The determinants *of recent foreign bank* penetration in Brazil

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This paper sets out to analyse the determinants of recent foreign bank investments in the Brazilian retail banking market and the strategies of the major European banks in Brazil. Since the recent wave of banking internationalization, financial institutions have continued to pursue their existing relationships while seeking greater integration into local markets. The recent influx of European banks into Latin America and Brazil, meanwhile, has been due to a varied range of factors, including bank restructuring in Europe, the dynamic of internationalization in the Spanish banking system and the process of market deregulation in the region. The paper also stresses some common and specific features of the major European banks in Brazil. One common feature is that they are large universal banks which have chosen to develop abroad as a business expansion strategy.

I

Introduction

During the 1970s and 1980s, the presence of foreign financial institutions in Brazil was confined to minority stakes in investment banks and leasing companies, although there were no restrictions on the establishment of representative offices. Later, the 1988 Constitution prohibited foreign financial institutions from setting up new agencies or increasing their capital holdings in locally based financial institutions. However, article 52 of the temporary provisions act of the 1988 Constitution established that such restrictions did not apply to authorizations resulting from international agreements, reciprocity or decisions made in the interests of the Brazilian government. In 1995, owing to the banking crisis triggered by contagion from the Mexican crisis, the Brazilian Government allowed some foreign institutions to take over certain troubled local banks. This step was also intended to strengthen the domestic banking sector. Consequently, foreign banks increased their stake in total Brazilian banking sector assets from 8.4% in 1995 to 27.4% in 2000. Interestingly, it was European banks –Banco Santander Central Hispano (BSCH), HSBC and ABN Amro, among others– that led the main operations involving foreign banks in Brazil during the 1990s.

This paper sets out to analyse the factors that have recently led foreign banks to enter the Brazilian market and the strategies of the major European banks in Latin America and Brazil.[1]

Section II analyses the factors giving rise to the banking internationalization process, and shows that the recent wave of banking internationalization has been characterized not only by the pursuit of existing relationships, with financial institutions catering mainly to their home country customers, but also and increasingly by greater integration into local markets. Section III examines the determinants of foreign bank investment in Brazil and shows that the recent arrival of a wave of European banks in Latin America and Brazil has been driven by a varied range of factors, including the process of banking sector restructuring that has resulted from European monetary union (EMU), the dynamics of internationalization among Spanish banks (which have been the main players in the recent influx of foreign banks into Latin America), the process of market deregulation in the region since the early 1990s, the better prospects of rising returns to financial institutions offered by the region in comparison with developed countries, and the potential for efficiency gains. In the case of Brazil, the banking crisis of 1995 was a milestone, since it resulted in the country opening up to foreign banks.

Section IV considers the recent penetration of European banks in Brazil. Section V analyses the Latin American expansion strategies of the major European banks –BSCH, Banco Bilbao Vizcaya Argentaria (BBVA), HSBC and ABN Amro, one of whose common features is that they are large universal banks which chose to extend their operations abroad as a business expansion strategy– and identifies some specific factors behind the expansion of each financial group. Lastly, section VI summarizes the main arguments developed in the paper.

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[1] It thus seeks to analyse only the factors leading foreign banks to enter the retail banking market in Brazil, and not the effects of this process. These are discussed by Carvalho (2002) and Paula (2002b).

II

Banking internationalization: the strategic rationale for expansion

Cross-border consolidation among financial institutions has accelerated over the last few years, and has recently reached the retail banking market. For the purposes of this section, what needs to be asked is why banks headquartered in particular countries set up branches or subsidiaries in foreign countries.

Generally speaking, the literature of the 1970s and 1980s (Grubel, 1977; Aliber, 1984) built up a theory of international banking that was heavily influenced by the theory of foreign direct investment in manufacturing, as advanced by Kindleberger (1969), Vernon (1966) and Caves (1971). According to this explanation, multinational banks have some comparative advantages. Banks go abroad to serve their domestic customers who have done likewise, a process sometimes termed the "gravitational pull effect". Multinational banking grows in parallel with foreign direct investment as banks try to meet the demand for banking services from multinational firms abroad. The willingness of banks to move abroad in these circumstances is seen as essentially defensive, a way of ensuring that they will continue to do business with the domestic parents of foreign subsidiaries, so that the existing flow of information resulting from the bank-client relationship will not be pre-empted by a competitor bank. Secondarily, multinational service banks also do some business with wealthy individuals locally, supplying them with the specialist services and information required for trade and capital market dealings with their home countries.

The motives leading banks to expand abroad can be interpreted in price-theoretic terms. According to Grubel (1977), "the continuous commercial contacts between the bank and manufacturing firm permit the bank to have access to information about the firm's financial conditions at such a low cost and high speed that it is in a better position than any other competitor to evaluate and respond to the firm's demand for loans". Thus, "the ability to draw on the information and personal contacts between the bank's and manufacturing firm's parents in a [foreign country] at very low marginal cost represents the main source of comparative advantage that the bank's foreign branch has in dealing with the firm's subsidiary abroad in competition with the local banks" (Grubel, 1977, pp. 352-353). According to this view, the internalization of information is the principal advantage enjoyed by the multinational bank. In this connection, Casson (1990, p. 18) states that "when technology draws a firm to a new location abroad, the bank which has serviced the expanding firm at its home location has an advantage over indigenous firms in serving the new foreign subsidiary. This advantage is goodwill derived from special knowledge of the customer's requirements and it is a monopolistic advantage which is not patentable and which can be transferred abroad. The internalisation of this advantage transforms the domestic bank into a multinational bank". This is indeed the case with the large United States banks that are involved in wholesale and business banking. The connection with other United States businesses and with the local customers of these businesses creates the opportunity to internalize information at a low cost.

Historically, as is stressed by Focarelli and Pozzolo (2000, p.1, my italics), "the pattern of bank international shareholdings followed that of economic integration between countries: banks extended their activities abroad in order to provide services to their home-country clients in international transactions; afterwards, with a growing understanding of the foreign market (in particular of regulatory and institutional aspects) and a developed network of relationships with local financial institutions, some banks were induced to increase the range of their operations and provide services to the local population too. Although this account is likely to be accurate in general (…) *today the actual pattern of bank international shareholdings depends on a wider range of factors than just the overall degree of economic integration between countries.*" In particular, Grubel's theory of internalization cannot be applied to the retail banking market, since the majority of the retail customers of foreign banks have no previous connection with the banks in their home countries.

In the recent wave of banking internationalization, financial institutions have not only continued to pursue their existing relationships, but also (and increasingly) global banks have been seeking to widen their activities in host-country financial markets, mainly by acquiring controlling majority stakes or non-controlling minority stakes. Thus, the present strategy of global universal banks is aimed at diversifying their activities into certain domestic financial markets by creating branch networks and integrating more deeply into the local market, whereas in the past multinational bank strategies were geared mainly towards serving their home-country (corporate) customers, while helping some local firms to access the international financial market. To a great extent, this new strategy has been stimulated by the gradual easing or even, in some cases, the abolition of legal restrictions on the presence of multinational banks in local markets, in both developed and developing countries (Freitas, 1999).

