International Expansion
by the Banking & Finance Services Industry Sector:
Strategy Analysis and Key Strategic Decisions –
An Australian Perspective

A thesis submitted in partial fulfilment of the requirements for
the degree of Doctor of Business Administration

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Declaration

I certify the following in respect of the content and conduct of the work presented here:

a. the work is submitted in part fulfilment of the requirements of a degree of Doctor of Business Administration (DBA) at RMIT University;

b. the work has not been submitted, in whole or in part, to qualify for any other academic award;

c. the work is mine alone, except where due acknowledgement has been made; and

d. this thesis is the result of research and work that I have performed since my candidature for the DBA began.

Garry F Nolan
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It was a great privilege to have had the opportunity to work for one of Australia’s leading companies for 37 years and to have worked with some of the ‘best and brightest’ not only in Australia but in international banking and financial services. It was a great honour that a number of these individuals gave so generously of their time to contribute to this research. To those senior Australian business executives and corporate directors who took part in the research; my sincere thanks. The hours that I have spent with the corporate directors, chief executives and other senior executives in undertaking this research have been very interesting and highly enjoyable.

Serious research is detailed, meticulous hard work. To identify the concepts, analyse the reasons why events occurred, encapsulate the data, and write a thesis that will be of interest to others and add to the general body of knowledge requires guidance and direction to keep the project on track and relevant to the research topic. One of the challenges in completing this thesis was that I had eight supervisors, many of whom had different ideas concerning how a DBA thesis should be presented. My deepest thanks go to my final academic supervisor, Dr Doug Thomson, who guided me through to a successful conclusion.

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Garry Nolan
Abstract

The aims and purpose of this thesis are to develop a model of the key strategic decisions necessary for international expansion that may be used as a guide for Australian publicly listed companies in the banking and financial services sector that are seeking to develop their business in foreign markets and, to develop an understanding of the various elements of such a model.

This was undertaken through a review of the literature to see if a comprehensive model for international business expansion is available for use by Australian companies, with a focus on the banking and financial services sector. The findings from the literature review were that the current literature addresses many aspects of international business expansion, including the location of foreign direct investment, the mode of entry and cultural issues. However, a contribution to the current body of knowledge could be made by drawing together different theoretical foundations into the one document. The findings from various elements of the literature were used to progressively build the model of international expansion by focusing on the key strategic decisions that must be made in looking to expand offshore. The model, based on the literature review, was then supplemented by a case analysis focusing on key factors in the international expansion of one Australian company in the banking and financial services industry. The case analysis involved an examination of published data and a series of interviews with Australian business directors and executives with extensive experience in the formulation and implementation of strategic decisions that a company in the banking and financial services industry must take in expanding offshore. The interviewees were generous with their time and provided many insights from practical experience and a deeper level of understanding in the field of international business expansion, as it applies to an Australian company in the banking and financial services sector. These interviews make a further contribution to the current body of knowledge and have been included in full in an appendix to this thesis.
A great deal has been written about globalisation. Much of it has been negative, dealing with the exploitation of labour in developing countries. Some has been positive, referring to the level of competition leading to lower prices for consumers and providing downward pressures on inflation. This intensity in competition has placed significant pressures on Australian companies, as well as opening opportunities. A number of Australian companies have been taken over by foreign entities and this, if it continues to occur in large numbers, could leave Australian companies in danger of becoming sales and service outlets in some industries. The limited size of the Australian population has placed limits on the domestic growth of Australian companies, some of whom have looked to offshore markets for growth with mixed results. In the banking and financial services sector, deregulation of the Australian financial system, which began in the 1980s, saw foreign banks enter the Australian market. The Australian banks and non-bank financial institutions responded in a variety of ways, including taking on additional risk in the home market to protect the size of their balance sheet and offshore expansion.

The findings from the research appear in the form of a model for international business expansion by Australian banks and financial services entities. The model outlines five key strategic decisions, together with a number of sub-elements of each decision, as follows:

- **When:** Timing of Entry – a key strategic decision – when to undertake international business expansion;
- **Where:** Choice of Market – Country Selection;
- **What:** Product Selection;
- **How:** Mode, Scale, Speed and Governance of Entry; and
- **Who:** the Entry Team.
The interviews identified the need for a multi-disciplinary approach to international business expansion in the banking and financial services sector, drawing together international business, strategic planning, corporate decision-making and organisational development. They confirmed that international expansion is not a goal in its own right but simply a sub-strategy to achieve the overall corporate strategy. Accordingly, international expansion strategy and the strategy implementation teams should be fully integrated as part of a broader strategic framework. The need to review the organisational development of the company before venturing offshore and the development of capability were emphasised by a number of the interviewees. The interviewees also dispelled some of the myths about the value of large scale international expansion strategies in the banking and financial services sector, such as a transformational acquisition and the strategic aspiration to be in a top four market position in every market an organisation enters. The interviewees also addressed the short term focus of only allocating resources (capital, people and technology) to the divisions currently providing the highest returns and emphasised the need to allocate a certain level of resources, specifically quantified in the corporate plan, to long term growth.
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Chapter 1

INTRODUCTION

1.1 INTRODUCTION
The introduction chapter examines the aims and purpose of this thesis; the focus and scope; the contribution to professional practice, a critical factor in a DBA thesis; the professional practice research question; the limitations of the research; the structure of the research; the background; the global business environment in which the banking and financial services industry operates; and the implications for Australian banks and financial services entities. The motivation and significance of the study is to assist Australian companies in the banking and financial services sector to develop strong international businesses that will be internationally competitive and reducing the risk that Australia could simply become a ‘sales and service outlet’ for larger foreign owned international companies operating in this sector.

1.2 AIMS AND PURPOSE OF THIS THESIS
The aims and purpose of this thesis are to develop a model of the key strategic decisions necessary for international expansion that may be used as a guide for Australian publicly listed companies in the banking and financial services sector that are seeking to develop their business in foreign markets and, to develop an understanding of the various elements of such a model.

1.3 FOCUS AND SCOPE OF THIS THESIS
The focus and scope of this thesis is on professional practice qualitative research in the fields of banking and finance, and international business. The thesis also has a focus on
strategic management, strategic analysis, strategic decision making process and foreign
direct investment.

1.4 CONTRIBUTION TO PROFESSIONAL PRACTICE

There is an opportunity to make a contribution to professional practice in banking and
finance, and international business. A great deal of the literature on banking and finance is
focused on the technical aspects of banking and financial services, including: the structure
of the financial system; asset, liability and capital management; managing loans and the
loan portfolio; prudential regulation; derivatives; and risk management. A great deal of the
literature on international business focuses on business in general and provides only
passing or general guidance for the banking and financial services industry. There is only
limited coverage that provides a guide to Australian entities in the banking and financial
services industry that are expanding internationally. Accordingly, there is an opportunity to
contribute to professional practice by providing a model for international expansion which is
relevant to the banking and financial services industry and by drawing together into the one
place a range of views on this topic from the literature and by contributing a case analysis
of publicly listed Australian company in the banking and financial services industry that has
extensive international experience.

1.5 PROFESSIONAL PRACTICE RESEARCH QUESTION

The professional practice question to be addressed is: are there lessons to be learnt from
an analysis of the literature and the experience of one Australian publicly listed company in
the banking and financial services industry that has extensive international experience with
successes and failures that could assist other similar Australian companies in their strategy formulation and implementation?

1.6 THE LIMITATIONS OF THIS RESEARCH

The limitations of this research are that it involves a case analysis into one company in one industry. Other Australian companies which are in different industries, which are of a different size, which have different access to resources, which seek entry into different markets and which undertake international expansion at a different time, may experience a different outcome from the company covered in the case analysis. The research is also based on interviews with current and former directors and executives of the case analysis company who may have a personal bias in relation to past decisions made by that company and subsequent events which occurred. This research deals with strategy implementation concerning international expansion. This research does not address the many complexities involved in managing a successful offshore operation going forward, although some of the interviewees strayed into this area. Their experience concerning the ongoing management of an offshore operation in the banking and finance sector has been left in the record of interviews as a further contribution to the body of knowledge in the field of international business. In addition, this thesis does not address the opportunities for Australian companies to expanding offshore through electronic banking without the need for foreign direct investment.
1.7 STRUCTURE OF THE RESEARCH

The thesis is structured into a number of chapters as follows: The introduction sets the scene. It outlines the problem and sets out the rationale and the aims for this research within the context of the dangers and opportunities facing Australian banking and financial services companies.

The literature review examines the current body of knowledge and seeks to identify gaps in the current literature relevant to an Australian publicly listed company in the banking and financial services industry considering a strategy formulation of international expansion. It organises the data in the form of a decision making model to facilitate the strategic implementation of a company in the banking and financial services industry to expand internationally.

The methodology chapter outlines the research methods used in this research and the research design which follows a qualitative research and interpretivist methodology to analyse the empirical data collected. This approach is adopted to refine the model developed from the literature review.

The chapter on data collection and research findings for an Australian company in the banking and financial services industry comprises two key elements:

- it sets out a strategic analysis in the form of a case analysis of key elements of the international expansion practice based on published data; and
- it analyses interviews with current and former directors and executives of the case analysis company as a means of refining the strategy implementation decision model. The full transcript of the interviews is included in the thesis as an appendix as they may be a valuable addition to the current body of knowledge.
The conclusions from this research are set out in the final chapter and include a model of the key strategic decisions involved in international expansion that are relevant to the banking and financial services industry. It could be that this body of work and these conclusions may be of interest to other Australian public companies in the banking and financial services industry seeking growth through international expansion, whilst operating in uncertain conditions, with incomplete information, in a complex business environment.

1.8 BACKGROUND

Australia has a relatively small population and this will eventually lead many Australian companies to consider international expansion as a key strategy to achieve business growth. For many industries, this strategy may commence with an export operation and there is a good deal of literature to support business in this phase of development (Australian Chamber of Commerce 1991; Australian Government, Industry Commission 1992; Edwards & Buckley 1996; Malbon & Bishop 2006; National Executive of Small Business Agencies 1995; Pomfret 1996). However, this literature provides only limited assistance to the banking and financial services industry. A further phase in this area of development is the establishment of a business operation in an overseas market. This phase of international business expansion involved the establishment or purchase of a physical business presence with operational and managerial staff located in a country / market outside of Australia. There have been some successes and some failures by Australian companies establishing businesses in foreign markets. Much of the literature in this field is focused on American, European and Japanese companies. This thesis seeks to build on the current literature relevant to international business management theory and practice for Australian companies in the banking and financial services industry.
1.9 THE GLOBAL BUSINESS ENVIRONMENT IN WHICH THE BANKING AND FINANCIAL SERVICES INDUSTRY OPERATES

The major changes that are occurring in the global business environment have a significant impact on the banking and financial services industry, both in terms of managing its own industry and providing products and services to its highly demanding customer base. Much of the literature on the globalisation of business generally focuses heavily on the experiences of United States, European and Japanese companies and provides an evolution in thinking on this topic (Levitt 1983, Kanter 1984, 1985, 1990, 1992, 1992, 1995, 1997 and Ohmae 1982, 1992, 1995, 1996). Bartlett and Ghoshal (1992, 1993, and 1998) provide strong professional practice research. Porter (1980) stated that an increasing number of industries have become or are becoming global industries, and this important structural setting is likely to become even more prevalent. Levitt (1983) argued that companies could apply the same marketing methods everywhere in the world because consumers were becoming more and more alike. Almost 20 years later, Govindarajan and Gupta (1999) confirm that the economic landscape has changed and that there is growing economic interdependence among countries, as reflected in increased cross-border flows of goods, services, capital and know-how. Govindarajan and Gupta (1999) further state that they do not expect the pace of global economic change to slacken in the next 20 years. Waters (2001) states that just as postmodernism was the concept of the 1980s, globalisation may be the concept, the key idea by which the transition of human society into the third millennium is understood.

Hill (2005) states that there is a fundamental shift occurring in the world economy which is moving away from a world in which national economies were relatively self contained, isolated from each other by barriers to cross-border trade and investment; by distance,
time zones, language, government regulation, culture and business systems. The world economy is moving towards a world in which barriers to cross-border trade and investment are tumbling; perceived distance is shrinking due to advances in transport and telecommunications technology; material culture is starting to look similar the world over; and national economies are merging into an interdependent global economic system. The process by which this is occurring is commonly referred to as globalisation (Hill 2005).

Some of the literature on globalisation focuses on the exploitation of people and resources in third world countries; on the loss of control and power by sovereign states; and on the loss of employment opportunities in developed countries with high labour costs. The forces of globalisation also have significant implications for the strategic management of companies around the world. Companies in the banking and financial services industry are directly involved in these developments through their own operations and through the impact on their customers. Banks and financial services entities are facing increased competitive pressures and significant operational challenges and opportunities through advances in technology and communications. However, the learnings for business from these developments, and the processes best suited to guide a business through these challenges, are not clear. Govindarajan and Gupta (1999) state that many large corporations in both the emerging economies and in the industrialised nations have only recently embraced the challenge of building a global presence. Sorrell (1999) argues that the views of most business leaders concerning globalisation in the late 1980s were wrong. At that time, there was a belief that the 21st century would belong to Japanese companies, which had perfected a model of management that their United States rivals were scrambling to copy and whose fast-growing economy would eclipse the slower-growth markets of Europe and North America. Further, it was thought that the 21st century would belong to a small collection of dominant global brands, as ever-higher barriers to entry
would put the most savvy entrepreneurs at a crucial disadvantage (Sorrell 1999). Sorrell (2009) reflects on what a difference a decade makes with Japanese companies struggling to mimic their American rivals, and the internet unleashing an explosion of start-up-driven challenges to established players in almost every industry.

Sorrell (2009) asks why it keeps getting harder to make sense of what is happening in the new world of business and argues that the power of globalisation is not about leveraging economies of scale. Rather, it is about leveraging economies of knowledge and coordination - figuring out how not to reinvent the wheel everywhere a company does business, but how to benefit from knowledge created and knowledge shared. He sees the world living through a fundamental change in how companies operate. Venzin (2009) supports this view and states that an important role for the headquarters for an international financial services entity is to organise and incentivise knowledge sharing. However, he advises that for a financial services entity, this is quite a challenge given divergent regulatory frameworks and local business characteristics. Venzin (2009) sees the sources of competitive advantage in banking and finance as having shifted from physical assets to intellectual resources, and knowledge-based competition raises particularly significant organisational challenges for financial services entities competing internationally.

Hughes and MacDonald (2002) state that following deregulation and globalisation, international banking has evolved into a fiercely competitive arena, requiring a mix of technical, financial and managerial skills. In banking, ‘easy’ profits based on lending have disappeared and this has spurred bankers to move more aggressively into higher risk, higher dollar level frontiers of international finance based on fee income. Hughes and MacDonald (2002) state that the danger in the banking and financial services industry lies in being left behind, which in turn carries with it the risk of declining market share, reduced profitability and ultimately being bought out as part of an ongoing wave of consolidation.
throughout the field of financial services. However, Schoenmaker and van Laecke (2007) report that the global expansion of European banks represents close to 25% of their total business, and this appears to be larger than their American and Asia-Pacific counterparts with less than 15% of their total business coming from global expansion. The results of the research of Schoenmaker and van Laecke (2007) was that American and Asia-Pacific banks can be characterised as domestic banks with more than 50% of their business in the home country. They state that the only exception is Citigroup, which has truly international aspirations. Schoenmaker and van Laecke (2007) conclude that the consolidation process in banking has been primarily a domestic event in the Americas and Asia-Pacific. However, they saw the position as being different in Europe. Their findings indicated that 11 banks operate on a European scale and a further three banks operate on a global scale.

Hughes and MacDonald (2002) report that globalisation of trade and investment depends upon the globalisation of financial markets and perhaps even of the financial institutions themselves.

1.10 THE IMPLICATIONS FOR AUSTRALIAN BANKS AND FINANCIAL SERVICES ENTITIES

From about the mid-1940s to the 1970s, Western industrialised nations, including Australia, experienced a sustained period of growth. Post war migration contributed to economic growth by providing new sources of labour, money and knowledge of the international business environment. Australia’s affluence and rising living standard in the 1960s saw that around 70% of Australians owned or were buying their own homes and that Australia had the highest rate of car ownership in the world. During this boom period, Australia relied on its primary and mining industries whilst its manufacturing industry had grown
significantly. Tariffs continued to spiral in an ever-increasing manner until the 1970s. At that time, Australia had the highest tariffs amongst industrial nations (Cousins 2005). These events created strong demand for credit which provided domestic growth for Australia’s banking and financial services industry.

However, this situation was not sustainable and was reflected in publications such as ‘Death of the Lucky Country’ (Horne 1976), ‘The end of certainty’ (Kelly 1992), ‘When The Luck Runs Out, the future for Australians at work’ (Hilmer 1985) and ‘Turning Point: Australians choosing their future’ (Mackay 1999). Eventually the cost of the protected manufacturing industry and industrial labour had to be paid. Australia’s trading position gradually began to decline. Britain became a member of the European Common Market in 1973 and this adversely affected Australia’s export industry. Imports from Asia and other more technologically advanced countries began to successfully compete against local manufacturing industries. Globally, there was a retreat from dependence on primary produce. As prices for commodities fell and prices for manufactured goods and services rose, Australia’s terms of trade worsened. Australia’s reliance on international demand for exports and high commodity prices had placed its economy in a precarious position (Cousins 2005). These events impacted on the demand for credit and participants in Australia’s banking and financial services industry looked to domestic acquisitions and mergers to provide growth.

Kelly (1992) reflected on the booms and recessions in the Australian economy and saw the challenge posed by the 1980s as the separation of structural trends from the cyclical changes. He saw the story of that decade as the embrace of the free market agenda and its gradual application as the solution to Australia’s underlying structural problems. But
Mackay (1999) asked if Australia was really in control of its future, or if it was merely a pawn in someone else’s global chess game. These events also had a significant impact on Australia’s banking and financial services industry which was significantly deregulated during the 1980s. In 1983, The Commonwealth Government announced that it would allow entry of 10 new banks, including foreign banks, following the Campbell Committee which had brought down its final report in 1981. In 1985 the number of new foreign banks invited to establish trading operations in Australia was increase to sixteen (Appendix 2). This provided strong competition in the Australian banking and financial services sector but it also provided Australian banks access to relevant foreign markets.

