of a company's internationalization process (…) this process always requires a long-term vision of the company and of its enlarged market, understanding the cultures of every country where it sets up its business.

This point of view was confirmed by the former finance minister who noted that

> In the internationalization of Banco Real, there was implicit that the bank made a bet on the future by its internationalization

Mentioned strategy was developed combining different entry modes, as a function of the local conditions in every host country. The process which stretched over almost 15 years and commenced with a branch office in the neighboring South American countries (Paraguay, Uruguay, Colombia). In 1977 and 1979, agencies in two African countries were added and between 1979 and 1984 agencies in the main international financial centers were set up.

This sequence (see also Table 1 for an overview) can be explained as followed: some of the market entries occurred as a function of new opportunities, for instance, the possibility to buy a bank in Uruguay triggered market entry in that country. Other Latin American countries such as Chile were characterized by political uncertainties (Allende government and instability during the first years of Pinochet`s government). Similar reasons led to a later market entry (1977) in Argentina as well (second government of Peron). The late in European countries could be seen as a function of the development of South American banking operations which extended their scope into the realm of European banks. Consequently, European banks were asked to provide funding for these operations. Interestingly, Banco Real entered the Spanish market only in 1984, this is about two years after the debt crisis when the international financial market was quite closed for Brazilian banks. This can be explained by the Spanish banking regulations which did not require Spanish banks to make any provisions when dealing with the Madrid based branch office of Banco Real once this was officially authorized by the Spanish Central Bank. Thus, Banco Real created a new international funding opportunity in an hostile environment.

Year of opening	Branch office in	Observations
Before the 1970s	USA	Entry in the US occurred before the entry of other Brazilian Banks
Before the 1970s	Caiman Islands	
Beginning of 1970s	Paraguay	
Beginning of 1970s	Uruguay	Take over of a local bank
Beginning of 1970s	Colombia	
Beginning of 1970s	Panama	
1977	Chile	Late entry due to political uncertainties and sophisticated banking sector
1977	Argentina	Late entry due to political uncertainties and sophisticated banking sector
1977	Cote d'Ivoire	Bank branch sold in 1994
1979	Gabon	Branch closed in 1987
1979	London	
1980	Frankfurt	
1983/84	Madrid	Entry after debt crisis due to opportunities provided by Spanish banking regulations

Table 1 – The internationalization process of Banco Real

As a result of this process, Banco Real was in 1992 the most internationalized Brazilian private bank with 33 dependencies(subsidiaries, agencies, branch offices) abroad, including

the subsidiaries Banco Real Incorporated, Banque Real de Côte d' Ivoire, Banco Real del Paraguay, Real Paraguay de Seguros and Banco Real de Colombia; as mentioned, only two Brazilian state-owned banks, Banco do Brazil and Banespa, had undertaken a comparable considerable internationalization effort with 48 and 18 dependencies abroad respectively (Burle, 1995: 14).

DISCUSSION

This case study has identified a novel explication for the internationalization of retail banks. Retail banks may internationalize in order to differentiate themselves vis-à-vis their home country competitors, offering their clients, in a proactive manner, a portfolio of products and services which would not have been available otherwise. The case study also suggests that the focal bank targeted, at that time, a regional niche market. Using Porter's (1985) terminology, Banco Real combined two generic strategies: differentiation and focus.

That Banco Real built up new firm resources and capabilities by means of its internationalization process would be a complementary interpretation of the case study. Probably the most important resource created during the internationalization process was the network of branch offices in South America. With respect to capabilities, there are several, first and foremost, the capabilities related to export- and import- services; secondly, the set of capabilities necessary to establish new branch offices abroad and thirdly, the capability to leverage the whole integrated South American Bank network, increasing scale and profits. During the 1970s and 1980s, these resources and capabilities have been valuable, rare and exploitable by the existing organization, but probably not very difficult to imitate. Therefore, Banco Real has enjoyed a temporary competitive advantage over other domestic private banks. Lasting over a considerable period, roughly 15 years according to the former head of the international area, the advantage was a temporary, however not a sustainable one (see Peng, 2006).