Few recent works have sought an expansionary pattern behind the recent wave of banking internationalization.[2] One of the most common explanations points to the increase in banking competition caused by financial deregulation. As margins and fees tighten in the domestic financial services area, financial firms expand overseas in search of higher returns. Thus, with banks' net interest margins under downward pressure owing to the increase of banking competition, and with the big financial institutions usually based in mature economies with low growth potential, some banks are seeking to diversify their activities geographically into markets with growth potential and/or higher net interest margins. Generally speaking, internationalization is a way for banks to enhance their ability to generate profits as the minimum scale required to remain competitive continues to increase. Another explanation is that there are potential risk-reduction gains from the diversification of income that results from a multiplicity of products, client groups and geographies in multi-activity financial services organizations, and these gains increase with the number of activities undertaken.

Overall, the empirical evidence in the literature (Demirgüç-Kunt and Huizinga, 1998; Claessens, Demirgüç-Kunt and Huizinga, 1998) suggests that foreign financial institutions are actually less efficient than domestic institutions, except in developed countries. To analyse this claim, Berger and others (2000) considered two hypotheses:

i) *Home field advantage hypothesis*. According to this hypothesis, domestic institutions are generally more efficient than institutions from foreign nations. Their advantages derive in part from organizational diseconomies in operating or monitoring an institution from a distance, examples of which include turf battles between staff in different nations (affecting operations) and possible difficulties in evaluating the behaviour and effort of managers in a distant market (affecting monitoring efforts). Besides these, other barriers include differences in language, culture, currency and regulatory or supervisory structures, and explicit or implicit barriers against foreign institutions;

ii) *Global advantage hypothesis*. According to this hypothesis, some efficiently managed foreign institutions are able to overcome cross-border disadvantages and operate more efficiently than domestic institutions in other nations, as they attain greater efficiency by spreading their superior management skills or best-practice policies and procedures over more resources, lowering operating costs, or achieving risk diversification that allows them to undertake higher expected return investments.

Testing these hypotheses in five countries (France, Germany, Spain, the United Kingdom and the United States) during the 1990s, Berger and others (2000) found evidence for a limited form of global advantage, according to which only efficient institutions in one or a small number of nations with specific favourable market or regulatory/supervisory conditions in their home countries could operate more efficiently than domestic institutions in other nations. This finding suggests that some banking organizations can operate in foreign countries at or above the efficiency levels of domestic banks, paving the way for some additional global consolidation. A study carried out by Focarelli and Pozzolo (2000) shows in the same connection that banks with cross-border shareholdings are larger and have headquarters in countries with more developed and efficient markets. Banks operating in countries where the banking sector is larger and more profitable should be able to export their superior skills and are therefore more likely to expand their activities abroad. Local market opportunities –a higher expected rate of economic growth, more stable economic conditions and banking inefficiency in the destination country– are the main factors behind decisions by banks to expand abroad. Banks prefer to invest in countries that promise larger profits because economic growth is expected to be higher and there is scope for improving

[2] There are a few exceptions. See, for instance, Berger and others (2000) and Focarelli and Pozzolo (2000).

on the performance of inefficient local banks. Profit opportunities in host markets have become a key factor in determining the pattern of foreign bank shareholdings, which may take varied forms: full acquisition, targeted purchases of specific activities, joint ventures or alliances with local banks.

III
Factors leading foreign banks to invest in Latin America and Brazil

As the previous section shows, there are strong empirical and analytical reasons to believe that the process of consolidation in the banking industry is an international phenomenon, driven by financial deregulation and technological change. The new phase of banking internationalization is a consequence of this process, with financial institutions seeking to diversify their activities –in terms of products and services and/or geographical location– and increase their minimum scale of operations to remain competitive and enhance their ability to generate profits.

Banking crises, deregulation and the globalization of financial services led to a significant increase in the presence of foreign banks in emerging economies in the second half of the 1990s.[3] Banking consolidation in these economies has accelerated recently, transforming what was traditionally a highly protected industry. In this connection, Hawkins and Mihaljek (2001, p. 3) state that "global market and technology developments, macroeconomic pressures and banking crises in the 1990s have forced the banking industry and the regulators to change the old way of doing business, and to deregulate the banking industry at the national level and open up financial markets to foreign competition. (…) These changes have significantly increased competitive pressures on banks in the emerging economies and have led to deep changes in the structure of the banking industry."

The banking sector in Latin America (including Brazil) was one of the largest recipients of foreign direct investment (FDI) during the 1990s. However, the wave of bank FDI cannot be understood in isolation from the general influx of FDI into Latin America during the 1990s. The Latin America and Caribbean region received record levels of FDI in that decade, with inflows totalling US$ 76.7 billion in 1998 alone, or around 41% of all FDI flows to developing countries. Again, 42% of these inflows went to a single destination, Brazil, the largest country in the region and, since 1996, the leading Latin American FDI recipient and the second-largest destination for FDI among developing countries (ECLAC, 2000, pp. 35-6).

Some of the main factors behind the expansion of European banks in Latin America can be summarized as follows:

- *The banking sector restructuring process resulting from European economic and monetary union (EMU)*. For some European banks, expanding abroad is not only a source of earnings diversification, but also a way of strengthening their position in the European banking market given the increasingly competitive conditions facing banks in the European Economic Area. The European banks' strategy for Latin America may be interpreted as a response to this more competitive environment, in which several factors had been eroding income from traditional banking business (Paula, 2002, chapter 2). Further, political and regulatory constraints mean that there are some impediments to mergers and acquisitions in EU countries but incentives to such activity outside the bloc.[4] The preference for Latin America, and to a

[3] In Central Europe, according to Hawkins and Mihaljek (2001, p. 24), foreign banks now account for two thirds or more of both assets and capital, making these countries' banking systems among the most open in the world, while in Latin America the market share of foreign banks rose from an average of 7% at the beginning of the 1990s to 40% in 2000.

[4] One of these incentives is the absence of a single regulatory agency in the European Union (EU). This has limited the benefits of expanding areas of activity across borders and, at the same time, prevented European banks from diversifying earnings and reducing regulatory capital as has happened in the United States. Although the Single Market Act and the various European Commission financial directives should have created some uniformity, difficulties

lesser degree Central and Eastern Europe, is partly due to the fact that South-East Asia was in crisis during the second half of the 1990s, while the Indian and Chinese financial systems remained closed to foreign banks, leaving Argentina, Brazil and Mexico as the main big emerging markets open to FDI in the banking sector.