Hogan et al. (2004), reporting on why banks go overseas, stated that although banks can conduct many international banking activities with other banks from their headquarter from home, most major banking institutions have established operations overseas as well. There are several motives for banks to expand internationally. The most significant straightforward motive, reported by Hogan et al. (2004), is to follow their customers when their customers conducted operations abroad. This was particularly true for Australian banks in the nineteenth century, as a presence in London was then essential for Australian business. Given Australia’s much more important trade relations with the Asia-Pacific region now, Australian banks have tried to establish offices in a range of countries. Hogan et al. (2004) further states that international banking has certainly grown rapidly as a result of increased globalisation of both business and financial markets, but there are other reasons as well. In Australia, where the banking market is already well developed, domestic banks have sought earnings potential and market growth overseas. Banks also expand internationally to diversify their business base, with respect to their asset / liability and earnings streams.
Many Australian companies in the banking and financial services industry are at a significant disadvantage to United States, European and Japanese companies in terms of their market position, size, strength and access to much greater human and financial resources. In addition, Australian banks and financial services companies need to consider cultural issues, both in terms of the culture of the company expanding internationally and in terms of the new markets they are seeking to enter. Business practitioners such as Ralph (1997), Kraehe (1998) and Argus (1998) strongly emphasise the need for Australian companies to develop as global entities and cite specific successes and failures. Argus (1998), at the time the chief executive officer of one of Australia’s largest banks, stated: ‘Australian providers of goods and services must compete with the best in the world to protect their local market and must look to markets beyond the shores of Australia if they are to grow’.

1.11 CONCLUSION TO THIS CHAPTER

There appears to be considerable value in undertaking this research. Drawing together into the one place a range of views on this topic from the literature; contributing a case analysis of publicly listed Australian company in the banking and financial services industry that has extensive international experience; and providing a model for international expansion which is relevant to the banking and financial services industry, all provide a contribution to professional practice.

Globalisation is a fact of life today and Australian companies must compete at an international level. Whether a company is considering international expansion as part of its growth strategy or as part of its risk management strategy to protect it from being taken over by a foreign company or failing under the pressure of international competition, a comprehensive model that addresses the key strategic decisions to be made when
considering international expansion will provide contribution to professional practice.
Chapter 2

LITERATURE REVIEW

2.1 INTRODUCTION

This chapter examines the literature relevant to the fields of study for this thesis, bringing together two disciplines, one industry focused (banking and finance) and the other a managerially focus (strategic management relevant to international expansion). The literature review provides the basis for the construction of a model of international expansion. The literature review also provides an Australian focus; develops a more in-depth understanding of the elements of the model; and arrives at the overall conclusions on the key decision to be made when considering international business expansion as seen in the literature relevant to this thesis.

In a literature review it is important to critique and not just report. That is, to evaluate and integrate the literature relevant to the research topic. Part of this chapter reviews various texts and journal articles relevant to this thesis and follows a compare and contrast approach. Although the texts offer a guide from which a model of international expansion can be developed to identify the key strategic decisions an entity needs to consider before it enters a foreign market, various writers see the key issues differently. The latter part of this chapter employs a compare and contrast approach to build a comprehensive model, but not in the more common method of challenging the writings of scholars against one another in order to prove or disprove a given hypothesis. Accordingly, the compare and contrast approach seeks to draw from various journal articles which focus on a single element of the model and are included to further develop an understanding of specific elements of the model.
2.2 THE FIELDS OF STUDY

The fields of study for this thesis are in the areas of:

- banking and finance; and
- international business.

Much of the literature on banking and finance, bank management and management of financial institutions, have some coverage of international issues, including:

- what is international banking;
- why banks go overseas;
- banking systems around the world;
- cross-border banking;
- organisational forms in international banking;
- foreign exchange market and risk management;
- international borrowing and lending;
- bank financial management in a foreign environment;
- offshore financial centres; and
- money laundering, terrorism and international banking.

The issue of why banks go overseas was addressed in chapter 1 of this thesis, the introduction. However, the other issues do not address the aims and purpose of this thesis, which are to develop a model of the key strategic decisions necessary for international expansion that may be used as a guide for Australian publicly listed companies in the banking and financial services sector that are seeking to develop their business in foreign markets and, to develop an understanding of the various elements of such a model.
2.3 CONSTRUCTING A MODEL OF INTERNATIONAL EXPANSION - THE KEY STRATEGIC DECISIONS

Some of the literature on banking and finance, bank management and management of financial institutions does cover aspects of international issues which are relevant to the aims and purpose of this thesis, as set out in 1.2. The literature will be used to develop the early phases of the model which is the subject of this thesis.

What are the key strategic decisions that must be made when a banking and financial services business is looking to establish an international operation and can they be constructed into a model?

Young and Devinney (2005) developed what they referred to as the internationalisation model. Their model was developed to address the question: Is there a case for Asian expansion for Australian banks and insurers? Accordingly, their model is directly relevant to the aims and purpose of this thesis. However, their focus is different to this thesis as their focus was on the three evolutionary phases of internationalisation: international adolescence; international adulthood and international maturity. Notwithstanding this, there are aspects of their model which provide a theoretical basis for a model of the key strategic decisions that need to be made by a company in the banking and financial services sector when expanding internationally.

Figure 2.1 has been adapted from Young and Devinney’s (2005) internationalisation model and identifies four key strategic decisions that a bank or financial institution must make when considering international expansion.
These four key strategic decisions are:

- Country choice;
- Entry mode;
- Timing and sequencing; and
- Exploit existing products and services.

The country choice and entry mode are seen by Young and Devinney (2005) as being connected decisions taken before considering the timing and sequencing. The exploitation of existing products and services is seen by them as a separate decision not connected, at least in their model, with the other three decisions. Although not explained, it is possible that they see exploitation of existing products and services as an activity rather than a decision, or as an overlaying decision impacting on all three of the other decisions; country choice, entry mode and timing and sequencing.
Figure 2.1 A model of the key strategic decisions in international expansion for the banking and financial services sector – Stage 1

Source: Adapted from Young, O & Devinney, T 2005, Leaving home: Is there a case for Asian expansion for Australian banks and insurers? AGSM (Australian Graduate School of Management) Magazine, Issue 1.
Young and Devinney (2005) consider that bank managers are risk averse and do not ‘bet the bank when expanding internationally’. They see the internationalisation process as one of dynamic expansion, learning, more expansion, more learning and continual reorganisation of organisational processes, functions and structures. They state that early in the process, banks tend to look for markets that allow them to exploit existing products and operations with minimal adaptation. It is only later in the process that companies seek to truly learn and innovate in foreign markets directly. They see the hallmark of internationalisation as an evolving process; with the creation of a multinational enterprise takes considerable time to achieve.

Young and Devinney (2005) believe that successful internationalisation in banking and financial services requires the company to have a product/service that is valued in the target market. Additionally, when direct service delivery is required in the target market, it must be consistent with local market capabilities and norms, and represent significant improvements on local processes. They confirm that a secure home base can reduce financial constraints while also making available the managerial resources to the new venture. The internationalisation process requires complementary assets and capabilities to be successful. These include individuals knowledgeable in local culture, regulations, organisational systems, and so on.

Further, Young and Devinney (2005) see the two most commonly highlighted complementary capabilities are those associated with product/service adaptation for the target market and those associated with international management itself. For the newly internationalising company, They see the major issue with complementary assets and capabilities as being how they are acquired.
Many international expansions fail because of an unwillingness to commit sufficient capital, physical and organisational resources. Invariably this boils down to financial conservatism reflected in staged under-investment and a tendency to make small, inappropriate steps: amounting to classic managerial risk aversion. (Young and Devinney, 2005)

The more the target market differs from those in which the company currently operates, the more the operation becomes strained. The likelihood that the offered product will be accepted in the new market without any alteration is lower, and the relevance of home market processes and systems becomes less relevant and managerial experience less useful. This results in greater reliance on complementary capabilities external to the company (e.g. consultants) and greater change to products/services and value chain components. It is natural for risk averse managers to question whether or not the fit between the company’s strengths and its opportunities is sufficiently high to warrant substantial investment. The least experienced companies and those with bad international experiences are most likely to feel the mismatch is just too great. (Young and Devinney, 2005)

One of the outcomes of a desire to avoid risk and a need to exploit product and service strengths is that a company’s path to expansion is based on geographic, socio-economic and political similarity, but such a focused expansion path is not without risks. The company can develop a false sense of security about its ability to truly internationalise, its ability to be successful in markedly different countries. Although a company picks up some international experience, that experience is not sufficiently different to put it into a position to move into a more exploratory stage of expansion. (Young and Devinney, 2005)
The key insight, according to Young and Devinney (2005), is that successful internationalisation is a process of learning, adjustment and adaptation that occurs in real time. Each situation is unique but this does not mean that the development from local champion to international player is not without its rules and checkpoints. They advise that quick internationalisation is difficult, not because it is risky but because it requires skills that build on prior skills and experience: an incremental approach. As these develop, they expand the possibilities. This implies that companies need to develop not just internationalisation strategies but strategies for developing the assets and capabilities.

Some of the points expanded on by Young and Devinney (2005) raise the question: can the model in Figure 2.1, being part of Young and Devinney’s (2005) internationalisation model relevant to this thesis, be developed further to meet the aims and purpose of this thesis? Young and Devinney (2005) emphasise that the internationalisation process is one of learning, more expansion and more learning; and requires skills that build on prior skills and experience. They also emphasise that the internationalisation process requires capabilities, including individuals knowledgeable in local culture, regulations and organisational systems; and capabilities associated with international management. They further emphasise the reliance on complementary capabilities external to the company (e.g. consultants). Such learning, skills, experience and capabilities can only be achieved through individuals and this raises a further point of focus, an additional key strategic decision for the model being developed in this thesis, concerning the selection of the entry team. For the purpose of this thesis, the entry team may be comprised of individuals who manage the new venture in the foreign / local market and individuals in the home market who occupy critical decision making roles relevant to the offshore operation and who provide critical support to the offshore operation.
The model can also be developed further by the inclusion of various elements within the key strategic decision categories. This addresses part of the aims and purpose of this thesis to develop an understanding of the various elements of the model. The model in Figure 2.1 includes the exploitation of existing products and services as a key strategic category. Young and Devinney (2005) emphasise that successful internationalisation requires the bank to have a product/service that is adapted to and valued in the target market. In addition, when direct service delivery is required in the target market, it must be consistent with local market capabilities and norms, and represent significant improvements on the local processes. Accordingly, Young and Devinney (2005) stand alone category of exploitation of existing products and services is more than just an action step. It requires a strategic decision to select which products and services could be adapted to and valued in the target market; are consistent with local market capabilities and norms; and which represent significant improvements on the local processes. But the decision derived at in relation to individuals products may vary from country / market to country. Accordingly, these elements appear to be relevant to both country choice / selection and product selection and illustrate that, for the purpose of the model developed for this thesis, country selection and product selection may be linked or concurrent decisions.

Young and Devinney (2005) see the major issue with complementary assets and capabilities as being how they are acquired. This is directly relevant to the entry mode. Young and Devinney (2005) also emphasise the importance of a secure home base and the willingness to commit sufficient capital, physical and organisational resources. Although not specifically categorised in this way by Young and Devinney (2005), these are elements of the timing decision, and raise a mater concerning sequencing. Young and Devinney (2005) see
sequencing as a step-by-step expansion that is a ‘first this country, then this country’ approach, which Young and Devinney (2005) consider to be an approach that may stall when the ‘first roadblock’ appears. However, for the purpose of the model being developed in this thesis, the sequence or order in which the key strategic decisions concerning international expansion in the banking and financial services industry could be made has been influenced by the significant importance of the issues raised by Young and Devinney (2005) concerning a secure home base and the willingness to commit sufficient capital, physical and organisational resources. In the internationalisation model developed by Young and Devinney (2005), they saw the timing category as an area of focus following country choice and entry mode. However, for the purpose of the aims of this thesis, confirming that the bank has a secure home base and the willingness to commit sufficient capital, physical and organisational resources are factors that may be considered before the decisions concerning country choice and entry mode.

This new key strategic decision category, the entry team, and the elements to the other categories have been added to the model in Figure 2.2. In addition, the order of the key strategic decisions has been amended to place the timing of entry decision before country selection and entry mode decisions. The model in Figure 2.2 discloses the changes from the model in Figure 2.1 in red to highlight the development of the model. Appendix 1 shows the model in Figure 2.1 and in Figure 2.1 immediately following one another for ease of reference.
Figure 2.2 A model of the key strategic decisions in international expansion for the banking and financial services sector – Stage 2 (with changes from stage 1 (Figure 2.1) highlighted in red)

Looking to develop the model further, Venzin (2009) does not provide a model for international expansion but he addresses a number of the key strategic decisions necessary in international expansion with a direct focus on building an international financial services company. Venzin (2009) describes four strategic decisions for a financial services organisation, which are relevant to the model being developed in this thesis, as follows:

- Where to compete? The logic behind market selection;
- When to enter? The timing and speed of market entry;
- How to enter? The choice of the market entry mode; and
- How to compete? The development of business and functional-level strategies.

These strategic decisions offered by Venzin (2009) confirm and expand on the strategic decision categories in Figure 2.2 as follows:

- Venzin’s (2009) ‘where to compete’ confirms the country selection category in Figure 2.2;
- Venzin’s (2009) ‘when to enter’ confirms the timing of entry category in Figure 2.2 and adds a new strategic decision of the speed of market entry;
- Venzin’s (2009) ‘how to enter’ confirms the entry mode category in Figure 2.2; and
- Venzin’s (2009) ‘how to compete’ appears to add a new strategic decision category to those displayed in Figure 2.2.

Venzin (2009) does not address product selection and entry team as individual strategic decision categories.

In addressing the new decision concerning the speed of market entry, Venzin (2009) states that financial services companies frequently face the trade-off between penetrating new countries
quickly (speed of entry) and entering new countries without consolidating the position in previously served countries (timing of entry). He further states that the essential choices bank managers face are between speeding up local market penetration at high costs and risks or slowing it down and ceding – at least for the short term – market share to competitors who move faster. Venzin (2009) states that international expansion in financial services entities has in the past seen many mergers and acquisitions, but relatively fewer strategic alliances which he sees as offering accelerated internationalisation to entities with limited internationalisation experience and resources. Accordingly, for the purpose of the model being developed in this thesis, the speed of entry will not be included with the timing of market entry as suggested by Venzin (2009), but will be included as a concurrent decision to be made with the mode of market entry. In addition, Venzin’s (2009) reference to mergers and acquisitions raises a further strategic decision that has to be made by a bank or financial services company expanding internationally: the scale of entry. Again, this is a concurrent decision to be made with the mode of market entry. These developments in the model will be reflected in Figure 2.3.

Venzin’s (2009) focus on ‘how to compete’ addresses a range of issues for a financial services company that include:

- positional competitive advantages such as early mover advantage, which can be located in the timing of entry category in the model being developed in this thesis;
- understanding the local market, which can be located in the country selection category;
- a focus on selected products where he refers to custody, finds administration or clearing, which can be located in the product selection category

A new strategic decision category that does come from Venzin’s (2009) ‘how to compete’ is a focus on business-level strategies in relation to specific market segments. Venzin (2009) expands on this to include a financial services company following its large corporate clients to
selected foreign markets and providing services to specific industries where he refers to energy, commodities or transportation. This is a process of matching which product offerings will be made available to which market segments and accordingly, the model in Figure 2.3 reflects the further development of the model to include market segment and customer selection in the decision category with product selection.

The fields of study for this thesis are in banking and finance and in international business. In looking to develop further the model which is the focus of this thesis, it is appropriate to review the literature on international business, notwithstanding that it may not specifically address international expansion in banking and financial services but which may be relevant to the banking and financial services industry. Young and Devinney (2005), in addressing the case for Asian expansion for Australian banks and insurers, stated that they drew on what they referred to as the seminal work in international business by Johanson and Vahlne (1990). Johanson and Vahlne (1990) seek to defend themselves against certain criticisms raised against their research in Johanson and Vahlne (1977). However, Johanson and Vahlne (1977) provide certain insights that may be relevant to the banking and financial services industry and accordingly to the model being developed in this thesis. Johanson and Vahlne (1977) developed a model of the internationalisation process focused on market knowledge and market commitment; two areas of focus for the banking and financial services industry. Johanson and Vahlne (1977) advised that the internationalisation of an entity is an incremental process owing to the progressive increase in managers' gradual accumulation of knowledge of foreign markets and on the incrementally increasing commitment to such markets. Johanson and Vahlne (1977) saw lack of knowledge as an important obstacle to the development of international operations and that the necessary knowledge can be acquired mainly through having operations abroad. A bank which has a
strategic goal to expand internationally but lacks knowledge and experience in offshore markets may consider entry into a foreign market with varying levels of commitment as set out in 2.4.4.

Johanson and Vahlne (1977) stated that the more resources an entity committed to a market, the greater their gain in exposure and experience and the trust to commit more resources. Johanson and Vahlne (1977) demonstrated that the choice of entry mode is dependent on the degree of opportunity, risk association, the size of the prospective market, and the urgency of expansion. Such considerations may be relevant to a bank or financial services organisation.

Johanson and Vahlne (1977) saw organisations entering those markets that they know best and only moving into more distant/unfamiliar markets after feeling that they have gained sufficient knowledge. Johanson and Vahlne (1977) refer to ‘psychic distance’ to measure a market’s foreignness. They defined psychic distance as ‘the sum of factors preventing the flows of information from and to the market’, including variables such as language, education, business practices, culture and industrial development. Such factors may all be relevant to the banking and financial services industry. The order of the different stages in the internationalisation process is directly related to the relative psychic distance between home country and host country: the ‘further’ countries are in terms of psychic distance, the fewer resources firms are willing to commit to those particular markets. Organisations that internationalise will enter markets with an increasingly higher ‘psychic distance’ (choice of target market). Accordingly, the model developed in this thesis has been expanded to reflect the findings of Johanson and Vahlne (1977), as set out in Figure 2.3.
Figure 2.3 A model of the key strategic decisions in international expansion for the banking and financial services sector – Stage 3 (with changes from stage 2 (Figure 2.2) highlighted in red)

TIMING of ENTRY
Secure home base and the willingness to commit sufficient capital, physical and organisational resources. Early mover advantage.

COUNTRY SELECTION
Improvements on the local processes. Level of commitment to host country. Level of market knowledge and understanding. Psychic distance to the target market: language, education, business practices, culture and industrial development

PRODUCT SELECTION, MARKET SEGMENTATION and CUSTOMER SELECTION
Adapted to and valued in the target market. Consistent with local market capabilities and norms.