Figure 2 – Retail bank internationalization & performance

This rationale is presented schematically in Figure 2: due to incentives and pressures originated in the domestic and regional market and institutional environment, the bank chooses to internationalize. Internationalization triggered the development of new resources and capabilities which permit to differentiate its products and services focusing a regional niche market. Consequently, the domestic and international client base increases, reaping economies of scale and projecting a reputation of a solid 'South American Bank'. Resulting improved access to international funding made further expansion of South American trade financing possible. Reinvestment of profits directed to strengthen the new resource and capability base allowed to stay ahead of domestic competitors. The bank's superior performance has been confirmed by one of the respondents from a competitor bank who informed that the main outcomes of the internationalization process were faster growth compared to the main private competitors, an increase of domestic and international foreign trade clients, increased competitiveness on the international market, strong improvement of its image both domestically and internationally and, finally, increased attractiveness as a take-over target (which actually has happened in 1998 when Banco Real was acquired by ABN Amro).

Hence, we may conclude that Banco Real's motivation to internationalize was to develop some sort of competitive advantage over its domestic competitors. This advantage was based on superior resources and capabilities which supported the differentiation and focus (niche) strategy. Revisiting the question of why banks internationalize, we may thus add a novel argument to the list (see literature review): retail banks may internationalize in order to develop a competitive advantage combining differentiation and focus.

Though the application of the competitive advantage literature (generic strategies and RBV) and the institutional approach is not completely new by itself (see Peng, 2006), to our knowledge, applications to service firms in general and banks in particular are rarely found in literature. A further difference compared to previous research is that RBV approaches assume that competitive advantages (and an underlying resource and capability base) exist prior to internationalization (see for example, Fahy, 1996).

Revisting internationalization arguments
We will now re-examine the alternative arguments mentioned in the literature review in order to analyze to what extent our explanation is different from and compatible with those arguments.

First of all, the internalization theory presupposes that MNBs possess an ownership advantage prior to internationalization which does not apply to our case as none of the executives questioned in our research was aware of such an advantage.

Furthermore, internalization theory proposes that international physical presence in the form of subsidiaries or branch offices are necessary as market imperfections hinder the free flow of information across borders. However, it is important to notice that there is an essential difference between international capital market operations on the one hand and international commercial operations on the other. While international capital market operations do not necessarily need a physical presence abroad, international commercial operations do. The problem was not so much the efficient transfer of existing information (capital market), but rather the creation of information about the needs of existing and potential export and import clients, about influencing factors of the business environment (regulations, economy) in distinct countries. This information creating process was facilitated by a repetitive four-point interaction within a given network (branch office in country A with export client, branch office in country A with branch office in country B, branch office in country B with import client and vice-versa). A possible explanation for the relevance of information creation by the mentioned four-point network interaction could have been the relatively underdeveloped

import/export practices and institutional frameworks. Nevertheless, once created, the information regarding the most adequate product / service package for both clients could easily be transferred between countries.

As noted above, physical presence abroad helped the bank to improve its image both in the eyes of its existing and future clients and in the eyes of international banks which could provide credit lines and fund the banks further internationalization process and foreign trade business. This marketing related argument (image) is independent of the market imperfection argument. Accordingly, internalization theory does not explain why Banco Real went international.

Undeniably, international diversification has been a major benefit of Banco Real´s strategy. However, international diversification advantages such as more stable earnings, better access to privileged information, new growth opportunities, etc., were rather a secondary outcome than an objective in the first place.

The defensive expansion argument is not a valid explication of Banco Real´s strategy, because the bank expanded internationally in a proactive (and not a defensive) manner. The primary intention was to increase the client base and not just to maintain existing clients. Moreover, the focus was on foreign trade related products and services as Brazilian companies, at that time, were initiating export activities. Foreign direct investment of MNEs, however, the main cause of bank internationalization according to the defensive expansion argument, was a negligible phenomenon until the beginning of the 21st century among Brazilian firms.