- *In particular, the dynamics of internationalization among Spanish banks*, since these have been the main players in the recent wave of foreign bank investment in Latin America. These banks pursued growth strategies based on mergers and acquisitions in their natural market before they launched their international growth strategy.[5] Thus, they were already "mature" banks when they decided to expand overseas. Indeed, with the implementation of EMU and the prospect of euro introduction, the larger Spanish banks –in particular, Banco Bilbao Vizcaya (BBV), Banco Santander and Banco Central Hispano (BCH)– had to look beyond their natural borders in search of global markets, in order to maintain their competitive position and defend themselves against the threat of hostile bids by either local or foreign competitors. In the initial stages of this process there was a proliferation of alliances and cooperation agreements with other financial institutions, chiefly within the European Union, while the second phase has involved a fast-paced, aggressive expansion strategy aimed at the main Latin American markets (ECLAC, 2000, p. 159). During the 1990s, Dutch and German banks were busy expanding into Central and Eastern Europe, while American banks were occupied with mergers and acquisitions in their own domestic market, leaving Latin America –cultural linkages also played their part– as the natural market for the Spanish banks.
- *The deregulation process that began in Latin America in the early 1990s, in the broader context of economic and political reform*, made it possible for foreign companies to enter key economic sectors such as banking, telecommunications and utilities. Bank privatization programmes generally formed part of longer-term public-sector reforms, which also involved privatization of major public enterprises with the aim of consolidating the public finances and cutting borrowing requirements (Hawkins and Mihaljek, 2001, p. 13). Another important motive was to deepen the role of the market.
- *The valuations of Latin American companies, including banks, are much lower than those of European companies*, making it easier to attain a large market share at a lower cost. According to Sebastian and Hernansanz (2000, p. 19), a 1% share of the German deposit market would have cost US$ 2,285 million in 1999, if attained by purchasing shares in the major listed banks (i.e., Deutsche Bank, Bayerische Hypo und Vereinsbank, Dresdner Bank, Commerzbank and Bankgesellschaft Berlin). The same share could have been obtained for an outlay of US$ 196 million in Argentina and US$ 205 million in Mexico.
- *The Latin American banking market has much greater growth potential than Europe's mature banking market*. The size of the financial system in terms of the ratio of M3 to gross domestic product (GDP) is only 28% in Latin America, while in the euro area it is 77% and in the United States 71% (Sebastian and Hernansanz, 2000, p. 18).
- *The Latin American banking sector offers financial institutions much better prospects for raising returns*, since the intermediation margins with which banks operate in these countries are considerably higher than in the developed world. While domestic banks' average margin on assets (net interest income over total assets) in Latin America was 5.76% for the period 1988-1995 (in Brazil it was 6.6% and in Argentina 9.9%), in the OECD countries it was 2.8% over the same period (Claessens, Demirgüç-Kunt and Huizinga, 1998, p.26). Again, Latin American banks steadily improved their already high profitability during the 1990s, although net interest revenue was stable. Their profitability is high compared both to the G3 countries (Germany, Japan and the United States) and other emerging countries (table 1).

have arisen and hampered cross-border operations. There are multiple supervisory agencies in European countries and no coordinating agency or single bank regulatory body for the entire euro area. As a result, mergers and acquisitions remain largely confined within national borders. See Kregel (2002) for further details.

[5] The expansion of Spanish banks into Latin America must also be seen in a broader context, with the major Spanish service firms (transport, telecommunications, energy and financial services) deciding to expand abroad after a period of structural change in the Spanish economy that was driven partly by the privatization of State firms. Since 1994, Latin America has been the prime investment destination in the international strategy of these firms, with total investments from Spain jumping from US$ 4.5 billion in 1990 to over US$ 18.5 billion in 1998 (ECLAC, 2000, p. 133).

TABLE 1

Selected regions and countries: Banking sector performance
(*As percentage of total assets*)

	East Asia[a]			Latin America[b]			Central Europe[c]			G3[d]		
	1992-1997	1998	1999	1992-1997	1998	1999	1992-1997	1998	1999	1992-1997	1998	1999
Net interest revenue	2.6	1.8	2.2	5.2	5.3	5.4	3.1	2.8	2.5	2.0	1.8	2.0
Other income	0.7	1.2	0.8	2.3	2.0	1.8	2.3	2.1	2.0	0.7	0.8	1.0
Operating costs	1.6	2.4	2.3	5.5	5.5	5.7	4.1	3.5	3.1	1.7	1.6	1.8
Loan losses	0.6	6.3	1.8	1.2	1.1	1.7	0.6	0.6	0.4	0.2	0.4	0.3
Pre-tax profits	0.8	-5.5	-0.7	1.4	1.3	2.4	0.5	0.7	1.0	0.7	0.6	0.8

Source: Hawkins and Mihaljek (2001, p. 6).

[a] Simple average of Indonesia, Malaysia, the Philippines, the Republic of Korea and Thailand.
[b] Simple average of Argentina, Brazil, Chile, Colombia, Mexico and Peru.
[c] Simple average of the Czech Republic, Hungary and Poland.
[d] Simple average of Germany, Japan and United States.

- *There is great potential for efficiency gains in Latin America*, since banking efficiency is generally lower than in developed countries. Domestic banks' ratio of operating costs to assets in Latin America averaged 5.5% in 1992-1997, as against 1.7% in the G3 countries, 1.6% in East Asia and 4.1% in Central Europe in the same period (table 1). The high operating costs (and high interest rate spreads) of domestic banks in Latin America are in large part the legacy of the high-inflation period of the 1980s and the early 1990s, when inflationary revenues generated easy profits for the banks and, consequently, there was little pressure to cut costs.

The previous section stressed that local market opportunities (higher expected rates of economic growth, more stable economic conditions and banking inefficiency in the host country) are the main factor leading banks to expand abroad. Accordingly, the main domestic factors behind the recent influx of foreign banks into Brazil were the more stable economic conditions deriving from price stabilization since 1994 (which changed the long-term business landscape in Brazil), higher expected rates of economic growth, and the growth potential of the banking market. Besides, since the early 1990s the Brazilian economy has been undergoing a wide-ranging liberalization process that has opened up previously restricted activities to foreign investors. Thus, investment by foreign banks in the country has followed a gradual easing of legal restrictions on the presence of foreign companies in the Brazilian banking sector. Article 52 of the temporary provisions act of the 1988 Constitution prohibits foreign financial institutions already established in the country from setting up new agencies or increasing their stakes in local financial institutions, until such time as a complementary law is enacted. However, this Constitution leaves open the possibility of foreign institutions having access to the domestic market, since article 52 also establishes that such restrictions do not apply to authorizations deriving from international agreements, reciprocity or decisions made in the interests of the Brazilian Government (Puga, 1999).

A particularly important change occurred in 1995, when a banking crisis was triggered by the tighter monetary policy and rising interest rates resulting from the 1994-1995 Mexican crisis. According to Carvalho (2000, p. 148), "the banking crisis of 1995 opened a window of opportunity for foreign banks to set foot in the country. The crisis devalued the existing banks, putting a larger number of them under the control of the central bank, without compromising, it seemed, long-term possibilities for the industry. In a report dated December 1998, the Central Bank of Brazil identified 104 financial institutions as going through some kind of 'adjustment' between the launching of the Real Plan and that date".

The recent process of banking consolidation in Brazil is in some ways similar to the Mexican experience, in the sense that in both countries the authorities responded to the banking crisis with an array of support programmes for financial institutions and their borrowers. These programmes were intended to bolster the health of the financial sector while at the same time opening it up to foreign banks, in the hope that the presence of the latter would help strengthen the banking sector.[6] The entry of foreign banks was also used as a policy to weaken the effect of local monopolies that had been established under the previous regulatory structure.