MODE, SCALE AND SPEED OF ENTRY
Acquisition of complementary assets and capabilities – from internal or external. Degree of opportunity. Risk association. Size of the prospective market. Urgency of expansion. Incremental. Mergers and acquisitions,

ENTRY TEAM
Learning, skills, experience, capabilities, knowledge in local culture, regulations, organisational systems and international management. Consultants

In seeking to identify if there are gaps in the model presented in Figure 2.3, the literature from a number of eminent scholars in international business (one of the fields of study for this thesis) was reviewed as outlined in the reference list. Holt (1998), Gupta and Govindarajan (1999) and Hill (2005) provide relevant practical guidance on the key strategic decisions required to establish an international business that may be relevant to the banking and financial services industry. Although there are some common features between Holt (1998), Gupta and Govindarajan (1999) and Hill (2005), there are also differences in what each of them consider to be the key strategic decisions that need to be made when looking to develop a business offshore. One of the contributions of this thesis is to review these differences and to develop a model than may not be obtained from looking at the views of one scholarly writer alone. The key strategic questions, as seen by each of these writers, are compared in Table 2.1.
Table 2.1  A Comparison of the Key Strategic Decisions in developing an international business, which may be relevant to the banking and financial services industry.

<table>
<thead>
<tr>
<th>Holt (1998) looks at Going Global and Implementing Strategies, the key focus of which is as follows:</th>
<th>Gupta and Govindarajan (1999) looked at How to Build a Global Presence, the key focus of which is as follows:</th>
<th>Hill (2005) wrote on Entry Strategy and Strategic Alliances, the key focus of which is as follows:</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Locating Activities – Global Alternatives</td>
<td>• Which market to enter first and when to enter?</td>
<td>• Which Foreign Market?</td>
</tr>
<tr>
<td>• Foreign Entry Alternatives</td>
<td>• What mode of market entry to use?</td>
<td>• Timing of Entry</td>
</tr>
<tr>
<td>• Management Capabilities</td>
<td>• How rapidly to expand?</td>
<td>• Selecting an Entry Mode?</td>
</tr>
<tr>
<td>• Competitive Advantage within a location</td>
<td>• Which product to launch with? (Gupta and Govindarajan (1999) also saw this as their first area of strategic analysis to address)</td>
<td>• Scale of Entry and Strategic Alliances</td>
</tr>
</tbody>
</table>


Holt (1998) offers the model set out in Figure 2.4 as the organisational activities required to meet the company objectives for strategic competition. He sees this implementation as part of the planning stage of strategic development because management must decide where to compete / the location of foreign operations; how to organise foreign operations / how to enter foreign
markets; and how to manage foreign operations. Such management decisions will be relevant to many industries, including the banking and financial services industry.

Figure 2.4 Implementing International Strategy

Holt (1998) sees three key decision categories; location, entry and management. The location and entry decisions confirm the decision categories of country selection and entry mode categories in Figure 2.3, which was developed for this thesis and which is directly relevant to the banking and financial services industry. Holt (1998) sees the location and entry decision categories as being interactive decisions in a similar way to that reflected in Figure 2.3. However, the Holt (1998) model in Figure 2.4 does not include the timing of entry, product selection, scale and speed of entry categories as set out in the model developed in Figure 2.3. Holt (1998) also contributes the decision category - management – which raises the question: is
this the same as the entry team category in Figure 2.3? Holt (1998) sees the management category as influencing the location and entry decisions, but the management involvement is more that an influence, it is the decision-making body (subject to a higher authority such as a board of directors as would normally be the case in the banking and financial services industry). Accordingly, the management category in the Holt (1998) does not add a new decision category for the model being developed for this thesis as management is the decision-makers and not one of the decisions to be made.

Holt (1998) continues to ask whether a company’s managers are capable of implementing the strategic plans and, although he does not refer to the decision step or category as such, this is the critical issue to be addressed in the entry team decision category illustrated in Figure 2.3. Banks and financial services companies are particularly at risk in selecting a highly skilled team to implement a strategic plan for internationalisation. In many industries the decisions of management will be reflected in financial performance of a company within a relatively short time. However, in banking and financial services, the decisions of management today could impact on the financial performance of the bank for (say) the next twenty years (the life of long-term loans). Holt (1998) also looks at management’s willingness to implement a strategic plan. He states that strategy does not become reality until senior management buys into it as a strong executive with other ideas can veto the most logical plan. He further states that researchers have found several patterns of behaviour peculiar to international companies. Implementation problems tend to occur far more frequently among multidomestic enterprises than among globally integrated organisations. Within a multidomestic configuration, foreign managers and company expatriates in foreign subsidiaries compete through country-centred strategies, and they become accustomed to locally responsive business methods. In contrast, subsidiary managers of a globally integrated company compete as part of a network of organisational interests, often pursuing broad-based strategies of globally branded goods or services.
Consequently, managers in multidomestic companies tend to expect autonomy within focused national strategies and local decision-making systems, while their globally oriented counterparts enjoy autonomy and decision-making authority only within networks of interrelated activities. Company-wide strategies therefore seem less important to multidomestic managers of foreign subsidiaries than to managers in globally integrated firms. Holt (1998) believes that corporate-level strategies may directly conflict with local priorities, worrying subsidiary managers that their operations are jeopardised by distant priorities. These polar opposite configurations reinforce two distinct patterns of behaviour: one can result in open conflict between subsidiary managers and home-office executives; and the other tends to reinforce support for mandates from the top. A bank or financial services company expanding internationally may find these conclusions by Holt (1998) worthy of closer examination when developing an international structure to manage an international operation.

Accordingly, the category of ‘management’ in the Holt (1998) model in Figure 2.4 may be too narrow and there appears to be three factors that are relevant to the model being developed in this thesis. Although Holt (1998) has not expressed it in this way, it is possible to draw from his writings that a company expanding internationally should make a strategically significant decision in relation to each of the following:

1. Is the home office / head office management fully supportive of the international expansion strategy?
2. Will the offshore management team have the capabilities to run the offshore operation?
3. What governance / organisational design model will ensure the home office and offshore office management will work effectively together?

Holt (1998) provides some guidance in relation to these questions that may be relevant to the banking and financial services industry. He states that the actions of management result from an
entire range of psychological and social considerations related to individual career aspirations, personalities, managerial values and ethics. Holt (1998) further states that companies cannot implement strategies or compete globally through traditional hierarchical organisations.

The Holt (1998) decision category of ‘management’ can be better reflected, for the purpose of the model being developed in this thesis for the banking and financial services industry, in three separate decision categories as follows:

- The question as to whether the home office management is fully supportive of the international expansion strategy appears to raise questions of a company’s readiness to follow this strategy. Accordingly, management must ask: is this the right time to expand internationally or should the organisation get its existing operations in order first? Although Holt (1998) did not include the timing of entry in his model illustrated in Figure 2.4, his writings appear to support such a decision category and provide a further element for this category. This decision category – timing of entry - is supported by Gupta and Govindarajan (1999) who see ‘when to enter’ as a key question in building a global presence. Hill (2005) also supports this decision category for the model developed in this thesis as he saw the ‘timing of entry’ as a key entry strategy decision.

- The question as to whether the offshore management team will have the capability to run the offshore operation raises the second decision category following the division of Holt’s (1998) ‘management’ category in his model into three decision categories. For this thesis Holt (1998) has provided additional elements to the entry team category that need to be taken into consideration when deciding to appoint the entry team, namely career aspirations, personalities and managerial values and ethics.

- The third question from Holt’s (1998) ‘management’ category relates to whether the offshore management and the home office management will work effectively together raises a new decision category for the model being developed in this thesis in relation to the governance or organisational design structure. This will be reflected in the further
development of the model as a joint decision category with the mode, scale and speed of entry.

Gupta and Govindarajan (1999) state that there are four decisions a company must make to build a global presence in a way that minimises risk and maximises returns which may be relevant to the banking and financial services industry. They are as follows:

1. Which product line or lines should be used as the launch vehicle for globalisation?
2. Which market should be entered first?
3. What would be the optimal model of market entry?
4. How rapidly should the company expand globally?

It can be noted that Gupta and Govindarajan (1999) place product selection first when that was not a decision category in the Johanson and Vahlne (1977) and Holt (1998) models. Although Holt’s (1998) reference to competitive advantage within a location is linked to the reference to competitive advantage in the model developed in this thesis under product selection and reinforces the concept adopted in this thesis that the decisions concerning country selection and product selection are strategically linked. The first three decision categories of Gupta and Govindarajan (1999) above confirm the categories in Figure 2.3, of product selection, country selection and entry mode.

The fourth decision to be made, as outlined by Gupta and Govindarajan (1999) - How rapidly should the company expand globally? – is consistent with Johanson and Vahlne (1977) when they looked at the urgency of expansion under the entry mode. However, this was not a key focus for some other writers, but the speed of entry can also be relevant to the scale of entry. Gupta and Govindarajan (1999) state that rapid globalisation enables a firm to grow aggressively but can also spread managerial, organisational and financial resources too thinly. This raises significant risks for all organisations, particularly organisations in the banking and financial
services industry. Hogan et al. (2004) state that ADIs (Australia’s authorised deposit-taking institutions, which include banks, building societies, credit unions and other authorised financial services companies) have to take considerable risks to earn a reasonable return and, the measurement and management of such risks is one of the most important aspects of financial institutions management. Gupta and Govindarajan (1999) see that rapid international expansion can jeopardise a company’s ability to defend and profit from the global presence it has created. Gupta and Govindarajan (1999) state that faster global expansion is more appropriate under the following conditions:

- It is easy for competitors to replicate a company’s recipe for success;
- Scale economies are extremely important; and
- Management’s capacity to manage global operations is high.

These three dot-points are directly relevant to the banking and financial services industry. Success factors in the banking and financial services industry would be a research topic in its own right, but would include factors such as the attractiveness of its products, its customer management framework, IT systems, resource allocation management and risk management. Some of these factors could be difficult to replicate where they are internal to the bank, but factors such as new product development can be easily copied. Banking and financial services is a low margin high volume business where economies of scale play an important role in the profitability of an organisation. This links in directly to the second dot-point above. Management’s capacity to manage global operations is directly linked to the management team at any one point in time. The critical factor for a bank or financial institution is that successful bank executives can be highly mobile, providing a bank with the opportunity to bring in good people whilst at the same time being at risk to loosing valuable members of a successful team.
Hill (2005) states that the entry strategy for international business is concerned with three closely related topics, which may be relevant to the banking and financial services industry. However, he actually raises five strategic decisions as follows:

- Which foreign market to enter?
- When to enter them?
- On what scale?
- The choice of entry mode?
- The role of strategic alliances?

Which foreign market to enter, when to enter, on what scale and the choice of entry mode, have already been identified in the model in Figure 2.3. Hill (2005) states that strategic alliances (his final strategic decision) run the range from formal joint ventures, in which two or more firms have equity stakes, to short term contractual agreements, in which two companies agree to cooperate on a particular task (such as developing a new product). These will be brought into the model developed for this thesis under the entry mode category. However, it is worth noting that Hill (2005) shows strategic alliances separately from his question on the choice of entry mode.

Venzin (2009) in ‘building an international financial services firm’ makes a number of references to strategic alliances. He states that many retailers, including Tesco and Marks and Spencer, have partnered with banks and insurance companies to offer a vast array of finance products. He also outlines details of a strategic alliance between the largest insurance company in Italy and the largest state-owned energy company in China to sell insurance products in China. Venzin (2009) states that the Italian insurance company contributes specific know-how in the insurance business alongside technology and financial skills and the Chinese energy company contributes local market research, a service network and 50% local ownership (thus making it possible for the venture to obtain a licence to operate in China). However, Hill (2005) appears to shows strategic alliances separately from entry mode (which includes joint ventures) because of what he
sees as the unusual nature of strategic alliances which he describes as cooperative agreements between potential or actual competitors, in this case from different countries. This may be an interesting development in the banking and financial services industry in the future.

Accordingly, the literature of Holt (1998), Gupta and Govindarajan (1999) and Hill (2005) confirms many aspects of the model developed in this theses and appearing in Figure 2.3. These scholars have also provided additional contributions which have been reflected in the further development of the model in Figure 2.5.

2.4 AN AUSTRALIAN FOCUS

The literature review to this point has been focused on the two fields of study for this thesis: banking and finance and international business. Another focus for this thesis is to consider if there may be any factors that are unique to Australian banking and finance companies expanding offshore. Much of the literature on international business expansion focuses on companies from the United States, Europe and Japan.

This thesis had the benefit of the Young and Devinney (2005) internationalisation model which was directly focused on Australian banks and insurers. Looking more broadly at the Australian literature, Mahoney et al. (1998) provide a managerial perspective on international business which may be relevant to the banking and financial services industry. They identified the following as part of a comprehensive framework for international expansion:

- What products and / or services does the firm intend to sell?
- Where and how will it make these products or deliver these services?
- Where and how will it sell them?
- Where and how will it acquire the necessary resources?
• How does it expect to outperform its competitors?

Mahoney et al. (1998) made product selection their first area of strategic analysis to address and this supports that category in the model in Figure 2.3. Their second point concerning - where and how will it make these products? – is focused on manufacturing companies and is not relevant to this thesis. In banking and financial services, products and services can be developed in a nominated country and transported at very little cost and then reproduced in the host country. The points about - where and how to deliver these services and where and how will the products be sold? – are addressed in the category of country selection and mode of entry in the model in Figure 2.3. The next point raised by Mahoney et al. (1998) relates to where and how it will acquire the necessary resources. Mahoney et al. (1998) address resource deployment which might be specified along product lines, geographic lines, or both. Mahoney et al. (1998) see this part of strategic planning determining relative priorities for a company’s limited resources. In the banking and financial services industry, the key resources are capital, other forms of funding, management and staff, and information technology. Resource availability and allocation is not specifically covered in the model developed in Figure 2.3, although it may be implied under the timing of entry: obtaining the full support of the home office. Johanson and Vahine (1977) referred to the commitment of resources but this was not carried through into the model as the principal focus of Johanson and Vahine (1977) was on country selection, entry forms and scale of entry. Resource allocation may also be implied in the scale of entry. Given the significance of adequately resourcing a new venture, particularly offshore, this is an important addition to the model and will be added in Figure 2.5. The final point of Mahoney et al. (1998) - how does it expect to outperform its competitors? – is relevant to the model under the product selection category. However, the model in Figure 2.3: product selection does not appear to adequately address this point raised by Mahoney et al. (1998) and will be addressed further in developing a more in-depth understanding of elements of the model in 2.4.3. Outperforming the
competitors is also relevant to the entry team category in the model when considering capabilities.

Ferguson and James (1998) offer the following blueprint for Australian companies on how to go global, which may be relevant to the banking and financial services industry:

- Assess competitive advantage against the world's best. If it does not stack up, stay at home: it is possible to be the best in the world at servicing the Australian market;
- Form joint ventures with overseas companies, and swap information, technology and managers;
- If the organisation is relatively small, form alliances with larger companies to link into global growth;
- Consider outsourcing areas the organisation is not strong in, and redirect resources into the organisation’s strengths;
- For medium-sized companies, focus on one part of the business and find partners overseas with a complementary speciality;
- Go overseas with a clean aim, for example, to build sales to achieve economies of scale;
- Recognise that the whole business is important, not just the brand. Marketing alone will not turn a company into a global participant; and
- Hire managers with a global perspective.

The contribution by Ferguson and James (1998) provides valuable information and raises important issues. The contribution does not provide a strategic framework that will guide the strategic decision making process but many of the points have been addressed in the model developed in Figure 2.3. An addition will be made to the model in Figure 2.5 to include reference to joint ventures, alliances and partnerships. Johanson and Vahine (1977) saw the choice of
entry mode as being dependent on the degree of opportunity, the risk associated with the size of the prospective market and the urgency of expansion, as illustrated in the model in Figure 2.3. However, another aspect of the entry mode for the model is the vehicle that will be used to enter the new market. Accordingly, joint ventures, alliances and partnerships will be added to the model. It is noted that Ferguson and James (1998) did not mention acquisitions. They may have had a partly owned acquisition in mind when they included joint ventures but they made no reference to a wholly owned acquisition.
Figure 2.5 A model of the key strategic decisions in international expansion for the banking and financial services sector – Stage 4 (with changes from stage 3 (Figure 2.3) highlighted in red)

TIMING of ENTRY
Secure home base and adequate resource allocation: capital, physical and organisational resources/ full support of the home office. Early mover advantage.

COUNTRY SELECTION
Improvements on the local processes. Level of commitment to host country. Level of market knowledge and understanding. Psychic distance to the target market: language, education, business practices, culture and industrial development

PRODUCT SELECTION, MARKET SEGMENTATION and CUSTOMER SELECTION
Adapted to and valued in the target market. Consistent with local market capabilities and norms.

MODE, SCALE, SPEED and GOVERNANCE OF ENTRY

ENTRY TEAM
Learning, skills, experience, capabilities, knowledge in local culture, regulations, organisational systems and international management. Consultants. Career aspirations, personalities, managerial values & ethics.

2.5 DEVELOPING A MORE IN-DEPTH UNDERSTANDING OF ELEMENTS OF THE MODEL

One of the aims of this thesis is to develop an understanding of the various elements of the model developed in the thesis. This section of chapter 2, section 2.4, addresses this aim and further seeks to identify if there are any gaps in the model illustrated in Figure 2.5.

In seeking to identify any gaps in the model, the approach of Pearce (2000) has been applied. Pearce (2000) states that a strategy reflects a company’s awareness of how, when and where it should compete; against whom it should compete; and for what purposes it should compete. This approach applies to the banking and financial services industry as it may too many industries. The Pearce (2000) approach has been adopted with some modifications with the ‘whom’ in the model being applied to the entry team. That is not to discount the importance of Pearce’s (2000) point that a strategy reflects a company’s awareness of those against whom it should compete. This important point has been addressed in the model under the level of market knowledge in the country selection category, but illustrates that a broader literature review may be warranted under the product selection category. It is further illustrated in the model developed in this thesis with the country selection and the product selection being strategic decisions to be made as a contiguous process not a sequential process. In addition, the model applies the ‘what’ to the product selection and not to Pearce’s (2000) point that a strategy reflects a company’s awareness of the purpose for which it should compete. Pearce’s (2000) point here is again important but, for the purpose of this thesis it is assumed that a company’s strategy
formulation process has addressed its mission, goals and objectives and made the decision that to achieve such objectives a strategic expansion offshore is a strategy to pursue. It is at this point that the focus of this thesis begins.