The beachhead argument is perfectly compatible with ours as the aim of the combined differentiation and focus strategy was precisely to win over new domestic and foreign clients using three different mechanisms: (i) unique positioning as the only retail bank which provides products and services for domestic exporters and importers who are involved in South American business; (ii) identifying new domestic clients on demand from foreign (South American) clients who interested in importing Brazilin goods or interested in exporting to Brazil; (iii) identifying new foreign clients on demand from existing Brazilian clients. In other words, the beachhead argument is an obvious consequence of the differentiation strategy outlined above. Yet, different from what has been argued by Qian & Delios (2007), looking at our case, we would refrain from considering Banco Real's strategy as incremental or akin to the behavioral approach of internationalization (Johanson & Vahlne, 1977) because "the development of a new bank branch office abroad", so the former head of the bank's international area, "had to be very fast until reaching its profitability".

In sum, we may conclude that the beachhead and the international diversification arguments can be seen as a corollary of our competitive advantage argument, while the ownership advantage, follow-the-client and internalization arguments do not apply to the case at hand.

REFERENCES

Aliber, R. 1976. Toward a theory of international banking. Economic Review, Federal Reserve Bank of San Francisco, p. 5-8.

Barney, J. 1991. Firm Resources and Sustained Competitive Advantage. *Journal of Management*, 17(1): 99-120.

Buch, C. M. 2003. Information or Regulation: What Drives the International Activities of Commercial Banks? *Journal of Money, Credit, and Banking,* 35(6): 851-869.

Burle, L.L. 1995. A Internacionalização do Sistema Financeiro: 1990-1992, *Analise Econômica*, 13(24): 3-18; Available:

http://www.ufrgs.br/fce/rae/edicoes_anteriores/pdf_setembro95/LAURLOBO.pdf, Accessed: December 2007.

CEPAL – Comisión Económica para la América Latina (2002). La Banca Transnacional en América Latina: Estrategias Corporativas e Impacto Regional (capítulo III), in: La inversión extranjera en América Latina y el Caribe, pp. 113-164.

Fahy, J. 1996. Competitive advantage in international services: A resource-based view. *International Studies of Management & Organization*, 26(2): 24- 37.

Fieleke, N. S. 1977. The growth of US banking abroad: An analytical survey. In: Key issues in international banking. Federal Reserve Bank of Boston. pp: 9–40.

Freitas, M. C. Abertura do sistema bancário ao capital estrangeiro. In: Abertura do Sistema Financeiro no Brasil nos Anos 90. São Paulo: IPEA/Fapesp. 1999.

Hultman, C. W. & McGee, L. R. 1989. Factors affecting the foreign banking presence in the U.S, doi:10.1016/0378-4266(89)90049-6

Hymer S. 1976. The international operations of national firms: a study of direct foreign investment. MIT Press: Cambridge, MA

Nigh, D., Cho, K.R. & Krishnan, S. 1986. The role of location related factors in U.S. banking involvement abroad: an empirical investigation, *Journal of International Business Studies*, 17: 59-72.

Peng, M. e Wang, D. 2000. Innovation capabilities and foreign direct investment: toward a learnign option perspective. *Management International Review*, 40: 79-93.

Peng, M. *Global Strategy*, Thomson: Mason, 2006.

Peng, M. 2001. The Resource-Based View and International Business, *Journal of Management*, v. 27, p. 803-829.

Porter, M. 1985 Competitive Advantage: creating and sustaining superior performance, Free Press, New York.

Qian, L. & Delios, A. 2007. Internalization and experience: Japanese banks' international expansion, 1980–1998, *Journal of International Business Studies*, Doi:10-1057/palgrave.jibs.8400317

Rugman, A. 2006. *Inside the multinationals: The Economics of Internal Markets*, Palgrave-McMillan, New York (25th Anniversary Edition; first published in 1981).

Tschoegl, A. 1987. International Retail Banking as a Strategy: an assessment, *Journal of International Business Studies*, 18(2): 67-88.

Williams, B. 2002. The defensive expansion approach to multinational banking: Evidence to date, *Financial Markets, Institutions and Instruments*, 11:127-203.

Yin, R. 2001. Estudo de Caso – Planejamento e Métodos, Bookman, Porto Alegre, 2nd edition (original version: Case study research: design and methods, Sage Publications, 1994).