In this context, the Brazilian government allowed some foreign banks to enter the country to take over certain problem banks, such as Excel-Econômico and Bamerindus, and also to strengthen the domestic banking sector. Legislative Intent ("Exposição de Motivos") no. 311 of 23 August 1995 allowed the President to authorize the entrance of foreign banks into Brazil on a case-by-case basis. On that occasion, the Brazilian Government announced that foreign banks would not be allowed to open new branches or acquire smaller banks unless they purchased one of the troubled banks. The norm pronounces that the entrance of foreign banks is in the country's interests, and emphasizes the following favourable aspects:

- Improvements in the operational efficiency of the banking sector, with positive effects on bank intermediation.
- Increased banking competition, which would lead to lower spreads and banking fees, with positive effects on lending interest rates.
- Diversification and improvement of the supply of financial services, with lower costs.
- Introduction of new management technologies and innovations in products and services.

Thus, with greater flexibility in the regulatory framework governing the entry of foreign banks, the Brazilian Government let in a large number of these, in line with the international tendency towards the expansion of financial conglomerates seeking new markets for their businesses. Another factor that attracted foreign banks to Brazil was the privatization programme for State-owned banks. The programme of incentives for the restructuring of the State public financial system (PROES) was established in August 1996 by temporary measure 1,514. It forms part of a comprehensive process of State fiscal adjustment and debt restructuring. Under PROES arrangements, the federal Government finances the restructuring of State banks (Maia, 2000).

Taken together, the changes in the regulatory framework for foreign banks, the privatization programme for State-owned banks, price stabilization since 1994, the growing potential of the Brazilian retail banking market, the (still nascent) development of pension funds and a securities market in Brazil and the increasing integration of the Brazilian economy into trade and financial flows have all had the effect of attracting foreign capital into the Brazilian banking sector.

IV

The recent wave of European bank investment in Brazil

The recent wave of mergers and acquisitions (M&As) in the Brazilian banking sector began with takeovers of failing banks by solvent ones, typified by the acquisition of Nacional by Unibanco, Econômico by Excel, and Bamerindus by HSBC. Furthermore, bank takeovers increasingly involved a strong bidder and sometimes a weak but not yet insolvent target, examples being the acquisition of Banco de Crédito Nacional (BCN) by Banco Brasileiro de Desconto (Bradesco), Noroeste by Santander and Real by ABN Amro.

The M&A wave in Brazil involved different movements. Four large domestic private-sector banks (Bamerindus, Econômico, Real and Noroeste) were acquired by foreign institutions (HSBC, BBVA, ABN Amro and BSCH, respectively). Conversely, some foreign banks sold their local operations to domestic banks: BNP Paribas sold Banco Francês e Brasileiro to Itau

[6] See Dages, Goldberg and Kinney (2000) for an analysis of recent foreign bank penetration in Mexico and Argentina. According to a report on Brazilian banks (*Gazeta Mercantil*, 1999), in November 1995 the Brazilian federal Government launched a programme called PROER to finance the absorption of problem banks by healthy ones. Financing was provided under this scheme for the acquisition of seven banks: Nacional, taken over by Unibanco (a Brazilian bank); Econômico by Excel (Brazilian); Mercantil de Pernambuco by Banco Rural (Brazilian); Banco Antonio de Queiroz by Banco United (Brazilian); Banorte by Bandeirantes (Brazilian); Banco Martinelli by Pontual (Brazilian); and Bamerindus by HSBC (British).

TABLE 2

Brazil: Main mergers and acquisitions in the banking sector, 1995-2002

Year	Acquirer	Acquirer's country of origin	Institution acquired
2002	Bradesco	Brazil	Mercantil de São Paulo
	Bradesco	Brazil	Banco Ford
2001	Itau	Brazil	Banco do Estado de Goiás (BEG)
2000	BSCH	Spain	Banespa
	Itau	Brazil	Banestado
	Bradesco	Brazil	Boavista
	Unibanco	Brazil	Bandeirantes/Credibanco
	BSCH	Spain	Meridional/Bozano, Simonsen
1999	Bradesco	Brazil	Banco do Estado da Bahia (Baneb)
	Bradesco/BCN	Brazil	Pontual
1998	ABN Amro	Netherlands	Banco Real
	ABN Amro	Netherlands	Banco do Estado de Pernambuco
	Itau	Brazil	Bemge
	Unibanco	Brazil	Dibens
	Sudameris (Intesa/Crédit Agricole)	Italy/France/Brazil	America do Sul
	Chase Manhattan	United States	Patrimonio
	Bradesco	Brazil	Pontual
	CSFB	Switzerland	Banco Garantia
	BBVA	Spain	Excel-Econômico
	Caixa Geral de Depositos	Portugal	Bandeirantes
1997	Santander	Spain	Banco Noroeste
	Banco Interatlantico	Portugal/France	Boavista
	Santander	Spain	Banco Geral de Comercio
	Itau	Brazil	Banerj
	Bradesco	Brazil	BCN/Credireal
	HSBC	United Kingdom	Bamerindus
	Bozano, Simonsen	Brazil	Meridional
	Robert Fleming	United Kingdom	Graphus
	NationsBank	United States	Liberal
	American Express	United States	SRL
	Banco de Crédito Nacional (BCN)	Brazil	Credireal
	Lloyds	United Kingdom	Multiplic/Losango
	Unibanco	Brazil	Fininvest (50%)
	Icatu	Brazil	Fininvest (50%)
1996	Banco de Crédito Nacional	Brazil	Itamarati
	Banque National de Paris	France	Banco Comercial de São Paulo
	BBA Creditanstalt	Brazil/Austria	Financiadora Mappin
	Itau	Brazil	Banco Francês e Brasileiro
	Itamarati	Brazil	Crefisul
	Excel	Brazil	Econômico
1995	Unibanco	Brazil	Nacional
	Pontual	Brazil	Digibanco

Source: Prepared by the author with information from Chase Manhattan Bank (2000) and the Central Bank of Brazil.

and Caixa Geral de Depositos sold Banco Bandeirantes to Unibanco, while Crédit Agricole and Espirito Santo sold Boavista to Bradesco. One big state bank, Banco do Estado de São Paulo (Banespa), was acquired by BSCH, while several medium-sized state banks were purchased by the country's two largest private-sector banks, with Bradesco buying Credireal and Itau buying Banco do Estado de Rio de Janeiro (Banerj), Banco do Estado de Minas Gerais (Bemge), Banco do Estado de Goiás (BEG) and Banestado.