Based on the data analysis earlier, the following strategic framework of key strategic decisions has been formulated. These key strategic management decisions should be considered by any company seeking to expand internationally, including companies in the banking and financial services industry, as follows:

- **When: Timing of Entry** – the timing at which the home office is prepared to deploy adequate resources;
- **Where: Country Selection** – the choice of the new market;
- **What: Product Selection** - the choice of the product/s to be offered in the new market, and including market segmentation and customer selection;
- **How: Entry Mode** - the vehicle or corporate entity used to enter into the new market, and including the scale, speed and governance of entry;
- **Whom: Entry Team** – the selection of local and home market personnel who will run, have oversight and support the international operation.

### 2.5.1 When: Timing of Entry - a key strategic decision - when should a company in the banking and financial services industry undertake international business expansion

The literature on international business generally gives much less attention to the strategic decision of when to enter a foreign market than it does to the strategic questions of where and how. Many writers appear to simply assume that once the strategic decision is taken to expand internationally, the next step is to implement the strategy with the selection of the market and the mode of entry.
Hill (2005), looking at international business expansion generally, sees the timing of entry as the second strategic decision to be made by a company expanding internationally. He sees this decision being made after an attractive new market has been identified. Venzin (2009), looking at building an international financial services company, also states that once the target market has been selected, the right timing and speed for market expansion has to be identified.

Venzin (2009), states that sometimes being first into a market pays off, but at times the superior strategy for financial services companies is to watch competitors make mistakes and enter later. Hill (2005) also focuses his consideration of the timing of entry around the first-mover advantages and the first-mover disadvantages. Hill (2005) sees the first-mover advantages as:

- The ability to pre-empt rivals and capture demand by establishing a strong brand name;
- The ability to build sales volume in the other country and ride down the experience curve ahead of rivals, giving the early entrant a cost advantage over later entrants. This will enable the company to spread the fixed costs associated with setting up operations and realise economies of scale (an important profit driver in the banking and financial services industry). Training local staff ahead of a competitor should result in a rise in productivity due to learning economies, which again translates into lower costs. These cost advantages may enable the early entrant to cut prices below the higher cost structure of later entrants;
- The ability to develop a deeper understanding of the needs of the customer and to build deeper customer relationships before the level of competition intensifies (an important factor in Asian countries where long-term relationships have traditionally been very important in business and social settings); and
- The ability of early entrants to create switching costs that tie customers into their products or services (often an important part of the product structuring in the banking and financial services industry).
Venzin (2009, cited Berger & Dick 2007) stating that in the banking literature there is limited empirical evidence of early mover advantage. However, he then appears to contradict that view by stating that early mover advantage in banking mainly results in higher market share and derive from consumer switching costs as well as economies of scale. He further states that there is indeed a robust relationship between a bank’s entry timing and its market success.

Hill (2005) sees the major first-mover disadvantages as also relating to costs. Pioneering costs are costs that an early entrant has to bear that a later entrant can avoid. Such costs arise when the business system in a foreign country is so different from that in a company’s home market that the enterprise has to devote considerable effort, time and expense to learn the rules of the game.

Hill (2005) states that a certain liability is associated with being a foreigner, and this liability is greater for foreign firms that enter a national market early. Hill (2005) further states that research seems to confirm that the probability of survival increases if an international business enters a national market after several other foreign companies have already done so. The later entrant may benefit by observing and learning from the mistakes made by the early entrants. Late entrants may be able to ride on an early entrant’s investments in learning and customer education by watching how the early entrant proceeded in the market, by avoiding costly mistakes made by early entrants, and by exploiting the market potential created by the early entrant’s investments in customer education. An earlier entrant may be put at a severe disadvantage, relative to a later entrant, if regulations change in a way that diminishes the value of an early entrant’s investment. Conversely, in the banking and financial services industry, a relaxation in government regulations in East Asian countries may result in banking licences being granted to foreign banks that have supported the local market for some years. Venzin (2009) outlined a similar market opportunity when in 1999, most Central and Eastern European
governments recognised that they had to improve the efficiency of their banking system in the European Union enlargement process and consequently started to privatise their banks with foreign partners.

Gupta and Govindarajan (1999) see the factors to be considered in assessing the best time to enter a foreign market differently to Hill (2005). Gupta and Govindarajan (1999) see the timing of entry into a particular market depending on the barriers to entry and the intensity of competition at the time. These factors are highly important in the banking and financial services industry as banks are highly regulated in many countries and companies must be licensed to provide banking services. It is also a highly competitive industry and becoming more so with the development of e-commerce across borders. In Figure 2.6 Gupta and Govindarajan (1999) provide a conceptual framework that companies, including banks, can use as they consider which markets to enter, and when, based on the strategic importance of the market.
Figure 2.6 *Strategic importance of a market*

*Strategic importance of a market*

<table>
<thead>
<tr>
<th>High</th>
<th>Low</th>
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<tbody>
<tr>
<td><strong>Phased-in entry</strong></td>
<td><strong>Rapid entry</strong></td>
</tr>
<tr>
<td>(create beachhead first)</td>
<td></td>
</tr>
<tr>
<td><strong>No entry</strong></td>
<td><strong>Opportunistic entry</strong></td>
</tr>
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</table>

*Company’s ability to exploit the market*


The Gupta and Govindarajan (1999) framework in Figure 2.6 combines the two key dimensions of a market’s strategic importance and the company’s ability to exploit it. A company should enter rapidly those markets characterised by high strategic importance and high ability to exploit. By comparison, a company can afford to be much more opportunistic and ad hoc with respect to those markets that have low strategic importance but are easier to exploit. In the case of markets with high strategic importance that are very difficult to exploit, Gupta and Govindarajan (1999) recommend a phased approach where market entry is preceded by the development of needed capabilities. They suggest that such capabilities can be developed by first entering a beachhead market. In the banking and financial services industry, a market like the United States may be of a high strategic importance but it may be difficult to exploit. In these
circumstances, Gupta and Govindarajan (1999) have recommended a phased approach and various modes of entry could be considered which involve limited risks and exposure to capital.

Porter (1980, 1990 & 1996) progressively developed the concept of competitive advantage, which is an evolution of the concept of comparative advantage. Competitive advantage occurs when an organisation acquires or develops an attribute (skill or opportunity) or combination of attributes that allows it to outperform its competitors. These skills or attributes can include access to highly trained and skilled human resources and / or new technologies such as information technology, both of which are critical in the banking and financial services sector.

Porter (1996) focused on the competitive intensity and attractiveness of a market; with attractiveness in this context referring to the overall industry profitability. He states that companies must benchmark continuously to achieve best practice, and that rivals can quickly copy any market position and competitive advantage is, at best, temporary. Porter’s (1996) guidance here applies equally to domestic or international business and at any point in time a company may have a competitive advantage or be the rival seeking to copy a competitor. Again, this is particularly pertinent to the banking and financial services industry where new products can be copied within a relatively short period of time. Other aspects of a bank’s operations like its customer relationship management model may be more difficult to copy in the short term.

The concept of competitive advantage is reflected in the model developed in this thesis under product selection, but it is also pertinent here when considering the right timing of entry into a foreign market. A bank or financial services company needs to assess if it has a competitive advantage in a product or operating model in its home market and in international markets, and if it does not: is it ready to expand internationally? This reinforces the concept developed in this thesis that each strategic decision which needs to be made concerning international expansion
should be made having regard to all of the interrelated decisions, not as independent, stand-alone decisions.

2.5.1.1 When: Timing of Entry – Conclusions

The conclusions drawn from this segment of the literature review are that first mover advantages and disadvantages; prospects of change in barriers to entry; intensity of competition and a competitive advantage at a given point in time are key factors in deciding the best point in time to enter an external market. The sequencing of the decision making process is in question following this segment of the literature review. Hill (2005) and Venzin (2009) both believe that the country selection decision should be made before the timing of entry decision. Is this change in the sequence of the decisions significant? Should the model be changed to reflect the views of Hill (2005) and Venzin (2009)? These questions will be addressed in chapter 4, in the case analysis interviews, and chapter 5, the conclusions.

2.5.2 Where: Choice of Market - the New Market Selection – Country Selection

Venzin (2009) has been selected to begin the literature review on country or market selection as it is contemporary with this thesis and has a focus on the industry which is the focus of this thesis. Venzin (2009) states that financial services companies are being forced to constantly search for sources of competitive advantage to defend their home markets and to carefully select the foreign market they aim at. He advises that the time in which financial services companies could easily find countries with lucrative takeover targets and a free avenue to increased market share are gone. As a result, market selection and entry strategies have to be addressed in a more careful way. Venzin (2009) presents a similar model for international financial services companies concerning where to compete to that illustrated in Figure 2.6 which related the strategic importance of a
market to the timing of entry. Venzin (2009) refers to as a matrix for clustering geographical target markets and describes the matrix as a learning vehicle in strategic planning processes. However, the matrix could be more clearly described as a market analysis tool for international financial service companies, as illustrated in Figure 2.7. Venzin’s (2009) matrix compares market penetrability with market attractiveness; the key elements of which are as follows:

- **Market Penetrability**
  - Potential strength of brand;
  - Existing relations with local institutions;
  - Potential application of superior capability;
  - CAGE distance (cultural, administrative, geographical and economic – which is similar to the concept of psychic distance introduced into this thesis from Johanson and Vahine (1997)).

- **Market Attractiveness**
  - Growth (GDP);
  - Country wealth (GDP per capita);
  - Banking assets / GDP
  - Credit card penetration; and
  - Availability of local financial service companies.
Figure 2.7 Market analysis tool for international financial services companies

Market Penetrability

Market Attractiveness


But are the points raised by Venzin (2009) the only points to consider when considering the critical question of country or market selection? Holt (1998) did not focus on a particular industry and this broader focus raises a number of issues that are relevant to the banking and financial services industry, not only in terms of creating a new business but in establishing the foundations for a viable business through a deeper understanding of factors impacting on loan recovery. Holt (1998) sees the key factors in market selection as dependent on host country conditions and local competition. He outlines the following steps in developing a multi-tiered environmental scanning analysis to develop a short list of potential host countries:

- Political risk analysis; and
• Systematic industry analysis.

Holt (1998) recognises that these investigations generate only broad based planning scenarios, but he states that they usefully eliminate inappropriate foreign locations. He comments on the following areas for analysis:

• a competitive analysis of the organisation and its potential match with the conditions in each foreign location; and

• social and cultural factors, including cultural values, work ethic, consumer behaviour patterns, labour skills, social trends, educational variables and ideologies. These factors are particularly relevant in the banking and financial services industry where an assessment of risk pertaining to loan recovery needs to be made in relation to each potential new market.

Holt (1998) highlights that a nation that seems to be a logical candidate for expansion based on competitive factors may be entirely wrong for a company that cannot accommodate likely social and cultural issues within the constraints of its own organisational culture and management capabilities. Holt (1998) adds what he calls an important twist to the location decision; he would have each possible nation compete for selection. Every nation actively courts foreign investment and he states that even states and regions within countries compete for foreign investment. Holt (1998) cites the Republic of Ireland as a country that exploits its advantages emphasising that a foreign company locating there also benefits from the country’s privileged access to other European Union markets. The Republic of Ireland established an International Financial Services Centre in Dublin for this reason, as well as raising capital for its own economy.

Gupta and Govindarajan (1999) take a somewhat different focus to Holt (1998) in looking at which market to enter first. Gupta and Govindarajan (1999) ask which market is of most strategic importance, and when to enter that market. They believe that a market’s strategic importance is determined by the following key factors:
• the market potential, which refers to both current market size and growth expectation (and is consistent with Venzin (2009)); and

• learning potential, which includes the presence of sophisticated and demanding customers for a product or service who force the company to innovate continuously and, the pace at which technologies are evolving in that market (which is an additional factor not included by Venzin (2009)).

Holt (1998) refers to culture in various contexts and this broad ranging topic is worthy of closer examination as it may have implications for how an Australian company in the banking and financial services sector operating in an offshore market deals with and relates to its staff, its customers and the regulators in the local market. Hill (2005) states that scholars have never been able to agree on a simple definition of culture. Hill (2005) cites three definitions of culture:

• That complex whole which includes knowledge, belief, art, morals, law, custom, and other capabilities acquired by man [written in the 1870s without reference to women] as a member of society (Edward Tylor);

• The collective programming of the mind which distinguishes the members of one human group from another .......... Culture, includes systems of values, and values are among the building blocks of culture (Geert Hofstede);

• Culture is a system of ideas and these ideas constitute a design for living (Zvi Namenwirth and Robert Weber).

Feaver and Mahmood (1997) state that an individual’s values, attitudes and beliefs are acquired as learned behaviour patterns and comprise the whole of an individual’s experience and knowledge gained as a member of society. The experience and knowledge accumulated by an individual from their environment is influenced by language, religion, ethnicity, race, aesthetics, technology, education and social institutions. Feaver and Mahmood (1997) illustrate some, but not all, of these factors in Figure 2.8.
Feaver and Mahmood’s (1997) factors affecting cultural composition has significant implications if an Australian company in the banking and financial services industry is considering an Islamic country in its country selection process because of its growth potential. Hill (2005) states that although Islamic law is primarily concerned with moral behaviour, it has been extended to cover certain commercial activities. The payment or receipt of interest is considered usury and is outlawed by the Koran. Abdul-Rahman (2010) states that many may think that Islamic banking is for the Muslims only and that Islamic banking is a gateway to the significant wealth amassed by the oil-producing countries in the Gulf but, he advises, that is not true. Following the increase in migration to Australia of people from Islamic countries, some Australian banks are already
considering Islamic banking as a new product to offer in their domestic operations and, a small, low risk, low capital exposure, operation in an Islamic country could offer valuable learning opportunities for an Australian bank in line with the strategic importance of a market as suggested by Gupta and Govindarajan (1999). Riba/ribit-free banking is a system that is not built on renting money at a price called the interest rate, but on renting tangible assets such as homes, tools, equipment and businesses.

Hofstede (1991) conducted a comprehensive study of how values in the workplace are influenced by culture. From those results, and later additions, Hofstede developed a model that identifies four primary dimensions to differentiate cultures: Power Distance; Individualism; Masculinity; and Uncertainty Avoidance. He later added a fifth dimension, Long-term Outlook. A summary of Hofstede’s Dimensions of Culture appears in Appendix 3. Holt (1998) states that Hofstede’s work is somewhat controversial because it attempts to classify patterns of behaviour for individual countries without taking into account sub-cultural differences or ideological orientations. Nevertheless, Holt (1998) states that Hofstede’s work has significantly changed the prevailing view of behaviour in various cultures and, in particular, how to understand work-related values among many of the world’s nations. Accordingly, an Australian bank or financial services company considering international expansion should develop a knowledge bank on the significance of various cultural dimensions on banking and financial services in a range of markets. For example, countries with a High Long-Term Orientation ranking, which is the case for many Asian countries, indicates the countries prescribe to the values of long-term commitments and respect for tradition. Therefore, an Australian bank or financial services company seeking to establish an operation in Asia may have to invest more time than may be needed to establish an operation in other regions.
Holt (1998) states that Hofstede’s four dimensions are useful for describing general cultural patterns, but they do not work independently of one another, and the interrelated dimensions in Hofstede’s work present various clusters that indicate patterns of behaviour. In Figure 2.9, Holt (1998) adapted the work of Hofstede (1991) to plot clusters of power distance against individualism. A culture high in power distance would value hierarchical status and authority. Members of the lower levels of a society, or an organisation, tend to accept their subordinate status and are expected to conform to authority. Hofstede found that Mexico, Indonesia, Pakistan, India and Japan, among others, scored high in power distance. In these societies, people respect formal hierarchical authority and employees seldom violate chains of command or openly question decisions by their superiors. Holt (1998) points out that in contrast, countries that score low on power distance include Australia, New Zealand, the United States, Denmark and Finland. In these countries, superiors and subordinates feel relatively comfortable with shared decision making and decentralisation. The individualism dimension measures the degree to which a society values independent initiative relative to collective effort. A culture high in individualism would emphasise personal achievement, innovation, autonomy and adventure. These countries include the United States, Australia and Great Britain where individual achievement is highly valued. In contrast, a society low in individualism would likely endorse group harmony, social order, and conformity in group relationships. These societies exhibit collectivist behaviours and include many Asian, Latin American and West African nations.

For a bank or financial services company expanding offshore, an understanding of these cultural dimensions can be highly relevant in setting the level of delegated authorities of local staff to act in the new market, the communications channels that need to be established, the risk profile settings, and the level of strategic innovation that may be expected from such new market. The nature and level of head office control that may be exercised over an offshore operation may vary considerably based on where a country sits in these cultural dimensions. For a bank or financial
services company making its first offshore expansion, there can be comfort in going into a market with cultural similarities. Venzin (2009) saw advantages in clustering geographical target markets when building an international financial services company. Figure 2.9 illustrates that New Zealand, Netherlands, Canada, Great Britain, Australia and the United States are clustered together. This may seem self evident in relation to most of these countries, but the inclusion of the Netherlands may open the possibility of another market not previously considered, subject to other factors including language, for a bank or financial services company looking to expand internationally within a low cultural risk framework.
Ronen and Shenkar (1985) also focused on the cluster approach and analysed four categories of organisational variables, which may be relevant to the banking and financial services industry in making a country selection as part of an international expansion strategy:

- Work goals;
- Job satisfaction;
- Leadership and organisation; and
Interpersonal roles.

For the model developed for this thesis, these categories appear to relate mainly to the entry team, but for the banking and financial services industry they may have broader cultural implications relating to customer behaviour and partnership/joint venture relations. From their research, Ronen and Shenkar (1985) defined eight clusters they called attitudinal dimensions. Their clusters appear in Figure 2.10 and countries have been positioned within their clusters according to per capita gross national product (GNP) as Ronen and Shenkar (1985) believe that successful economic development, indicated by a high or rising per capita GNP, significantly influences cultural values related to work customs and organisational behaviour. However, Holt (1998) states that the Ronen and Shenkar (1985) model in Figure 2.10 has been controversial due in part to the underpinning assumption of a strong connection between GNP and convergent cultural values. Subject to caveat, the model in Figure 2.10 has been included here as a high or rising per capita GNP is an important indicator of a potential market’s growth potential and strong demand for banking and financial services. A high or rising per capita GNP also adds to the attractiveness of a market as illustrated by Venzin (2009) in Figure 2.7.
Figure 2.10: A Synthesis of Country Clusters

The clustering method used in Figure 2.10 did not include the Netherlands with Australia as was the case in Figure 2.9. However, Figure 2.10 did highlight South Africa in the same cluster as Australia. A company in the banking and financial services industry may consider the political, security and economic risks in South Africa to be too great to establish an operation there, however, the use of these clustering methods may be a valuable tool for a bank or financial services company looking to narrow their country selection options.