Table 2 lists M&As in the Brazilian banking sector during the period 1995-2000. It shows that:

i) Foreign banks (overwhelmingly European) were the dominant force in major acquisitions until 2000, followed closely by the large domestic private-sector banks. By contrast with neighbouring Argentina, where foreign bank acquisitions included two of the three largest private-sector banks, foreign acquisitions in Brazil mainly involved medium-sized banks. This partly reflects the prohibitively high market capitalization of the very largest banks.

ii) The principal foreign acquisitions, in terms of size, were the purchase of Bamerindus by HSBC (which was paradigmatic since it involved a big domestic retail bank for the first time), Excel/Econômico by BBVA, America do Sul by Sudameris, Banco Noroeste by Santander, Banco Real by ABN Amro and Banespa by BSCH. This last acquisition was the largest of recent years in Brazil, since it involved the purchase of a bank with assets worth around US$ 15 billion and made Banco Santander do Brasil the third largest private-sector bank in Brazil and the fifth largest overall, including State-owned banks. Banespa has a strong retail network, mainly in the state of São Paulo, the country's richest, but it also has high overheads. Its acquisition was something of a turning point in the history of BSCH in Brazil, since prior to the Banespa acquisition in November 2000 Santander do Brasil's relatively modest investments in Meridional and the prestigious investment bank Bozano, Simonsen left the group still locked out of the market elite, as it ranked only seventh in the banking industry.[7]

iii) The big American banks already established in Brazil –Citibank and BankBoston– did not participate in the M&A wave but opted to grow organically in the Brazilian banking market, where they have traditionally focused on a smaller and more select clientele.[8] The recent strategy of these banks in Brazil has been to increase their customer base, bringing in segments of the middle class and medium-sized firms. BankBoston has sought to operate in a more select segment of the retail market, with clients being required to have a monthly income of over 4,000 reais, while Citibank has sought to extend its customer base to lower segments of the middle class (those with monthly incomes of over 1,000 reais) and firms with annual revenues of over 5 million reais. The inactivity of United States banks in the recent M&A wave in Brazil can be partly explained by the good returns they have obtained by supplying new products in their own domestic market, where they have been able to expand geographically thanks to deregulation of the financial system. Diversification abroad, and specifically in Latin America, thus came to play only a secondary role in the overall strategy of American banks, with the possible exception of Mexico, which has strong linkages with the American economy via the North American Free Trade Agreement (NAFTA) and where Citibank recently bought Grupo Financiero Banamex-Accival (Banacci) and became the leader in the Mexican banking sector.

iv) The three largest domestic private-sector banks –Bradesco, Itau and Unibanco– have reacted to the penetration of foreign banks by participating actively in the M&A process with some important purchases, such as that of Nacional and Bandeirantes by Unibanco, BCN/Credireal and Mercantil de São Paulo by Bradesco, and Banerj and Bemge by Itau. Itau in particular has been a major acquirer of state banks, such as Banestado (Paraná), Banerj (Rio de Janeiro), Bemge (Minas Gerais) and BEG (Goiás). The reaction of Unibanco and Itau –both smaller than Bradesco, the largest private-sector bank– was partly defensive, as they used acquisitions/mergers to maintain their market share and leadership in the banking market and avoid being taken over themselves.[9] It is worth noting that Bradesco and Itau have been more aggressive in their acquisitions since end-2001, taking advantage of the interruption of foreign banking sector investment in Latin America due to the Argentine crisis. Bradesco has purchased part of Banco Ford (leasing and consumer credit) for 1 billion reais and Mercantil de São Paulo, a medium-sized bank with strong roots in São Paulo state, for 1.4 billion reais, while Itau has acquired BEG for 665 million reais. The acquisition of Mercantil de São Paulo by Bradesco was particularly important since the latter was one of the country's top 20 private-sector banks.

The growing presence of foreign banks in Brazil is confirmed by the available data. In terms of market share, banks controlled by foreign financial groups raised their share of total banking sector assets almost fourfold in just six years, from 7.2% in 1994 and 12.8% in 1997 to 27.4% in 2000, while the participation of all other segments,[10] especially State-owned banks,

[7] The Meridional group (Banco Meridional and Bozano, Simonsen) was bought by BSCH for close to US$ 1 billion, while Banespa was bought for US$ 3.7 billion, a sum five times higher than its book value.

[8] Recent acquisitions of local banks or branches in Latin America by BankBoston and, particularly, Citibank suggest that these banks' strategies may be changing.

[9] See Paula (2002b) for more information on the reaction of domestic private-sector banks in Brazil.

[10] With the exception of credit cooperatives, whose market share is negligible.

TABLE 3

Brazil: Share of total banking sector assets controlled by different financial institutions, 1993-2000
(*Percentages*)

Institution	1993	1994	1995	1996	1997	1998	1999	2000
Foreign-controlled banks	8.35	7.16	8.39	9.79	12.82	18.38	23.19	27.4
Private-sector domestic banks	40.67	41.21	39.16	39	36.76	35.29	33.11	35.2
Public-sector banks								
(+Caixa estadual)[a]	13.41	18.17	21.9	21.92	19.06	11.37	10.23	5.6
Caixa Econômica Federal	14.51	14.98	16.4	16.47	16.57	17.02	17.06	15.4
Banco do Brasil	22.93	18.28	13.91	12.52	14.42	17.44	15.7	15.6
Credit cooperatives	0.13	0.2	0.24	0.3	0.37	0.5	0.7	0.8
Banking sector	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Central Bank of Brazil (2002).

[a] Excluding the two big federal banks, Caixa Econômica Federal and Banco do Brasil.

declined (table 3). The rise of foreign banks in Brazil was mainly at the expense of domestic private-sector banks and, to a lesser extent, state and federally-owned banks.[11] Although the relative share of the public-sector (state and federal) banks segment –including that of the two "giants", Caixa Econômica Federal and Banco do Brasil– has tended to decline, as of end-2000 they still led the market with 36.6% of total assets, followed closely by the domestic private-sector banks (35.2%). For their part, the major domestic private-sector banks have increased their market share in the banking sector through M&As involving state and private-sector banks and, to some extent, through organic growth. Consequently, the banking sector market share (as a proportion of total public- and private-sector bank assets) of the top four domestic private-sector banks – Bradesco, Itau, Unibanco and Safra– increased from 23.7% in 1999 to 27.6% in 2000, a significant increase of 3.9 percentage points in just one year (table 4). The market share of these banks doubtless increased further after the recent acquisitions by Itau and Bradesco.

Furthermore, the major Brazilian domestic banks are regional leaders in Latin America, something that reflects both the size of the country's economy and the dynamism that enabled Brazilian banks to survive and even expand during the period of high inflation. In 1999, eight of the 15 largest domestic banks in Latin America were Brazilian (table 5), including the top four (two public-sector banks and two private-sector banks). Table 4 also shows that seven of the 12 largest private-sector banks in Brazil are owned by foreign institutions, including five top European banks, namely HSBC, ABN Amro, Santander (BSCH), Sudameris and BBV Banco (BBVA), and two American banks, Citibank and BankBoston, part of Citicorp and FleetBoston groups, respectively. By end-2000, the top 12 private-sector banks accounted for around 40% of total banking assets (including federal and state banks) and 78.3% of total private-sector banking assets. In December 2000, the five big domestic private-sector banks (Bradesco, Itau, Unibanco, Safra and BBA) had 28.8% of total assets between them, while the seven big foreign banks had 21.1%. Domestic private-sector banks are still hegemonic in Brazil, therefore, although the relative share of foreign banks has increased a great deal in recent years. If the large Latin American countries are compared, it transpires that the market share of foreign banks is much smaller in Brazil than in Argentina and Mexico.[12]

[11] The term "state banks" is used in this section to refer to banks whose main owners are the governments of Brazilian states, while "federal banks" are those whose main owner is the federal government.

[12] According to Correa (2002, p. 11), the percentage share of total banking sector assets held by foreign banks was 48.6% in Argentina (1999) and 80% in Mexico (2001), while in Brazil, according to our data (see table 3), the 2000 figure was 27.4%.

TABLE 4

Brazil: Share of total banking sector assets controlled by the top 20 banking conglomerates, 1999-2000[a]

(*Millions of reais and percentages of total banking sector assets*)

Banking conglomerate	Ownership[b]	Millions of reais (2000)	% of total assets (2000)	% of total assets (1999)
Banco do Brasil	FE	128 486	15.99	17.78
CEF	FE	126 080	15.69	17.01
Bradesco+BCN+Credireal+Baneb+Boavista	DP	87 503	10.89	10.10
Itau+Bemge+Banestado+Banerj	DP	67 757	8.43	6.74
Santander+Banespa	FO	53 103	6.61	2.95
Unibanco+Bandeirantes+Credibanco+Dibens	DP	43 605	5.43	4.41
ABN Amro Real+Bandepe	FO	29 809	3.71	3.31
Safra	DP	22 632	2.82	2.45
BankBoston	FO	22 425	2.79	2.60
HSBC	FO	20 942	2.61	2.55
Citibank	FO	20 184	2.51	1.94
Nossa Caixa	ST	18 475	2.30	2.15
Sudameris+América do Sul	FO	15 332	1.91	1.95
BBA Creditanstalt	DP	10 451	1.30	1.26
BBV	FO	8 122	1.01	0.96
Banrisul	ST	7 723	0.96	0.88
Votorantim	DP	7 483	0.93	…
Mercantil de São Paulo	DP	6 935	0.86	0.77
Lloyds TSB	FO	6 917	0.86	…
Chase Manhattan	FO	5 329	0.66	…

Source: Prepared by the author with data from the Central Bank of Brazil.

[a] The table includes only deposit-taking institutions in Brazil (commercial banks, multiple banks and *caixas*).
[b] FE: federal bank; DP: domestic private-sector bank (more than 50% of shares in domestic hands); FO: foreign bank; ST: State-owned bank.

TABLE 5

Latin America: Top 15 banks, 1999[a]

Ranking	Bank	Country	Total assets *(millions of dollars)*
1	Banco do Brasil	Brazil	70 684
2	Caixa Econômica Federal	Brazil	68 441
3	Banco Bradesco[b]	Brazil	60 199
4	Banco Itau[c]	Brazil	33 241
5	Banco Nacional de México (Banamex)	Mexico	32 498
6	Bancomer	Mexico	27 497
7	Unibanco	Brazil	20 121
8	Banca Serfin	Mexico	19 055
9	Banco de la Nación Argentina	Argentina	17 751
10	Banespa	Brazil	15 617
11	Banco Internacional (Bital)	Mexico	13 248
12	Banco de Galicia	Argentina	12 519
13	Banco Safra	Brazil	10 077
14	Banco del Estado de Chile	Chile	9 400
15	Nossa Caixa - Nosso Banco	Brazil	8 635

Source: *Euromoney*, 2000.

[a] Total assets criterion.
[b] Including Credireal, BCN and Baneb.
[c] Including Bemge, BFB and Banerj.

V

The expansion strategies of the major european banks: BSCH, BBVA, HSBC and ABN Amro

As we saw in section III, Grubel's theory of internalization does not apply to the recent wave of multinational bank expansion into the retail banking markets of emerging countries. This is certainly the case with the European banks –BSCH, BBVA, HSBC and ABN Amro– that expanded into Brazil during the 1990s by buying local retail banks, since most of their customers are Brazilian, i.e., do not have any previous connection with the parent firms in the home countries of these banking groups.

According to Focarelli and Pozzolo (2000), banks operating in countries with larger, more profitable banking sectors should be able to export their superior skills and should thus be more likely to expand their activities abroad. Indeed, all the biggest European banks in Latin America –BSCH, BBVA, HSBC and ABN Amro– have recently increased market share in their home countries through mergers and acquisitions, attaining leading (or at least important) positions in these markets.[13] Expanding abroad is not only a source of earnings diversification for these banks, but also a way to strengthen their position in the European banking market under the competitive pressure of economic and monetary union.

There are some common and some distinctive features in the strategies of the biggest European banks in Latin America. One obvious common feature is that all of the top four are big universal banks that chose to invest abroad as a business expansion strategy. In 1997, overseas income represented more than 35% of these banks' total revenues (Nellis, McCaffery and Hutchinson, 2000, p. 57), and this relative share has increased in the case of the Spanish banks, owing to their recent acquisitions in Latin America.

All these financial groups are seeking to expand their activities in Europe, examples being HSBC in France[14] and ABN Amro in Italy. They also have a presence in other Latin American countries, but it is an uneven one, as table 6 shows. The total assets of the 20 largest foreign banks in the region are largely accounted for by just three banks, BSCH, Citibank and BBVA, which owned 44.8% of all foreign bank assets in Latin America in 1998 (ECLAC, 2000, p. 61). Interestingly, these are among the few banks in the world to have achieved leading positions outside their natural markets. They have increased their market share further since 1998 with the acquisition of some large local banks, examples being the takeovers of Bancomer by BBVA (June 2000), Serfin (May 2000) and Banespa (November 2000) by BSCH, and Banacci (May 2001) by Citigroup.[15] Furthermore, they are the only banks with an extensive network of branches in the region's six largest countries. Although ABN Amro has investments in various Latin American countries, it is only in Brazil that it has a relatively important presence, particularly since it purchased Banco Real in 1998. HSBC assets are concentrated in the three main countries of Latin America: Mexico, Brazil and Argentina.

Table 6 also shows that Citibank (part of Citigroup) became the second biggest foreign bank in Latin

[13] To mention only the more recent and important M&As involving these banks, HSBC bought Midland in 1992, lifting the group's total assets from £86 billion in 1991 to over £170 billion in 1992 and creating one of the largest financial organizations of its kind in the world; ABN merged with Amro in 1991 and took the lead in the banking market of the Netherlands; Santander merged with Banco Central Hispano (itself the product of a merger between Banco Central and Hispano) in 1999, becoming the largest Spanish financial group; subsequently, BBV (the product of a merger between Bilbao and Vizcaya) merged with Argentaria, forming the second largest Spanish financial group. Thus, the Spanish banking sector became one of the most highly concentrated in Europe, forming a sort of duopoly as the market share of the two largest institutions grew from 33% in 1987 to 50% in 1996 (ECLAC, 2000, p.158). This proportion has recently grown even further.

[14] According to HSBC's *Annual Review* (HSBC, 2000, p. 3), acquisition of the French bank Crédit Commercial de France (CCF) "was a major step forward for our wealth management strategy and gives us a substantial platform in the euro zone". Indeed, with 692 branches, CCF is one of the largest banks in France.

[15] In 2000-2001, Mexico saw a sweeping reorganization of foreign banking operations that sharply altered its financial system, with BSCH acquiring Grupo Serfin for US$ 1.56 billion, BBVA putting up US$ 1.85 billion to merge its Mexican operations with Grupo Bancomer, and Citibank acquiring Grupo Banacci, Mexico's leading financial institution, in a transaction totalling US$ 12.5 billion.