Hill (2005) states that while a society may be equivalent to a country, some countries harbour several societies (they support multiple cultures) and some societies embrace more than one country. This may be an important point if an Australian bank is considering the acquisition of a regional bank in the United States if that region is home to a large Hispanic population.

Perhaps one of the most difficult aspects of international business and the complexities of different cultures is dealing with, and understanding, differences in etiquette. For example, in Indonesia a person should not stand with their back to an elderly person or high ranking official. In Saudi Arabia it is common to remove shoes before entering a building and Friday is the day of prayer and rest. Failure to understand such matters can have consequences.

The Gupta and Govindarajan (1999) belief that the learning potential offered by a market can make a market of strategic importance. This learning potential could include the presence of sophisticated and demanding customers for a product or service who force the company to innovate continuously and, the pace at which technologies are evolving in that market. Porter (1990) also believes in the strategic importance of markets. The relevance of Porter’s (1990) focus to this thesis is to ask: What can an organisation learn from being part of a market that has a competitive advantage? Porter (1990) developed a framework to assess the competitiveness of regions, states and nations. Porter (1990) states that successful international industries tend
to be located within particular cities and regions. Geographic concentration is vital for companies to efficiently draw on each other’s resources and capabilities, and to benefit from a shared culture, learning experience, supply capabilities and local infrastructure. Industry clusters are geographical concentrations of interconnected businesses, suppliers, and associated institutions in a particular field. Such clusters lead to productivity increases, higher innovation rates and faster new business developments. Porter (1990) argued that productivity is the main factor for international competitiveness and that the standard of living of a country’s population can be improved as a direct result of increases in that factor. Clusters may take different forms between firms producing different products across value-added chains or between firms producing similar products at different stages of the same chain. Examples provided by Porter (1990) include banking in London and New York and internet/software (a major banking tool) in Silicon Valley and Bangalore.

Having considered a theoretical framework in relation to the strategic decision of country selection, it is necessary to consider the practical implications that arise from banking and financial services being a regulated industry. Hogan et al. (2004) advise that foreign banks are currently banned from operating in Cambodia, Malaysia and Thailand. This was the position in 2004 and may change from time to time. In addition, Hogan et al. (2004) focused only on countries in APEC (Asia Pacific Economic Cooperation) and foreign banks may be banned from operating in other countries. Further, if a country appeared favourable from the theoretical framework, the local banking regulations would need to be examined in detail as it may be possible for an Australian bank to operate as a representative office, branch, merchant bank or finance company, with a limited product range, or it may be possible to operate through a partly owned entity or joint venture, if the bank is banned from holding a full banking licence in a favoured country. More details on the mode of entry appear in 2.4.4.
Young and Devinney (2005) advise that the Australian Graduate School of Management (AGSM) and Rothschild conducted a research project on Australian financial institutions in Asia. This research presents an overview of the key factors and suggests that Asia, for some banks and financial institutions, represents a golden opportunity for profitable expansion. Insights from interviews of over 20 leading executives and market commentators with Asian experience, together with reviews of existing cases and research, have been synthesised into ‘Ten Lessons’ for successful internationalisation as set out in Table 2.2.

**Table 2.2: Ten Lessons for Asian Internationalisation by Australian banks and insurers**

1. Provide a Superior Offering: Transferable competitive advantages are required to overcome the “home ground advantage” of local competitors and international competitors entering that market
2. Build Enabling Assets and Capabilities: Competitive advantages are not enough. Firms need to develop assets and capabilities to support internationalisation
3. Commitment, Commitment, Commitment: Companies need to invest with a long term view and accept that this may require large and ongoing capital investments
4. Modus Operandi: It is not just where to enter but how to enter
5. Know the Marital Partner: When partnering (joint venture/alliances), partner selection and governance is key
6. Focus: Do not overextend to too many markets
7. Do not send the B-team: Send the best, not just the “available”
8. Diversity is King: Insufficient locals and too many expatriates spoil the broth
9. Be Prepared for Significant Organisational Change: International operations will transition through several growth stages that require changes in structure, processes, people and culture
10. Keep the Organisations Hands on the Wheel: There is no such thing as excessive vigilance when it comes to controls on finance, operations and organisation.
Although these lessons appear, in the first instance, to be applicable in most international expansions, their importance is made all the more salient by the wide diversity of the cultures, economic development, societal composition and regulatory environments in Asia, and the broad implications that the factors raise for a financial institution’s risk management framework.

2.5.2.1 Where: Choice of Market - the New Market Selection – Country Selection - Conclusions

The conclusions drawn from this segment of the literature review are focused on an analysis of the strategic importance of the market; the market’s ability to add to the company’s knowledge of markets and products; the growth potential; barriers to entry in the home market and in offshore markets; the intensity of competition; the social and cultural factors; the legal system; understanding customer needs; political risks and local government incentives. These factors will be added to the model developed in this thesis.

2.5.3 What: Choice of Product - Product Selection for International Expansion

Gupta and Govindarajan (1999) made product selection their first area of strategic analysis to be address when considering international expansion. However, product differentiation was not an area of strong focus by Holt (1998) or Hill (2005). Hill (2005) and Venzin (2009) both believe that the country selection decision should be made first followed by the timing of entry decision.

Financial products offer one of the most significant opportunities for a competitive advantage for a bank or financial services provider, but such advantage can generally be copied by competitors within a short period of time. Given the potential significance of this strategic decision in
international expansion and the differing views of Gupta and Govindarajan (1999), Holt (1998), Hill (2005) and Venzin (2009), it is appropriate to obtain a further view on product selection in international expansion and, the views of Bartlett and Ghoshal (1998) may be relevant to the banking and financial services industry.

Bartlett and Ghoshal (1998) stated that layers of competitive advantage can be built upon:

• the capture of global efficiencies;
• worldwide creativity; and
• high quality and low cost products, with new innovative products coming on stream.

Looking at the challenge in a slightly different way, they see that there are three strategic requirements / capabilities which must be built:

• the need for global efficiencies;
• the need for national responsiveness; and
• the need for world-wide innovation and learning;

all of which a company in the banking and financial services industry must build at the same time.

In addition, the organisation must build scale capabilities which can be favourably measured against competitors / benchmarked. Such scale capabilities are directly relevant to the banking and financial services industry as it is a low margin high volume business.

The views of Bartlett and Ghoshal (1998) provide guidance on how the model being developed in this thesis can be expanded. Although Bartlett and Ghoshal (1998) have a different focus to the model being developed in this thesis, it is possible to draw from their work. They see that different products (financial and otherwise) will require different transnational responses and their focus on competitive advantage is related to a particular product or service. However, a product that provides a competitive advantage in one country may not provide the same competitive
advantage in another country. Thus the decision-making process of expanding internationally must involve a decision about a product or products that will be offered outside of the home country and that decision cannot be made in isolation from the decision concerning the country selection. In addition, the need expressed by Bartlett and Ghoshal (1998) to develop new innovative products feeds into the product decision-making process when looking to expand internationally and is again linked to the country selection process. This is consistent with the views of Johanson and Vahine (1977) that current commitment decisions and activities in turn change the level of market knowledge and market experience, with such a feedback loop creating a learning cycle. Also within the product decision-making process, Bartlett and Ghoshal (1998) highlight the need for high quality and low cost. Although this may generally be seen as most relevant to a manufacturing operation, it is also relevant to the banking and financial services industry. A new financial product may be identified in a foreign market by an Australian bank or financial services company and the development of that product may require a new system which could be developed in a variety of countries with varying degrees of quality and cost. The views of Bartlett and Ghoshal (1998) appear to support many of the views of Gupta and Govindarajan (1999) in relation to the product selection for international expansion which have relevance to the banking and financial services industry.

Figure 2.11 sets out a framework developed by Gupta and Govindarajan (1999) for choosing the product or product lines that should be used as a vehicle for internationalisation. Gupta and Govindarajan (1999) present a conceptual framework to identify those product lines that might be preferred candidates in international expansion. Each line of business in the bank or financial service provider’s portfolio should be evaluated along two dimensions: one pertaining to potential returns (expected pay-offs from internationalisation); and the other pertaining to potential risk (degree of local adaption required). In Figure 2.11, if a financial product requires a high level of adaptation or modification to be acceptable in a local market, this may raises costs associated
with the development of IT systems, documentation and staff training and will increase the level of risk as the effectively new product (depending on the level of adaption required) may have implications that were not fully understood at the time of adaption. However, if this product is well accepted in the local market it may have a short pay-back period and therefore the product may have a good risk / return ratio in the local market. Accordingly, such a product may be a good selection in the international expansion process and may even be a vehicle for internationalisation as contemplated by Gupta and Govindarajan (1999).

The Gupta and Govindarajan (1999) risk management approach balances risk against returns. In Figure 2.11, the products that require a low degree of local adaptation (low risk) with a high expected pay-offs from internationalisation (high return) are considered the most attractive. This approach can be adopted in the banking and financial services industry where the primary customers would be international companies or ‘globetrotting’ corporate executives looking for consistent high levels of quality and service. In this market a bank could leverage a well-known brand name and make few changes to their proven formula from their home market. Conversely, a retail mortgage product in an offshore market may require a high degree of local adaptation (which Bartlett and Ghoshal (1998) describe as national responsiveness). The greater the degree of adaptation the greater the risk of failure.
Bartlett and Ghoshal (1998) take a different approach to the Gupta and Govindarajan (1999) model set out in Figure 2.11. The Bartlett and Ghoshal (1998) matrices set out in Figure 2.12 focuses on the opportunity for global integration compared with the need for national responsiveness. In Figure 2.12, a financial product that can be taken from country to country with little or no modification is an attractive product on which to base an international expansion strategy. However, if a product requires extensive modification, or some level of modification in all or most new countries it is taken into, that product is less attractive for use in an international expansion strategy. The principal difference between the two approaches is that Bartlett and Ghoshal (1998) adopt a marketing approach, whereas Gupta and Govindarajan (1999) adopt a risk management approach with a focus on financial payback.

Figure 2.12 Opportunity for global integration compared with the need for national responsiveness.


The Gupta and Govindarajan (1999) approach goes further than the Bartlett and Ghoshal (1998) and is a more comprehensive model on which to build international expansion.

2.5.3.1 What: Choice of Product - Product Selection for International Expansion – Conclusions

The conclusions drawn from this segment of the literature review are focused on an analysis of the competitive advantage of a financial product in a new market and the level of local adaptation / national responsiveness required, assessed under a risk management framework. There is also a need to develop new innovative financial products which are high quality, produced at low cost.
2.5.4 How: Mode of Market Entry - the mode of entry into the new market

Hill (1998) developed a theory based framework which categorised factors that influence a company’s decision for a particular market entry mode into three underlying constructs as illustrated in Figure 2.13 and explained as follows:

- **Strategic Variables**, as listed in Figure 2.13, are seen by Hill (1998) as influencing the choice of entry mode through the control requirements that they entail. Control is the ability and willingness of a company to influence decisions, systems, and methods in a foreign market. Different strategies require different degrees of control over the operating of foreign affiliates, and thus lead to different entry modes.

- **Environmental Variables**, as listed in Figure 2.13, are seen by Hill (1998) as influencing the entry mode decision primarily through their influence on the appropriate level of resource commitment. Resource commitments are dedicated assets that cannot be employed for other uses without incurring costs. Resources may be intangible, such as managerial skills, or tangible, such as capital.

- **Transaction Variables**, as listed in Figure 2.13, are seen by Hill (1998) as influencing the entry mode decision through their influence on dissemination risks and on the appropriate level of control. Risk comes from the chance that a company’s applied knowledge (tangible and/or intangible) can be unintentionally transferred to a local entity which may create a new competitor.

Hill’s (1998) entry mode selection model in Figure 2.13 discloses the strategic variables, the environmental variables and the transaction variables as stand-alone factors feeding into the entry mode decision. However, in the banking and financial services industry, these three sets of variables are likely to be inter-connected. If the resource commitment is high, there will be a strong desire for a high level of control and if the applied knowledge is unique there will also be a
strong desire for a high level of control. As a regulated industry, banking and many aspects of non-bank financial services will be subject to licensing restrictions / barriers to entry and Hill (1998) model does not address this pivotal point. Accordingly, a bank or financial services entity expanding internationally could consider the implications of Hill's (1998) model which may provide a greater level of awareness in relation to the risks involved. However, regulatory restrictions in a specific country or countries may prevent a bank or financial services entity from entering a market through the entry mode that may be most desirable having regard to Hill’s (1998) variable factors. If this is the case, the bank or financial services entity should reassess its decision to enter that country.

Figure 2.13

**entry mode selection**

- **strategic variable**
  - extent of national difference
  - extent of scale economies
  - global concentration

- **environmental variable**
  - country risk
  - location familiarity
  - demand conditions
  - volatility of competition

- **transaction variable**
  - value of firm-specific know-how
  - tacit nature of know-how

Depending on the composition of these three variables, various entry modes may be available. Venzin (2009) sees the choice of the market entry mode as being a decision between: organic growth, mergers and acquisitions, and strategic alliances. These entry strategies may be achieved through different legal forms of entering markets (or entry modes). Hogan et al. (2004) state that banks use a number of legal structures in their international banking arena as follows:

- Correspondent bank relations;
- Representative office;
- Offshore banking unit;
- Shell or cubical bank branches;
- Consortium or joint venture banks;
- Subsidiary banks;
- Agency or restricted bank branches,
- Full bank branches.

All of these structures provide access to international markets with varying degrees of capital commitment and control.

Feaver and Mahmood (1997), Holt (1998), Mahoney et al. (1998) and Hill (2005) all provide a range of alternatives as modes for foreign market entry. The following are relevant to the banking and financial services industry:

- Contracting;
- Joint venture; and
- Wholly owned subsidiary.

Contracting could relate to a correspondent bank relationship with another bank in another country. Franchising was included in the modes of entry suggested by the various writers but this mode of entry has not been included here as this mode of entry into a foreign market is unlikely
to be adopted in the banking and financial services sector in the near future. There has been franchising of banks in the Australian market, and this would be an interesting area for further research, but it is unlikely that the risks associated with franchising, including reputation risk, would be entered into in a foreign market in the near future.

A critical factor to emerge from the Hill (1998) entry mode selection model was the trade-off between resource commitment and control. Translating this trade-off into its application to the legal entity structures, Feaver and Mahmood (1997), who are writing from an Australian prospective, developed the model set out in Figure 2.14 based on the perceived uncertainty in managerial decisions. In their model, flexibility and control are seen as trade-offs with greater control and less flexibility coming with greater capital investment. Holt (1998) developed a similar model, which has been set sideways in Figure 2.15 to make it more comparable with the Feaver and Mahmood (1997) model in Figure 2.14. Although not all of the market entry modes in Figures 2.14 and 2.15 are directly relevant to this thesis, the full models provided by Feaver and Mahmood (1997) and Holt (1998) have been included to illustrate Hill’s (1998) point concerning the trade-off between resource commitment and control. For the purpose of this thesis, correspondent bank may be seen as the equivalent to an export operation.
Perceived uncertainty in managerial decisions

0%  Capital investment (equity participation)  100%

High

Flexibility

Low

Control

Indirect export  Licensing/franchising  Contractual arrangements  Joint ventures  Wholly owned production subsidiary

The trade-off between resource commitment and control may be out of the decision making process for many banks and financial services companies due to government regulations over the entry of foreign banks into their country. Accordingly, a bank or financial services entity may be forced to enter a market via a joint venture if it desires a scale of operation of a reasonable size. In Table 2.3 Hill (2005) provides a list of the advantages and disadvantages of a joint venture and a wholly owned subsidiary which may be relevant to the banking and financial services industry.
Table 2.3 Advantages and disadvantages of various modes of entry

<table>
<thead>
<tr>
<th>Entry Mode</th>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
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<tbody>
<tr>
<td>Joint venture</td>
<td>Access to local partner’s knowledge</td>
<td>Lack of control over technology</td>
</tr>
<tr>
<td></td>
<td>Sharing development costs and risks</td>
<td>Inability to engage in global strategic coordination</td>
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<tr>
<td></td>
<td>Politically acceptable</td>
<td>Inability to realise location and experience economies</td>
</tr>
<tr>
<td>Wholly owned subsidiary</td>
<td>Protection of technology</td>
<td>High costs and risks</td>
</tr>
<tr>
<td></td>
<td>Ability to engage in global strategic coordination</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Ability to realise location and experience economies</td>
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Gupta and Govindarajan (1999) believe there are two fundamental questions to be considered in relation to the mode of entry. These questions have been adapted here to focus their relevance to the banking and financial services industry as follows:

- To what extent will the company rely on expatriate versus local expertise within the target market?; and
- To what extent will the company exercise ownership control over those activities to be performed locally in the target market?

Gupta and Govindarajan’s (1999) answer to the first question, as it pertains to the banking and financial services sector, is that greater reliance on local expertise would be appropriate under the following conditions:

- The local market is large;
- The need for local customisation of financial products is high; and
- Local regulatory requirements are strong (as is the case in the banking and financial services industry).
On the second question of ownership control, Gupta and Govindarajan (1999) believe that entering a market via an alliance permits a company to share the costs and risks associated with market entry and allows rapid access to local know-how. However, they warn that such an arrangement also has potential for various types of conflict. Gupta and Govindarajan (1999) advise that alliance-based entries are often more appropriate under certain conditions. These conditions may be relevant to the banking and financial services industry. The conditions are as follows:

- The company is short of capital;
- The physical, linguistic and cultural distances between the host and the home country are significant;
- The subsidiary would have low operational integration with the rest of the multinational operations;
- The risk of asymmetric learning by the partner is low; and
- Government regulations require local equity participation. Many countries restrict equity ownership by a foreign entity in a local company to 49%.

Holt (1998) focuses on the solution to the mode of entry problem from both a marketing and a structural direction. Holt (1998) sees the entry into the new market as being achieved in various ways which are directly relevant to the banking and financial services industry:

- through a ‘green fields’ start up operation;
- the purchase of an existing business in that market, either partly or wholly owned; or
- the establishment of joint ventures and/or alliances.

Gupta and Govindarajan’s (1999) views in this regard complement the findings of Holt (1998), particularly in relation to the learning opportunities that are a significant element in an alliance.
However, if one company learns faster than the other, it may, sooner or later, seek to dissolve the alliance with its still-disadvantaged partner.

Bartlett and Ghoshal (1998) believe that the role of the overseas subsidiary is of particular importance with key resources and key assets being a strength of a national subsidiary. The subsidiary may convert from being an implementor of parent company policy to a strategic asset in its own right. According to Bartlett and Ghoshal (1998), the contributions of a national subsidiary can vary within a global organisation depending on:

- the nature of the national or local market and its strategic importance (performance in that market may impact other markets and thus raise the global importance of the national subsidiary. In the banking and financial services industry this could be a role for a subsidiary located in New York or London); and
- local resources and capabilities (high capabilities in a market of low importance may lead to the development of a global role for the subsidiary. In the banking and financial services industry this could be a role for a subsidiary located in New Zealand).

The parent company or global head office does not have to take a lead role for every issue; the subsidiary can take a key role. The bank subsidiary could take on the role of a strategic leader, developing a centre of excellence that will lead a specific worldwide activity (Bartlett and Ghoshal 1998).

2.5.4.1 How: Mode of Market Entry - the mode of entry into the new market – Conclusions

The conclusions drawn from this segment of the literature review are focused on an analysis of the various modes of entry, being contracting, alliance, joint venture or wholly owned subsidiary. The most appropriate mode of entry will depend on government regulation and the level of control required versus the level of investment a company is prepared to put at risk.
2.5.5 Scale and Speed of Market Entry

The mode of entry, covered in 2.4.4, has direct implications for any strategic decision concerning the scale and speed of entry. Entry via the acquisition of an existing bank or financial services company will provide immediate scale and speed into a new market, but will require a certain level of capital and a strong commitment from the head office. Whereas a greenfields start-up operation will not provide scale and speed of entry but it will not require a high level of capital nor head office management time. Given these interlinking factors, the scale, speed and mode of entry have been combined in the model developed in this thesis as strategic decisions to be made concurrently when considering international business expansion.

The speed of global expansion is the final topic addressed by Gupta and Govindarajan (1999). Again, Gupta and Govindarajan (1999) look at the problem from a risk management prospective and see rapid globalisation as enabling a company to grow aggressively but potentially spreading managerial, organisational and financial resources too thinly. Gupta and Govindarajan (1999) see faster global expansion as more appropriate under certain conditions. These conditions may be relevant to the banking and financial services industry. The conditions are as follows:

- it is easy for competitors to replicate a company's recipe for success;
- economies of scale are extremely important; and
- management's capacity to manage global operations is high.

2.5.6 Governance

Metzger (2004) states that prior to the 1997 Asian financial crisis, it seemed as though corporate governance was largely an Anglo-American concern. The Asian crisis was attributed by many observers, according to Metzger (2004), to the lack of accountability of major corporate groups in the crisis countries and the resultant debilitating effects on the national economies of their over-investment, over-indebtedness and lack of profitability. This is an area of significant importance
to an Australian company in the banking and financial services sector expanding internationally. This is not only the case in relation to its own governance, but in relation to the governance of any joint venture or alliance and also in relation to the corporate customers to whom the Australian bank may lend.

In providing assistance to the Asian financial crisis countries, Metzger (2004) states that the International Monetary Fund, World Bank and Asian Development Bank insisted that corporate governance be accorded a high priority on the agenda for recovery and reform. The Organisation for Economic Cooperation and Development Principles of Corporate Governance were adopted in 1999, giving global legitimacy to a set of standards which transcended any single country, legal system or legal tradition. This is reassuring for an Australian bank expanding internationally.

Metzger (2004) then recorded that, starting in 2001, a tidal wave of corporate scandals began to engulf United States corporations. Widespread examples of accounting fraud, criminal conduct and greed among leading corporate executives shook confidence in corporate United States and revealed fundamental flaws in the functioning of the United States system of corporate governance. The principal reform legislation in the United States in response to the scandals, the Sarbanes-Oxley Act of 2002, was passed by the United States Congress into law in considerable haste and was labelled, according to Metzger (2004), as containing many provisions which were out of step with prevalent thinking about best practices. Critics outside the United States considered Sarbanes-Oxley a rush to judgement and initially saw little in the legislation which had relevance to Europe, Asia or Latin America.

Metzger (2004) considers that the momentum of corporate governance reform has quickened and initiatives for reform (learning from the United States experience) touch almost every country in which shares are publicly traded. Metzger (2004) states that in response to extensive
commercial code amendments in Japan, some of its leading companies have adopted a
corporate governance system relying heavily on independent directors and a proactive board, in
a significant departure from the prevailing pattern of management-dominated governance. Korea
has authorised securities law class action lawsuits. China is beginning to experiment with
shareholder group litigation, while independent directors are required on the boards of all listed
companies and Chinese accounting rules are being brought into line with international standards.
Institutes of directors have recently been formed in a number of countries, and professional
training for independent directors is becoming widely available. The investigative and
enforcement powers of securities regulators are being strengthened by legislative reforms,
enhanced budgetary resources and greater international cooperation among such regulators.
This is again reassuring and addresses a potential risk factor for an Australian bank or financial
services provider expanding internationally.

Australian banks and financial services companies with operations in the United States, or with
borrowings in that country, now have compliance obligations under the Sarbanes-Oxley
legislation. But more importantly, Australian banks and financial services companies with best
practice governance standards in the home market may find that the standards applying in other
countries may not be considered to be best practice. If the mode of entry into a foreign market is
via the acquisition of a wholly owned subsidiary, the holding company / the home market
compny has the ability to adopt its own governance standards. However, if the mode of entry is
via a joint venture, the Australian banks or financial services company will have an influence but
may not have the power to impose its own governance standards. Accordingly, governance, as
a strategic decision category in the model of international expansion developed for this thesis,
has been combined with the mode of entry category as this is a significant risk factor which must
be taken into account in deciding on the mode of entry.
2.5.7 Who: the Entry Team – the mix of local and head office executives and staff that will run the offshore bank or financial services business

This strategic decision was addressed when Holt (1998) introduced Management into the research and this was picked up in the model developed for this thesis. However, a few additional comments relevant to the banking and financial services industry may be of value.

Sorrell (2009) worries about the leadership challenges that globalisation poses, asking if companies are building organisations that are unmanageable. According to Sorrell (2009), every CEO wants to run a company that is totally focused on its customers. Every CEO wants to instil a can-do spirit, a sense that nothing is impossible. Every CEO wants to run a business that has not only the power of scale but also the soul of a start-up. But Sorrell (2009) is concerned that bureaucracy and the big-company way of doing things gets in the way. This may be relevant to Australian banks and financial services companies expanding internationally.

Hill (2005) states that foreign management skills acquired through foreign direct investment may also produce important benefits for the host country. Foreign managers trained in the latest management techniques can often help to improve the efficiency of operations in the host country, whether those operations are acquired or green-field developments.

Bartlett and Ghoshal (1998), when considering the management challenges to building transnational capabilities, state that the key organisational task is not to design the most elegant structure but to capture individual capabilities and motivate the entire organisation to respond cooperatively to a complicated and dynamic environment. They consider that matrix management is not a structure but a frame of mind. Matrix management structures have been adopted by Australian banks with international operations and the comments by Bartlett and Ghoshal (1998) may be relevant in developing a cooperative culture.
2.6 CONCLUSIONS ON THE KEY ISSUES ON INTERNATIONAL BUSINESS EXPANSION IN THE LITERATURE RELEVANT TO THIS THESIS

In a broad summary of some aspects of the literature, Australian banks and financial services companies expanding internationally may need to focus on:

- research and development, particularly developments in market leading countries such as the United States;
- the formation of joint ventures or alliances, to build knowledge and skills, and to gain easier access to markets;
- reducing product costs through economics of scale;
- recognising that the experiences of one industry or product may provide valuable learnings to another industry or product;
- capturing individual capabilities;
- motivating the entire organisation to respond cooperatively to a complicated and dynamic environment;
- engaging in multiple networks of cross-cultural communications, within a system of coordinated interdependent activities; and
- establishing a comparative advantage.

Hill (2005) states the later entrant may benefit by observing and learning from the mistakes made by the early entrants. This is particular importance for Australian banks and financial services companies that are unlikely to have won in the race for first-mover advantage against much larger and well established United States and European competitors.
Australian banks and financial services companies need to recognise that the experience of companies within the same industry may vary with the implementation of an international strategy at a different time or under different management.

The multicultural nature of Australian society may be of benefit to Australian banks and financial services companies expanding internationally, and the will to win displayed by Australian sporting heroes is necessary in Australian business. Perhaps the words of James Wolfensohn, the former Australian head of the World Bank, carry part of the answer for Australian banks and financial services companies; ‘one of the national (Australian) characteristics is that you feel that you can do anything you want to do. When I (Wolfensohn) was younger I felt I could do anything and, as well, the Australian environment is such that you had the opportunity to do anything. So when I went overseas I just pretended that the world was the same sort of place.’

2.7 THE INTERNATIONAL EXPANSION MODEL

The aims and purpose of this thesis are to develop a model of the key strategic decisions necessary for international expansion that may be used as a guide for Australian publicly listed companies in the banking and financial services sector that are seeking to develop their business in foreign markets and, to develop an understanding of the various elements of such a model. This literature review has contributed to these aims.

In looking to gain a deeper understanding of the various elements in the model developed in this thesis as set out in Figure 2.5, it became evident that three decision categories: the scale of entry, the speed of entry and the governance of entry should be combined as part of the entry mode category. In addition, the entry mode category and the entry team were seen as closely linked decisions, in the same way that the country selection and the product selection decisions where linked, and were most effectively made as concurrent decisions rather than sequential
decisions. Further, a number of additional factors were identified as being important elements in
the decision making process. Accordingly, these additional factors have been added to the
model appearing in Figure 2.16, with the additions appearing in red.
Figure 2.16  A model of the key strategic decisions in international expansion for the banking and financial services sector – Stage 5 (with changes from stage 4 (Figure 2.5) highlighted in red)

**TIMING of ENTRY**

**COUNTRY SELECTION**

**PRODUCT SELECTION, MARKET SEGMENTATION and CUSTOMER SELECTION**

**MODE, SCALE, SPEED and GOVERNANCE OF ENTRY**

**ENTRY TEAM**
Chapter 3  
METHODOLOGY AND RESEARCH DESIGN  

3.1 INTRODUCTION  
This chapter describes the methodology and research design that will be undertaken to build a model of international expansion that will highlight the strategic analysis and key strategic decisions necessary for a company in the banking and financial services sector to expand its offshore business. Much of the literature draws from the experience of United States, European and Japanese companies across many industries and provides knowledge that is valuable across a broad spectrum of business. The contribution of this research is that adds to the current body of knowledge in relation to international expansion by a specific sector; the banking and financial services sector.  

3.2 RESEARCH METHOD  
This thesis will follow the guide of Miles & Huberman (1994) who see the methodology for research as being comprised of the research design, data collection, and qualitative or quantitative analysis. Blaikie (2000) considers that quantitative researchers tend to work with the idea that there is only one social reality, while qualitative researchers accept the possibility of, and search for, multiple realities or worldviews. Al Qur’an (2005, citing Darlington & Scott 2002; Jarratt 1996; Kohli & Jaworski 1990; Perry 1994; Yin 2003) states methodologists have urged that qualitative methods are suitable and vital when the research is exploratory. Methodologists have also urged the use of qualitative methods when the research questions are: what is, how, or why (Al Qur’an 2005, citing Amaratunga et al. 2002; Yin 1994).  

A qualitative research method has therefore been adopted for this thesis in preference to a quantitative approach as this thesis does not commence with a preconceived theoretical idea or
seek to statistically test the validity or otherwise of a given hypothesis, but seeks to develop a model of the social reality, as the research unfolds, for strategic business decision in a given field. This qualitative research method is guided by Mintzberg (1979) where he encourages the use of rich description and details that derive from the narrative (story style) methods of qualitative research and by tracing the flow of decisions in an organisation.

Husen (1998) states that the interpretive approach is founded on the humanities with an emphasis on holistic and qualitative information to provide rich insights into components of a social phenomenon. The interpretive theorist sees the social world as possessing an uncertain ontological status and that truth is socially constructed (Ticehurst & Veal 2000). An interpretive approach is used to understand meanings of particular situations (Schwandt 1994) and where research is adding new understanding and concepts in that field, the investigation necessitates adopting the interpretive approach (Yeung 1995). Accordingly, an interpretive methodology has been employed in this thesis.

3.3 RESEARCH DESIGN

Bryman & Bell (2003) see business research design as a framework for the collection and analysis of data which is comprised of five different types: experimental design, cross-sectional or social survey design, longitudinal design, case study design and comparative design. This research will include a case example to assist in the development of the model based on the practice of one company, in one industry, with extensive experience in this area.

From the literature review, a model for international business expansion was built as the theoretical framework. The model evolved throughout the literature review and was constructed by drawing together the models and research findings of a number of writers on international business. A case example was then undertaken from published data (secondary data). The
design of this secondary data followed the model developed from the literature and against which the theoretical model was examined. The case example was then expanded by a series of semi-structured interviews with key directors and corporate executives of the case example company (primary data). These interviews were open in style in order to draw out the opinions of the interviewee and in order that they were not influenced by the direction or nature of a set of questions in a structured interview. The findings from the secondary and the primary data were then analysed against the model, in order to identify if there were any gaps in the model and to gain a greater understanding of how the model may be applied to guide a company in the banking and finance sector in Australia considering overseas expansion. It is from the experience of the case example company compared with the theoretical model that the conclusions for this research were based.

3.4 DATA COLLECTION AND ANALYSIS

Data collection for the research came from:

- a literature review;
- a case analysis, based on published data; and
- an expanded case analysis, based on a series of semi-structured interviews.

3.4.1 Information Drawn from the Literature Review

The literature review is on international business with a focus on Australian companies in the banking and financial services industry. Global events which impact on international business may have an impact on the banking and financial services industry in two ways: the direct impact on the operations of banks and financial services entities themselves; and indirect through the impact on their customers, causing the banks and financial services entities to respond to a changing business environment. The review was undertaken to identify the extent to which the
current literature addresses the issues which are relevant to the aims of this research project, and to identify where a contribution could be made to the current body of knowledge in relation to professional practice in the banking and financial services industry in Australia.

The findings from this part of the research were that certain factors pertaining to international business were well covered in the literature. A good deal has been written that provides a guide to effective exporting, but this is only of limited value to the banking and financial services industry. A good deal has also been written concerning international cultural differences, the mode of entry into a foreign market and the location of foreign direct investment. Relevant aspects of this literature have been reviewed in the literature review in this thesis.

For United States, European and Japanese companies, the literature on globalisation and internationalisation is extensive. There is only a limited amount of relevant literature on Australian companies in the banking and financial services sector seeking to establish operations in countries other than Australia.

The literature on international business examines specific elements of the strategic decision-making process that must be undertaken when a business is looking to expand its operations into a market beyond the home market, but does not cover all of the strategic decisions. The more comprehensive literature addresses a number of the key strategic decisions, but the views of a number of the writers differ in their focus and the strategic decisions they regard as the most important. This raises the questions as to whether there is an opportunity to contribute to the current body of knowledge by providing a strategic decision-making framework for international business expansion by drawing together into one place the diverse views of a number of writers.
and also by providing a focus on Australian companies in the banking and financial services sector.

Based on the review and analysis of the literature, the information collected as the key strategic management decisions was used to develop a model for international expansion in the banking and financial services industry. This model outlined the areas where key strategy analysis is necessary in order to provide a sound basis to make key strategic decisions about expanding the operations of a company in the banking and financial services sector in international markets. This is directly relevant to the aims and purpose of this thesis which are to develop a model of the key strategic decisions necessary for international expansion that may be used as a guide for Australian publicly listed companies in the banking and financial services sector that are seeking to develop their business in foreign markets and, to develop an understanding of the various elements of such a model.

The model is based on the following key strategic management decisions relevant to the banking and financial services industry:

- **When**: the key strategic decision concerning when is the ‘right time’ to undertake international business expansion;
- **Where**: the new market / country selection;
- **What**: the product selection for the new market;
- **How**: the mode of entry into the new market.

Although somewhat obscure in much of the literature, a further key decision was later added as follows:

- **Who**: the entry team.
As the model evolved in the literature review, the mode of entry was expanded to include the scale and speed of entry and governance. These elements were all considered to be interrelated and should be considered at the same time. In addition, the decisions concerning country selection and product selection were considered to be decisions that should be made concurrently not sequentially. In the same way, the decisions concerning the mode, scale, size and governance of entry were decisions that should be made with a strong focus on the entry team and the capabilities of that team.

The key strategic decision concerning the right time to undertake international business expansion is not well covered in the literature and can involve a detailed strategic analysis of the position of the bank or financial services company in its home market, the availability of resources to expand internationally and an assessment of the company’s competitive advantages. The sequence in which the strategic decisions should be made and the inter-relationship between such decisions, were critical factors that were viewed with a variety of approaches in the literature.

3.4.2 Case Analysis

Much of the literature is broad in nature and provides general guidance which has relevance, in varying degrees, to all industries and to companies from all countries. However, in seeking to add to the general body of knowledge there is an opportunity to look more closely at Australian companies in the banking and financial services sector.

The case study strategy is accepted and widely utilised by doctoral researchers in the management field (Adams & White 1994; de Weerd-Nederhof 2001; Perry 1993; Yin 1994, 2003). The case study strategy allows investigators to retain the holistic and meaningful
characteristics of real-life events, including individual’s life cycles, organisational and managerial processes, neighbourhood changes, international relations and the maturation of industries (Yin 2003). The case method is an example of an interpretivist approach or methodology, including an abductive approach to generate the data (Blaikie, 2000). The case study design represents the research plan that guides the process of data collection, analysis and interpretation (Yin 1994, 2003). Cooper & Schindler (1998) state that a single case can provide a major challenge to a theory and provide a source of new hypotheses and constraints simultaneously. Brown, Steane and Forster (1998) state that case analysis is essential to allow students to learn something about the realities and practicalities of business. This thesis does not provide a full case study which would normally include a history and detailed financial summaries. This thesis provides a case analysis examining relevant aspects of a bank’s international development and experience in line with the aims of this research project.