TABLE 6

Latin America: Largest foreign banks by assets, September 2000
(Millions of dollars)

Bank	Origin	Argentina	Brazil	Mexico	Chile	Colombia	Venezuela	Total	%
BSCH[a]	Spain	26 130	28 682	20 100	30 200	1 376	2 556	109 044	33.99
Citibank[b]	United States	10 429	8 798	42 590	6 350	1 137	686	69 990	21.81
BBVA	Spain	9 174	5 004	37 300	4 900	2 811	3 700	62 889	19.60
BankBoston	United States	11 350	9 315	358	6 800	108		27 931	8.71
HSBC	United Kingdom	5 016	9 126	15 202				29 344	9.15
ABN Amro	Netherlands	2 801	15 581	154	2 900	110	95	21 641	6.75
Total		*64 900*	*76 506*	*115 704*	*51 150*	*5 542*	*7 037*	*320 839*	*100.00*

Source: Prepared by the author with data from Sebastian and Hernansanz (2000, p.37), Banco Santander (2002) and *Gazeta Mercantil* (2001).

[a] Including Banespa, with data from September 2000.
[b] Including Banacci, with data from December 2000.

America after purchasing Mexico's leading financial institution, Banacci. Although Citibank has been present in all the major Latin American countries for a long time, only in Mexico does it have market leadership. Historically, only Citibank and, more recently, HSBC have pursued a global retail banking strategy by establishing a presence in different countries and continents, although they have tended to focus on credit card and banking services for an urban professional class without attempting, at least until Citibank's recent acquisition of Banacci group, to enter the mass retail market as the Spanish banks have been doing. Their businesses in Latin America thus have a quite different focus from those of the Spanish banks, as Guillén and Tschoegl (1999, p.10) emphasize: "The Spaniards are competing in the lower and middle-income (LMI) markets where they come into competition with the largest domestic banks. The only foreign bank that had previously made forays into Latin America comparable in its geographic scope was Citibank. By contrast to the Spanish banks, Citibank traditionally focused on the upper-income market, frequently referred to as the A, B, and C1 segments."

The really big European investors in Latin America are the two large Spanish banks, BSCH and BBVA, which have recently developed an aggressive strategy of expansion in the region. Between them, they have more than US$ 170 billion of assets in Latin America, representing about 55.8% of the total assets of the top six foreign banks in the region (table 6). After purchasing Banco Serfin in Mexico and Banespa in Brazil, BSCH became the largest private-sector bank in the region, with assets of more than US$ 100 billion. It is also the leading foreign bank in Argentina, Brazil and Chile, while BBVA is the leader in Colombia and Venezuela and ranks second in Mexico. The difference between BSCH and BBVA in terms of total assets in Latin America is due mainly to Brazil, where BSCH recently bought Banespa while BBVA has only a small market share.

ABN Amro in the Netherlands and BSCH and BBVA in Spain achieved substantial growth in their domestic markets by pursuing M&A-based strategies aimed at attaining leadership positions at home. This policy allowed them to increase their competitiveness and reach the size necessary for them to expand abroad. After (or while) consolidating their position in their domestic markets they extended their operations in other countries, probably preparing themselves for an increase in European competition as a result of economic and monetary union. ABN Amro, BSCH and BBVA are large banks in highly concentrated small or medium-sized systems that are increasingly expanding their operations into other geographical markets, since domestic alternatives are limited.

Although the structural constraints were (and are) in some ways similar for all European banks, and these constraints were determinants in the international expansion of some financial groups, each group has its own distinct business philosophy and distinct internationalization strategy.

HSBC is one of the largest banking and financial services organizations in the world. Like Citigroup, HSBC Group is a global universal bank with around

9,500 offices in 79 countries and territories in Europe, the Asia-Pacific region, the Americas, the Middle East and Africa. The group moved its domicile from Hong Kong to London only recently, in 1992, after the Midland acquisition. HSBC is still strongly rooted in Asia, in spite of its worldwide presence. However, this has been changing over the last decade. Its strategy of "managing for value" emphasizes the group's balance of business and earnings between the older, mature markets and faster-growing emerging markets.[16] In 2000, the group made 48.2% of its profits in Asia, 39% in Europe, 9.6% in North America and 3.2% in Latin America (HSBC, 2000). The recent expansion into Latin America, like other investments in different regions, seems to have been motivated by the strategy of risk diversification through geographical diversification to make the bank less dependent upon Asia. It is interesting to note that HSBC itself significantly toned down its plans to challenge local market leaders, bombastically announced when it took over Bamerindus in Brazil. The original, aggressive talk from HSBC officials about occupying all market niches and reducing the price of bank services across the board has given way to the more cautious view that price wars would damage everyone (Carvalho, 2000, p. 160).

ABN Amro's two most important markets are outside the Netherlands. These are the United States Midwest and Brazil, but the group has a presence in a number of countries around the world. According to its 2000 annual report, North America contributed 44% of group profits outside the Netherlands, and Latin America and the Caribbean 24.1%. These data reveal the importance of North and Latin America for the group's earnings outside the Netherlands. In 2000, the ABN Amro board of directors decided that the bank would operate in the retail market only in the Netherlands, the United States and Brazil, the strategy being to end these operations in countries where the group was not large enough to compete. Accordingly, the Dutch bank sold its retail commercial banking units in nine countries, including Argentina, Ecuador, Morocco and Sri Lanka. Recently, it announced that it was going to sell its commercial banking subsidiaries in Chile (to BankBoston), Kenya (to Citigroup) and Venezuela (to Banco del Caribe) (*Gazeta Mercantil*, 2001, p. B2). ABN Amro has traditionally been a universal bank, combining commercial, corporate, private and investment banking. In Brazil, before the purchase of Banco Real, which was the Dutch group's largest acquisition to date and the largest ever in Brazil,[17] ABN Amro concentrated on private and corporate banking and to a lesser degree on retail banking, although its largest source of earnings was automobile financing. Thus, by purchasing Banco Real, a big retail bank, ABN Amro became a truly universal bank in Brazil, with different lines of business and the ability to compete with the large local retail banks. The operation allowed ABN Amro to consolidate its strategy of specializing in Latin American pension fund management and personal insurance, areas where Banco Real was strong. To counter competition from foreign banks locally, the bank is pursuing a fairly aggressive expansion strategy through organic growth, involving an extension of its branch network and acquisition of small, healthy banking franchises.

The Spanish banks BSCH and BBVA have the advantages of experience in dealing with instability owing to Spain's recent history, greater cultural affinities with Latin America, and some familiarity with the region, as most of the big Spanish banks have had offices, branches or small subsidiaries in Latin America since the 1970s or early 1980s. Both groups are mainly concentrated in Spain and in Latin America[18] where, together with Citicorp, Banco Santander, Banco Bilbao Vizcaya and Banco Central Hispano, they have been the largest foreign banks since 1995. Interestingly, while BSCH is the largest foreign bank in Brazil, with a 6.61% market share (total assets criterion) in 2000, BBVA has only a modest share of about 1% in Latin America's largest market. One possible explanation for the more cautious approach of BBVA since expanding overseas is that the group is consolidating its activities and seeking to cut costs and increase efficiency throughout the BBVA system, including Latin America.