The role of cases in business research was addressed by Brown, Steane and Forster (1998) who stated that the main concern of the case presented can be with a theoretical framework for which the case has some empirical relevance, or it may be that the case has a phenomenological significance, and so is more concerned with understanding and interpreting the specific real world situation of the case itself, rather than evaluating a particular theory. Brown, Steane and Forster (1998) drew on the work of AD Chandler in stating; ‘..... there is no ‘correct’ way to create, construct, analyse, criticise or use either individual cases or the case study approach in general’. Brown, Steane and Forster (1998) drew further on the work of AD Chandler in stating; ‘..... we must be prepared to accept that there is an extraordinary large number of ways, all potentially valid, through which to approach both individual cases and the case study method as a whole. Because of this, cases will necessarily always vary from each other, to at least some degree, in purpose, content, style, size and method’.
At the first conference of strategic management educators held at the Queensland University of Technology in 1994 there was a call for the development of new Australian and New Zealand case material. This call is still relevant. Managers in Australia and New Zealand operate in a unique economic, social and political context. Whilst United States and European cases have successfully been used in strategic management for many years, local instructors and students feel that Australian cases provide more relevant learning experiences (Lewis et al. 1996). This thesis contributes to the responses made to this call by undertaking a case analysis into an Australian company in the banking and financial services industry that had expanded internationally.

3.4.2.1 Selection of the company for the case analysis

Al Qur’an (2005, citing Stake 1994; Patton 1990; Yin 1994, 2003;) states that selecting the pertinent case study from the target research population is a decisive phase in case study design and influences understanding of the research issue being investigated. However, the purpose of the case study is not to represent the world but to represent the case. Al Qur’an (2005) cited Patton (1990) as introducing the concept of ‘purposeful sampling’ suggesting that case studies should be selected from among potential cases which are information-rich and provide the researcher with deep knowledge and understanding about the research issue.

The case example selection approach adopted in this thesis was initially to review the companies listed on the Australian Securities Exchange (ASX) from published ASX data (secondary research) in order to identify those Australian companies which met the following criterion:

- a developed international operation in several countries;
- a high proportion of its assets located outside of Australia;
- a high proportion of its revenue base generated outside of Australia;
had experienced both success and setbacks in foreign markets; and
access to individuals who would be suitable for the interview process.

A number of companies were identified as meeting this criterion, and a selection was made based on:

- decisions concerning international expansion that were not made many years ago and where such decisions where an ongoing part of core business; and
- the perceived access to individuals who would be suitable for the interview process. That is, executives and directors who were actively involved in the decision-making process and who are still with the company or who have left the company but are still available to participate in the interview process. The company selected was an Australian company in the banking and financial services sector. For this research, the company selected was code named – "AIFC".

3.4.2.2 Phase one of the case analysis – published data

Secondary research was then undertaken into AIFC. The secondary research involved a review of company announcements to the stock exchange, media releases, and annual reports over the period 1985 to 2009, with some earlier research into the history of AIFC. This secondary research also included a search of stock broker reports, business magazine articles, newspaper articles and literature on the development of banking and finance in Australia. The purpose of the secondary research was to identify strategies and a set of principles that could be regarded as the key strategic management decisions for the company in developing an international business.

The case analysis secondary research was used to refine the model developed from the literature review and to gain a greater understanding of the various elements of the model. This
step in the research to develop a model for international expansion then reflected characteristics applicable to an Australian company and as such has a greater relevance to the Australian business environment. However, this model has limitations and is not necessarily applicable to all Australian companies. This is discussed further in the section on Limitations on the Research later in this chapter.

3.4.2.3 Phase two of the case analysis – interviews

The case study research methodology relies extensively on interviews (Perry 1998). Blaikie (2000) states that from a qualitative researcher’s point of view, something more is required than simply publishing transcripts of in-depth interviews. Accordingly, the next phase in the research, the interview components of the case analysis, were structured in the form of a series of semi-structured interviews. The interviews were designed to provide data which was analysed in accordance with an interpretivist approach or methodology. The interviews were open in format to allow the interviewees to express their views openly and freely and not to be influenced by a set format or predetermined questions.

There were eleven interview candidates. They were drawn from current and former executives and non-executive directors of AIFC (the case analysis company). The individuals selected had all gained extensive international business experience. The current and former executives included a mixture of individuals who worked in offshore subsidiaries and in the head office in Australia in order to obtain a range of views concerning the key reasons for successes and the problems that had been experienced. An important factor in the value and quality of this research is the seniority of the people interviewed. That is, the individuals interviewed are at an eminent level of Australian business leadership. These people are not normally available for research interviews.
All of the interviewees were provided with a written Invitation to Participate in a Research Project, in accordance with the Ethics Approval granted by the RMIT University, in advance of the interview; and each interviewee signed a Prescribed Consent Form for Persons Participating in Research Projects Involving Interviews, Questionnaires, Focus Groups or Disclosure of Personal Information.

3.5 LIMITATIONS IN THE RESEARCH AND FIELDS FOR FURTHER STUDY

One of the limitations of this research is that it is focused on one large Australian listed public company in one industry sector; the banking and finance sector. The findings from this research may, or may not, apply to another company of a different size or operating in another industry sector. Large companies generally have access to greater resources, including financial and human, and therefore the findings from the research may not be directly relevant to smaller Australian businesses. Barriers to entry in foreign markets may vary from industry to industry and the banking and finance industry does not need to build production plants in a foreign country. The availability of skilled managers and workers for various industries may also vary from country to country. In addition, within the banking and finance sector, there are a number of sub-sectors, retail and business banking, specialist banking products and services such as foreign currency trading, project financing, structured financing and funds management. This thesis has focused on a large company that incorporates all of these sub-sectors, but a company operating in only one of these sectors or with a different segment mix, may experience a different outcome from those identified in this thesis. Advances in electronic commerce also allow a company in the banking and finance sector to establish business operations in a foreign market without the need to establish a physical presence in that market. This thesis does not focus on such a form of international expansion.
Another limitation to the research is that it is heavily influenced by the use of interviews. Yin (1994) has warned about the limitations of research based on interviews where bias, poor recall or inaccurate articulation of the interviewee and self-serving response may have an impact. There is also the possibility of an interviewee providing a self-serving response in order to justify his own business decisions. Accordingly, each of the interviewees was asked to speak about matters of principle pertaining to strategic decision making. None of the interviewees sought to ‘re-write history’ to better reflect their own involvement and all interviewees remained focus on the strategic decision making process and did not wander into reflections on personal success or failure.

This research is focused on the establishment of an international business operation and does not focus on the longer term management of such a venture. This ongoing phase of operational effectiveness beyond the establishment phase could be a topic for further research.

3.6 CONCLUSIONS

The various research methods were selected to develop a set of conclusions which were reflected in the model for international expansion, which, it is hoped, will contribute to the general body of knowledge for professional practice in this topic.
Chapter 4

DATA COLLECTION AND RESEARCH FINDINGS - CASE ANALYSIS

4.1 INTRODUCTION

Cooper & Schindler (1998) stated that a single case can provide a major challenge to a theory and provide a source of new hypotheses and constraints simultaneously. At the first conference of strategic management educators held at the Queensland University of Technology in 1994 there was a call for the development of new Australian and New Zealand case material. This call is still relevant and this chapter responds to that call.

This chapter, chapter 4, deals with data collection and uses a case analysis which is based on two stages of development as follows:

- based on published data; and
- based on a series of semi-structured interviews.

The analysed data from the case analysis will then be compared with the theoretical framework derived from the literature review as follows:

- The case analysis secondary research is based on data examined from annual reports, newspaper and magazine articles and literature on Australian history that is relevant to the subject company. This secondary research is used to validate and refine the model developed from the literature review; to develop a deeper understanding of the various elements of the model; and to reflect characteristics applicable to an Australian company in a specific industry and as such has a greater level of reliability to the application in an Australian business environment.
- The case analysis primary research is based on the interviews with current and former directors and executives of the selected banking and financial services company and is
again used to further refine the model and develop a deeper understanding thereof. This phase of the research reflects a richer level of research and provides greater insights than those available from the published data alone.

However, this model has limitations and is not necessarily applicable to all Australian companies, as outlined in chapter 3, section 3.5 Limitations in the Research.

### 4.2 THE CASE ANALYSIS COMPANY

Chapter 3, the methodology and research design chapter, set out the selection criterion for the case analysis company. This chapter sets out a case analysis into an Australian company that has expanded into international markets with mixed results. The subject company selected for the case analysis is in the banking and finance sector and will be referred to as “AIFC” (an Australian International Financial Conglomerate) for the purpose of this case analysis. This case analysis sets out the international expansion of AIFC. The case analysis company’s experience is compared against the theoretical international expansion model derived from the Literature Review and the theoretical model is then refined based on the experience of AIFC and the knowledge derived from the case analysis. These conclusions appear in 4.5.

### 4.3 PHASE ONE OF THE CASE ANALYSIS BASED ON PUBLISHED DATA

#### 4.3.1 Early Offshore Expansion

AIFC’s first moves offshore had specific focus driven by business needs from both sides of the balance sheet. These needs were:

- The need for capital; and
- The need to support Australian customers in their international trade businesses.

The business case for a branch in Mauritius derived from the trade between Mauritius and Australian. Australia was a major importer of sugar from Mauritius and this provided opportunities to profit from offering a range of banking services, eg discounting bills of exchange
and foreign currency transactions. AIFC advertised for ‘a gentleman, conversant with the French language’ to open a branch and to sell shares in Mauritius (Blainey and Hutton 1983). Within a year, the manager and the teller of the Melbourne branch set sail for Mauritius and established the new branch. The manager of the Melbourne branch returned after four months and the former teller of the Melbourne branch was appointed manager of the Mauritius branch. The Mauritius branch appears to have gotten off to a good start with strong business growth and subscriptions for shares. However, within a year of the opening of the first overseas branch, a struggle for control of the bank back in Australia resulted in a change in the chairman and the general manager. Special auditors were brought in to review all of the AIFC business and they condemned the Mauritius branch as not being within the objects of the bank to service Australasia. Apparently, the overseas branch was providing greater assistance to the local merchants and planters than it was to Australian merchants who traded with the island. It took some time to effectively close the branch and many of the loans proved to be irrecoverable (Blainey and Hutton 1983).

There were many lessons to be learnt from the opening and closing of its first overseas branch. Perhaps the most important of these lessons was that the business was totally dependent on managers of experience and integrity. The number of new banks opening in Australia at that time had resulted in demand for experienced bankers being greater than supply. These lessons are relevant to the model for international expansion, particularly in relation to the entry team. Although the choice of market may have been soundly based, the choice of product, at least by the local manager, appeared to be a major weakness. The mode of entry appears not to have been a problem but the scale of entry appears to have been too large, too early. This experience convinced the new directors at the time that they should be more conservative and cut back on their plans for expansion, particularly in relation to remote locations were close supervision was not possible (Blainey and Hutton 1983). These lessons are all relevant to the timing of entry. It
was too early in AIFC’s development phase / corporate life cycle to undertake an operation at such a distance from the home market, particularly when communications at the time was limited. The need for clear policy directives, procedures, adequate controls and accountability are a key lesson. This reinforces the element the model for international expansion that is not a strong focus in the international business literature: corporate governance.

The next offshore operation was to establish an office in London. AIFC was reliant on the reserves established from the gold sent to London and it sought to take matters in London under its direct control by discontinuing its English agent and opening its own London office. The manager sent to run the London office was the trusted and tested young Adelaide manager. He hired staff in London who had local experience and a Board of Advice was established to guide the new London manager. The Board of Advice was comprised of two individuals and was later expanded to three. These individuals had experience in both the London and Australian markets and understood the complexities of doing business in both markets. The London office had an active and successful business based around the import / export trade between the United Kingdom and Australia (Blainey and Hutton 1983).

4.3.2 More Contemporary Offshore Expansion

AIFC had only one offshore operation in the mid 1950s, its London branch. International expansion had been cautious, following the lessons learnt from earlier ventures and the severe disruption caused to normal commercial activities by World War 1 and World War 11. AIFC was represented overseas by a wide network of correspondent banks. This provided an opportunity for AIFC to gain a more in-depth understanding of international banking whilst exposing the bank to limited risks (Blainey and Hutton 1983). The importance of this period as a limited risk, limited cost, and high learning period in AIFC’s corporate life cycle should not be under estimated.
Australian banks, whether banks formed in Australia or formed in England with the prime purpose of trading in Australia, do not appear to have opened branches beyond Australasia, the Pacific Islands and London prior to 1960, with the exception of AIFC (Blainey and Hutton 1983).

The beginning of the 1970s saw Australian banks at the threshold of a period of rapid growth. Traditional patterns of trade were changing, the old familiar links with London were becoming weaker and the increasing probability that Britain would join the European Common Market made it prudent for Australian banks to look for alternative markets. Importers and exporters were already developing trade on the Pacific Rim, particularly with a resurgent Japan, which was replacing Britain as Australia’s main trading partner. The banks followed trade to service its needs and, with the mining boom at hand, Japan became an obvious area for expansion (Blainey & Hutton 1983). Senior officers of AIFC paid regular visits to Japan and two officers were sent for six months’ training with Japanese banks. AIFC enjoyed full correspondent relationships with all the authorised exchange banks in Japan. After these preparations, a representative office was opened in Tokyo (Blainey & Hutton 1983).

From 1980 on, profound changes began to occur in the banking and finance sector in Australia. Some key dates and events are recorded in Appendix 2. Most of these events impacted on the level of competition in the Australian financial system, including the entry of foreign banks into the Australian market and the removal of many restrictions on non-bank financial institutions. These events were major motivating factors for Australian banks to look offshore.

In 1981, AIFC undertook a major bank merger in Australia and this served as the foundation for a strong domestic base on which it would build its overseas expansion strategy. However, AIFC was still one of the smaller Australian banks when, in 1983, the Australian financial industry
began to deregulate following the Campbell Inquiry. Such deregulation allowed the banks to offer a broader range of services, the Australian dollar was floated and the distinction between savings banks and trading banks was abolished. The major Australian finance companies, which had become subsidiaries of the major banks during the previous decade, were more fully absorbed into their bank holding company. Eventually many of the smaller non-bank financial institutions disappeared, while some of the largest building societies were able to obtain banking licences. Foreign banks were able to open branches more easily and were granted full banking licences in Australia (Australian Bankers’ Association, Appendix 2).

The AIFC Annual Report 1984 page 65 lists subsidiaries, branches and representative officers in the following offshore locations:

**United Kingdom and Europe**

London, England

Athens, Greece

Frankfurt, Federal Republic of Germany

**United States of America**

New York

Los Angeles

Chicago

Dallas

San Francisco

**Asia / Pacific**

Singapore

Kuala Lumpur, Malaysia

Hong Kong

Beijing, Peoples’ Republic of China
Jakarta, Indonesia
Tokyo, Japan
Seoul, Republic of Korea
Port Moresby, Papua New Guinea.

In later years, a number of these operations were consolidated into a smaller number of centres as technology improved and allowed easier communications and electronic funds transfer.

AIFC also provided direct loans to offshore companies and participated in loan consortiums. AIFC had participated in loans to Latin American companies and governments in the late 1970s and early 1980s; much of this was a rite of passage into the international banking market. Many of the Latin American loans had rescheduled their loan repayments in the early 1980s but the AIFC Annual Report 1984 page 23 reports that the position was considered to be ‘most satisfactory’.

The future growth of China was well recognised and in 1985 cooperation agreements were signed with two provincial authorities, the Jiangxi and the Tianjin International Trust and Investment Corporations, taking to five the number of such agreements AIFC had entered into in China. AIFC also had a similar agreement with the Agricultural Bank of China, which marked a significant point in the development of agricultural trade and investment between the two countries (AIFC Annual Report 1985 p 24). AIFC subsequently made further investments in China, including a diversification of the investment profile with the purchase of a 20% interest in Union Trust & Investment Limited (UTI) based in China. UTI is part of China’s evolving trust sector and primarily originates and manages property trusts (AIFC’s announcement to the securities exchange 4 February 2008).
The opening of AIFC officers in London provided AIFC with access to a broader capital market, to raise capital and to borrow funds to finance the business. The AIFC annual report 1984 (page 23) stated that borrowings in international finance centres were able to raise funds at very fine rates. In the period up to 1980 the focus was also on supporting AIFC’s Australian business and individual customers in their international activities. Deregulation of the banking and finance market in Australia allowed the entrance of overseas banks which gave AIFC the opportunity to break through the barriers to entry in a number of other countries through reciprocity agreements (AIFC Annual Report 1985 p24).

Deregulation of the banking and finance sector brought intense competition and the older, well-established banks sought to retain market share against the new players in the market. The well-established banks adopted different strategies to maintain their position in the banking and finance market. Some banks eased their lending restrictions and this produced an increase in credit availability which fuelled the asset price boom in the 1980s. However, AIFC adopted a different strategy maintaining tight credit control in its domestic market whilst adopting a more active international expansion strategy. In 1987, AIFC international presence assumed a new dimension with the establishment of a bank in New Zealand and the acquisition of banks in the United Kingdom and the Republic of Ireland. In 1990, a further bank was acquired in the United Kingdom making AIFC the largest foreign bank in the UK (Submission to the Parliamentary Inquiry into the Australian Banking Industry by AIFC 1991).

The 1987 and 1990 acquisition of banks in the United Kingdom and the Republic of Ireland marked a significant increase in AIFC’s investment in offshore markets and a significant move into retail banking outside of Australia. The United Kingdom market was a market in which AIFC had a long history with its branch in London. AIFC’s annual report 1987 states that the acquisition of the offshore banks in that year were in accord with the group’s policy of selective
offshore expansion and fitted the criteria the group had previously set. The annual report further stated that the new banks were sound institutions with excellent reputations. They were seen as providing important benefits to the group, including:

- Access to an extensive branch network in the United Kingdom and Ireland and a strong retail deposit base to be used as a platform for further expansion into England and selected European markets;
- Nil exposure to debt-rescheduling countries (loans to South American countries was a major problem at that time); and
- Retail-oriented operations that are compatible with AIFC’s expertise in retail banking.

For AIFC the selection of markets followed:

- the strategic importance of the market;
- an opportunity to enhance knowledge of the international banking and finance market; and
- an understanding of customer needs.

This reinforces many of the theories raised in the Literature Review.

As a result of this different approach to deregulation, AIFC emerged into the 1990s as one of the largest of the Australian banks, based on stock market capitalisation and total assets. This success was based on a strong domestic franchise and a growing international expansion strategy, and AIFC became a preferred investment among fund managers. The international expansion strategy continued with the acquisition of a bank in New Zealand in 1992, the acquisition of a bank in the United States in 1995, an expanded Asian strategy in 1995, and the acquisition of a large mortgage origination and servicing company in the United States in 1998. At the same time AIFC’s technology / computer processing centres in the United Kingdom were consolidated into a single centre. In the Asia / Pacific region, the technology operations in New
Zealand, and some of the Asian operations were consolidated into Australia (AIFC annual report 1998).