The long-term approach of the Spanish banks meant that they continued to expand their presence in Latin America despite the financial turbulence of 1997-1999, in contrast with other foreign financial institutions

[16] The 1999 acquisition of Republic New York Corporation and Safra Republic Holdings reinforced HSBC's presence in some highly developed countries, namely the United States, Switzerland and Luxembourg.

[17] In July 1998, ABN Amro purchased a 40% stake in Banco Real for US$ 2.2 billion. Banco Real was the fourth biggest domestic private-sector bank in Brazil. It also acquired two state banks: Banco do Estado de Pernambuco (1998) and Paraiban (2002), both of which have a large presence in the north-east of Brazil.

[18] In 2000, BSCH obtained 34% of total net income from Latin America, which accounted for 37% of group assets (*The Banker*, 2001, p. 69), while in the same year BBVA had 32.6% of its assets in Latin America, according to its 2000 annual report.

that chose to pull out of the region. They have been very active in marketing new deposit products such as lottery-linked accounts, sometimes without waiting for them to be fully regulated, which testifies to their capacity for innovation. This has enabled them to respond more dynamically to the challenges of the Latin American banking market, bringing in banking skills that have served them primarily in the mass retail market of their home country. Latin America became an important strategic market for the Spanish banks as they sought to offset the decline of net interest income in Spain resulting from the lower interest rates that came with EMU convergence. To sustain and support a competitive position that would enable them to ward off hostile bids from competitors, they looked beyond their own borders for new markets (Calderón and Casilda, 2000, p. 76).

The two Spanish banks did not just focus on commercial banking but diversified into other financial activities that included investment banking, insurance and, in particular, pension fund management, so that by 1999 they controlled between them 45% of the private pension fund market in Latin America. The recent penetration of Spanish banks in Latin America is ground-breaking in that "rather than playing the traditional role of working alongside non-financial firms as they further their internationalization process (providing financing and financial services to such firms), [they] have aggressively expanded their core activity –commercial banking– with a view to building a presence in as many markets as possible" (ECLAC, 2000, p. 164). The other novelty is that they "are acquiring some of the largest domestic banks in their target countries and entering the general commercial and mass retail market" (Guillén and Tschoegl, 1999, p. 3).

Broadly speaking, while the two major Spanish banks are similar in terms of age, size and their focus on retail banking, they differ in terms of control, management style and strategic posture. Consequently, they have followed slightly different strategies in Latin America, although in both cases the aim is to dominate as many national markets as possible. Indeed, Banco Santander (and later BSCH) has sought to attain a strong, homogenous presence in Latin America. The group's emphasis in the region has been on banks that are strong in investment banking and on the acquisition from the outset of shareholdings large enough to provide both ownership and full management control. It has generally put its brand on the banks purchased.[19] According to Guillén and Tschoegl (1999, pp. 14 and 15), "Santander has been most assertive about its Latin American expansion primarily because of its strong capital base, prior investment banking experience in the region, and the strong personality and leadership of its chairman – who likes to make expeditious and far-reaching decisions. Numerous press reports confirm the contrast between Santander's 'presidencialista' style and BBV's 'team style' of management, which our interviewees singled out as a key difference between the two banks."

As for BBV (later BBVA), its expansion was initially based on small shareholdings or minority stakes (providing the project was large enough) and on partnerships with local banks, which were then gradually built up over time. Although this approach has not always ensured ownership, the bank has progressively gained a greater degree of management control over companies in the group. More recently, the strategy of BBVA seems to be to consolidate M&As already done, with a view to cutting costs and improving efficiency in the group as a whole.

[19] Before its merger with Banco Santander, Banco Central Hispano focused its Latin American strategy on the acquisition of majority stakes in association with a strategic partner, which in most cases was left to manage the business.

VI
Conclusions

In the recent wave of banking internationalization, financial institutions have not just followed up their existing relationships –serving mainly home-country customers– but have integrated more deeply into local markets. Therefore, although the pattern of international bank shareholdings has historically followed that of economic integration between countries, the actual pattern of expansion today depends on a wider range of factors than just the degree of overall integration. In this connection, Grubel's theory of internalization –

which states that the ability to draw on information and personal contacts between banks and a manufacturing firm's parent in a foreign country at very low cost is the main source of comparative advantage for multinational banks– does not apply to the recent wave of foreign bank expansion in the retail banking markets of emerging countries. This at least was typically the case in Latin America and Brazil in the 1990s, as the customers of some European banks –BSCH, BBVA, HSBC and ABN Amro– were mainly local and had no previous connection with the banks' parents firms in their home countries.

Furthermore, the recent process of banking internationalization has to be understood in the broader context of Latin American deregulation in the 1990s, which created an opportunity for foreign companies to enter key sectors of the economy such as banking, telecommunications and utilities. This was due both to the privatization of State-owned companies, including banks, and to the easing of legal restrictions on the presence of foreign banks in domestic banking sectors.

According to Focarelli and Pozzolo (2000), banks operating in countries where the banking sector is larger and more profitable should be in a position to export their superior skills, and should thus be more likely to expand their activities abroad. Indeed, all the biggest European banks in Latin America –BSCH, BBVA, HSBC and ABN Amro– have recently increased their market share at home through mergers and acquisitions, attaining leading (or important) positions in these markets. Expanding abroad is not only a source of earnings diversification for these banks, but also a way to strengthen their position in the European banking market under the competitive pressure of economic and monetary union.

There are some common features in the strategies of the biggest European banks in Latin America. ABN Amro in the Dutch market, and BSCH and BBVA in the Spanish market, grew substantially by following merger and acquisition-based expansion strategies in their domestic markets with a view to positioning themselves as leaders there. This policy allowed them to increase their competitiveness and grow large enough to expand internationally. Thus, after consolidating their position in the domestic market they extended their operations abroad, probably preparing themselves for an increase in European competition in the context of economic and monetary union. ABN Amro, BSCH and BBVA are large banks in highly concentrated small or medium-sized systems that are increasingly expanding their operations to other geographical markets, since domestic alternatives are limited. On the other hand, HSBC, one of the largest banking and financial services organizations in the world, has a more global internationalization strategy.

Compared to the other big Latin American countries, Brazil's policy on foreign bank investment has been successful in the sense that its selectiveness prevented domestic private-sector banks from being "swallowed up" by foreign ones. As a result, private-sector domestic banks are still hegemonic in Brazil compared to foreign ones. The events in Argentina in 2001 and 2002 demonstrate the problems that an economy faces during an economic and financial crisis when the financial system is dominated by foreign banks. By contrast, domestic private-sector banks in Brazil performed well during the turbulence of 2001-2002, and this has helped the Brazilian economy to mitigate the effects of the regional crisis. On the basis of the Brazilian experience, therefore, one possible policy recommendation for emerging countries is that a strong private-sector domestic banking sector can be an important factor in preventing a currency crisis from turning into a financial crisis.

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