However, by 1997 the cost of further international expansion became prohibitive. Gottliebsen (1997) quoted the chief executive officer of AIFC as saying that the problem was that United States and European bank prices were heading towards three and a half times assets, US banks were selling at a price / earnings ratio of around 16 compared with about 15 in Asia, 14.5 in Britain and about 12.3 in Australia. Accordingly, any acquisition would need to have substantial synergistic benefits.

Murphy (1995) states that AIFC’s move into the United States in 1995 did not mean the bank had forgotten expansion in Asia where the strategy was to gradually increase its own business in the region rather than buy someone else’s problems. Murphy (1995) quotes AIFC’s head of Asian operations, based in Hong Kong, who stated; ‘Until now we have operated in Asia in support of our regional banking customers. Our new strategy is to grow a local customer base in Asia’. The target for the Asian operation was to contribute at least 10% of annual group profit after tax within 10 years. Murphy (1995) suggests that in spite of the economic growth in Asia, the field is crowded, with markets such as Hong Kong and Taiwan probably over-banked after the establishment of a host of new private-sector banks. Hong Kong had about 180 deposit-taking institutions covering a population of 6.1 million. However, Murphy (1995) states that AIFC already has a strong business in housing finance for Asian customers investing in Australia, New Zealand and Britain. In its new strategy, AIFC did not plan a branch network but focused on a particular market segment; personal banking services aimed at the upwardly mobile customers, that were being overlooked by rival organisations, through a relationship banking model based on the latest technology (Murphy 1995). Other target market segments were the many would-be migrants from Hong Kong and Taiwan to Australia; and building on the financial services to
support trade between Asia and Australia by offering such services to support trade between Asia and Britain.

Looking at the 1995 target of growing the Asian profits to 10% of group profits within 10 years, it is not possible to see if this was achieved from the annual reports, as a later restructure saw Asian operations reported in with the Australian business segment in 2005. However, it is unlikely this target was achieved given that the East Asian Financial Crisis began in July 1997. Indonesia, South Korea and Thailand were the countries most affected by the crisis. Hong Kong, Malaysia, Laos and the Philippines were also hit by the slump. Mainland China, Taiwan, Singapore and Vietnam were relatively unaffected. Japan was not affected to any large degree by this crisis but was going through its own long-term economic difficulties.

Gottliebsen (1997) stated that AIFC’s United States and European bank subsidiaries account for more than half the share price of AIFC. Gottliebsen (1998) stated that the new shape of AIFC was remarkably similar to the template that Ford Motor Co president Alexander Trotman introduced to the company’s global operations three years earlier. Trotman converted Ford from a company operating individual subsidiaries in many countries to a truly global organisation. AIFC developed a new governance approach, restructuring the organisation into four international business units. Gottliebsen (1998) stated that the first of these units was the retail business, covering business and personal financial services, where cities and regions were divided into geographic circles. Within those circles financial service centres were established, surrounded by sales outlets, many of which were in shopping malls and operated during the same hours as retail stores. The second international business unit was responsible for the development and sale of global products (excluding mortgages). These two units operated under a matrix management model whereby the head of (say) leasing in the United Kingdom had a dual reporting line to the country head in the UK and the product head in Australia. The third
international unit was responsible for home mortgages and utilised the unique mortgage-processing technology acquired from the United States in a wholly-owned acquisition the year earlier. The fourth international unit was wholesale financial services. Gottliebsen (1998) added that the impact of this world-ranking technology on the US mortgage business makes AIFC vulnerable to a large US raider and this was one reason why the stock was performing so well. He also added that AIFC had benefited from three chief executives who built on the foundations of their predecessor, acquiring banks in Australia, Britain and the United States at prices that Gottliebsen (1998) described as ridiculously low a few years after their acquisition.

From a review of the annual reports of AIFC over the years 1984 to 2009, it appears that in these earlier years the senior manager in a representative office and an offshore branch is an expatriate who moved through various roles in the international banking network, supported by local staff who presumably had knowledge of the local market. In later years, the managers of representative office and offshore branch were not listed in the annual reports or any other public documents. The same position also applied to wholly-owned overseas merchant bank or finance company subsidiaries, with the chief executive normally being an expatriate, with a board of directors normally comprised executives from the home market, including the chairman. For partly-owned overseas merchant banks or finance companies, the chief executive was normally a local, with a board of directors normally comprised of local business people and a chairman who was from the local business community.

Full service retail banks are licensed to receive deposits from local retail and business customers and to provide a wide range of loans and other financial services to local retail and business customers. For wholly-owned overseas retail bank, the appointment of the chairman and the chief executive officer can be traced through AIFC’s annual reports, and continues to the current day. AIFC’s practice has been for the chief executive to be a local. The structure in the United
Kingdom and Ireland was to establish a regional holding company to oversee the operations of the four subsidiary company banks. The chief executive of the regional holding company has normally been an expatriate. The practice concerning the board of directors has been to appoint local business people, including the chairman. Local regulatory requirement may require the chairman and the majority of the members of the board to be locals as part of the mechanism of protecting local interests. For a wholly-owned bank, AIFC also appoints key executives from the home market, mainly the chief financial officer and the chief risk officer. For partly-owned overseas retail bank, the chief executive is normally a local, appointed by the majority shareholder. The minority shareholder will normally be offered a seat on the board of directors with other directors appointed from local business people and a chairman who is from the local business community.

After a period of strong success, to which the international expansion was a strong contributor, AIFC then suffered a major setback. AIFC incurred a significant loss in one of its subsidiaries in the United States. This began a period of unfortunate events and the stock market lost confidence in its preferred stock. AIFC then went through a period of re-evaluation. The global structure of the wholesale bank was retained but the retail and business banks adopted a regional structure. Its international growth strategy also went through a period of re-assessment and there was a review all of its operating and strategic assets (AIFC annual reports 2004 and 2005).

4.3.3 Are Offshore Operations Strategic Assets or Trading Assets?
A number of observations can be made from secondary data but it is difficult to ‘get inside the mind’ of the decision makers from published data. The interviews conducted as part of this research project will enable a more in depth exploration of the many facets of international
expansion. In the meantime, it may be possible to assess some of the strategic analysis concerned with the international expansion by looking at the sale of offshore assets.

In 1995, AIFC acquired a bank in the north of the United States; and in 2001 this bank was sold. In 1998, AIFC acquired one of the largest mortgage origination and servicing companies in the United States; and sold this company in 2002. In 1987, AIFC purchased banks in Northern Ireland and in the Republic of Ireland; and in 2005 it also sold these banks. The question to be explored is: Why did it sell these banks and are there any lessons to be learnt from the sale that may reflect back on the acquisition decisions?

Each of the banks was making contributions to total group profits but the reason for the sale of the United States bank, as outlined in the annual report 2001 of AIFC, was: ‘We apply portfolio management techniques to ensure that our portfolio of businesses is suited to the overall direction of the [AIFC] Group and offers sound financial prospects. We also appraise new opportunities that may enhance the value of our business. .......The decision to sell this asset was based on the view that further growth would require significant capital investment to build scale in the consolidating United States regional market’. A substantial write-down in the value of the United States mortgage origination and servicing company also occurred in that year and it was announced that the mortgage company would also be sold. The substantial write-down in the value of the mortgage company does not appear to have played a major role in the sale of the US bank as AIFC’s annual report 2001 states that the total capital position, which measures the regulatory capital reserves compared with risk weighted assets, is 10.2%. Even after recording the significant write-downs in relation to the mortgage company, this measure of the strength of AIFC’s capital base is well above the minimum regulatory and rating requirements. At that time, and subsequently, AIFC’s annual report disclosed a strong focus on the ‘Goals for growth’. The annual report 2001 states that AIFC is committed to maximising returns to shareholders. The
goals for growth were to provide 10% compound growth in cash earnings per share and 5% compound growth in EVA (Economic Value Added measures the economic profit earned in excess of the cost of capital. EVA is a registered trademark of Stern Stewart & Co). Accordingly, the sale of the United States bank was due to the need for greater capital if it was to grow and the question over its ability to provide the rate of return on that capital as required by the overall group objectives. Gottliebse (1998) described the price paid for the US bank as being ridiculously low a few years after its acquisition. The sale produced a substantial profit which allowed capital to be used elsewhere in the business which provided a better rate of return. AIFC then purchased another bank in the United States in 2008. The sale of the mortgage servicing company appears to have been a risk management decision as the annual reports of the time refer to the removal of risk from the balance sheet. The sale of the banks in Ireland occurred for the same reason as the sale of the United States bank and produced significant profits. These profits provided capital for an organic growth program in the south of England with the establishment of a network of strategically located financial solution centres. These centres offer integrated business and private banking services to business and high net worth customers.

The lesson for potential acquisitions offshore appear to be that every business in the group of companies must, at the time of purchase and continuously thereafter, contribute to corporate goals. Even though three banks offshore were subsequently sold, the original decisions to purchase these banks must be regarded as sound given the valuable contributions to group profits year-on-year and the subsequent capital gains. Although not quantifiable from the annual reports, it is inevitable that, in addition to the direct financial returns, there must have been a valuable knowledge management transfer from the offshore markets back to the head office.
4.3.4 Capitalising on the competitive advantage of a product

AIFC’s subsidiary banks in the United Kingdom issues a media release on 22 January 2007 headed – ‘Popularity of offset mortgages grows by a third’. The media release stated that this rate of growth had occurred since the Bank of England began increasing interest rates in August 2006.

The media release said that in the last few months (before January 2007), the bank had seen more and more people considering offset mortgages, as people with these types of mortgages would not suffer as much in that climate of rising interest rates as they link homeowners’ current, savings and mortgage accounts together. This meant their savings rate will have a greater offsetting effect on their mortgages, helping them save thousands of pounds and knock years off their mortgage term compared with a standard 25 year mortgage. The media release also stated that despite three Bank of England interest rate rises in recent months, research had found that only one in six (17%) homeowners were reviewing their existing mortgage arrangements to check if they are still getting the best deal. However, since the first rate rise in August 2006, AIFC’s subsidiary banks in the United Kingdom have together seen a 34 per cent growth in the total amount of money borrowed by homeowners taking out one of their offset mortgage accounts.

The media release went on to provide a practical example, illustrating that by investing £3,640 a year (the amount the AIFC subsidiary banks estimate a couple would save if they quit smoking) into their savings account with a starting balance of £16,000, linked to a offset mortgage account for £150,000, the customers would save £81,940.40 and knock seven years and one month off the term of their mortgage, compared to a standard 25 year variable mortgage at the same interest rate.
The strong competition in the banking and financial services sector in Australia followed the Campbell Committee of Inquiry into the Australian Financial System and the subsequent deregulation of banking and finance in Australia. In seeking to defend their market share against foreign banks coming into the Australian market, the Australian banks needed to be internationally competitive in product offerings and needed to develop new products to ensure that their customers remained loyal. One of these products was the offset mortgage account. This account allowed a person or company with deposit funds invested in a bank to offset the balance of this account against the balance of a mortgage account. In many instances, this also provided the customer with a tax advantage in that the previous arrangements produces tax assessable income for the customer through the deposit whilst the interest payable on a home mortgage was not tax deductible. Using the offset account normally resulted in no assessable income being derived and thus a reduction in the customer’s total tax bill. This product proved to be popular in Australia and was important in maintaining market share against the foreign banks that come into the Australian market. The lessons learnt from a need to protect the home market from international competition proved to be highly valuable when AIFC further expanded its own international operations.

In the United Kingdom, the mortgage offset account was not available when AIFC expanded its operations in that country. The UK banks and international banks which were well established in the UK would not want to introduce such a product as it would cannibalise their existing customer base. However, for AIFC to introduce such a product it must assess that the loss of revenue from existing customers in the UK would be more than offset by the new customers they would win from other UK banks. This provided AIFC with a competitive product advantage in its international expansion, dealing with a product in which it had a high level of expertise. Home mortgages are also considered to be an important strategic product in consumer banking as
home mortgage customers often take out other products such as credit cards with the bank or financier they have a home mortgage with.

4.3.5 Acquiring a new line of business in a foreign market

At the other end of the spectrum of success and failures was a significant loss incurred from a product in an offshore market; a product in which AIFC did not have in Australia and in which it did not have expertise. At the end of the 1990s, AIFC acquired a major well established business in the United States of America which, in time, would prove to be a major factor in the decline of AIFC from a preferred investment to just another stock listed on the securities exchange.

AIFC’s annual report 1998 describes the acquisition of a mortgage origination and servicing company based on automated and cost-effective processing systems and effective control of delinquencies and foreclosures in the United States of America. The annual report 1998 describes the acquisition as the ninth largest originator and the sixth largest servicer of mortgage loans in the United States. At that time, it was regarded as one of the most efficient servicers in the United States mortgage industry, with the annual report 1998 stating that it brought world best practice in mortgage servicing to the AIFC group.

AIFC was highly experienced in mortgage lending, both domestically and in a number of international markets including the United States. However, the operations of this company were different to mortgage lending. As a mortgage originator and servicing company, the new acquisition wrote mortgages and then packaged them up and sold them to investors (securitisation) retaining the relationship management element and providing and ongoing servicing role by collecting the mortgage loan repayments, deducting their servicing fees, and then passing on, in bulk, the remainder to the repayments to the investors.
The key problem arose in relation to the United States Generally Accepted Accounting Principles (GAAP) which, since the mid 1990s, allowed the present value of the future servicing fees to be deducted from the monthly mortgage loan repayments, known as mortgage servicing rights (MSRs), to be booked as an asset. The valuation of this asset became the key basis for future problems, resulting in major write downs of the mortgage servicing rights.

This product risk in a foreign market is examined in more detail to see what lessons can be learnt from this expensive experience.

In a mortgage loan, the asset on the balance sheet of the lender is the outstanding loan balance. The assessment of whether or not that asset is overvalued on the balance sheet is dependent on the lenders ability to recover the outstanding loan balance. This is based on the borrowers’ cash flow (normally from salary and wages); the value of the property if the property was to be sold; and any other securities such as personal guarantees. If the property market suffers a significant down turn a provision for doubtful debts may have to be charged against profit to reduce the value of the asset on the balance sheet. Thus, the key skills in writing and managing a mortgage portfolio are an expertise in assessing a customer’s ability to repay the loan; an expertise in the relevant property market; and a conservative valuation process over the security at the time the mortgage is written. All of these skills are required in the mortgage servicing industry, plus more.

Once the mortgage servicing company has written the loan, it normally packages hundreds of such loans and sells them to an investor such as a pension or superannuation fund, a fund manager or an insurance company. Other banks, finance companies and mortgage companies also purchase a portfolio of mortgages in this way. The credit risk associated with the loans normally becomes the risk of the purchaser / investor, but only after the investor has satisfied its
self in relation to the credit approval process of the mortgage servicing company. The mortgage servicing company then collects the monthly loan repayments, deducts its servicing fee, and passed on the balance to the investor. In Australia, the capitalisation of a future income stream would not normally be taken onto the balance sheet. But under GAAP, the capitalisation of a future income stream becomes an asset on the balance sheet of the US mortgage servicing company and is a key component in the purchase price of such a company.

The mortgage servicing business becomes more complex through the practice of not only originating mortgages but also buying and on selling bulk mortgage portfolios written by other mortgage originators. In addition, although the servicing charge there is a risk factor which diminishes over time but never the less continues for the full term of the mortgage. In the United States, a mortgage can be repaid at any time without a penalty payment. Thus, downward movements in interest rates that could cause a borrower to refinance a loan is the biggest single risk for the value of the mortgage servicing rights (MSR) asset on the balance sheet of a mortgage servicing company.

AIFC’s full form annual report 1998, page 82, describes the accounting policies concerning MSRs which must appear on the balance sheet at the lower of carrying value (cost) or fair value (market value). The fair value is estimated using market prices of similar mortgage servicing assets and discounting future net cash flows considering market prepayment rates, historical prepayment rates, portfolio characteristics, interest rates and other economic factors. There is trading in MSRs but such trades occur periodically and it is difficult to obtain an accurate ‘market value’ for one mortgage portfolio based on the sale of another portfolio.

Computer models are therefore used to provide the balance sheet valuation of the MSR. Such models use a discounted cash flow methodology to provide a net present value for the MSR
portfolio. It is the lower of this value and the book value which is reflected in the balance sheet. Where the net present value is lower than book value, a write down occurs and is charged against profit. Like all computer models, the accuracy of the output from the model depends on the accuracy of the input and the assumptions on which the model is constructed.

A further factor in the risks associated with the valuation of the MSR asset for AIFC’s United States subsidiary company was the size of its operations. AIFC’s full form annual report 1998 stated that the company serviced a portfolio of loans of US$115.8 billion (page 23) and an MSR asset of US$2.998 billion (page 103). AIFC’s annual financial report 2001 stated that the company serviced a portfolio of loans of US$187 billion (page 6) and an MSR asset of US$5.4 billion, down from US$8.2 billion the prior year (page 97). Accordingly, a small change in the computer modelling could have a significant impact on the valuation. Financial instruments are available in the market that can protect parties from movements in interest rates. The AIFC subsidiary used hedge contracts to support its asset valuations and its future income flow. However, this further adds to the complexity of the valuation process.

The operations of the mortgage servicing business appeared to have been going well and provided valuable support to AIFC’s growth strategy until 2001. Then interest rates in the United States fell and the exposure to refinancing grew. AIFC made a write down in the value of the MSR asset and issued an announcement to the securities exchange. It then dispatched a high level team from Australia to investigate the position with the support of local experts in the United States market. By the end of the investigation, a significant write down had been charged against profit to cover an impairment provision against the mortgage servicing rights; an incorrect interest rate assumption in the mortgage servicing rights valuation model; and to cover ineffective hedging.
Following deregulation of the banking and financial services industry in Australia, many of the banks and finance companies took on significant additional risk onto their balance sheet in order to protect their business against foreign competition. AIFC had resisted this temptation and maintained tight credit controls. Instead of going to great length to protect its balance sheet against foreign competition in the home market, AIFC believed that if foreign banks can come into Australia and take its business, then there must be reciprocity in the home markets of the foreign banks. Thus, AIFC’s international strategy took on a more active role. When the economic downturn occurred in Australia during the late 1980s and early 1990s, the banks that had taken on additional risks in the home market suffered significant losses. AIFC was substantially immune from such losses and became a preferred investment in the securities market.

The above charge against profits arising from the devaluation of the mortgage servicing rights had raised questions in the stock market concerning AIFC’s risk management controls and processes. Lekakis (2002) reported that investment analysts remained concerned the AIFC was likely to carry exposure to the troublesome hedge portfolio and mortgage servicing rights for several years. In order to quickly restore the confidence of the stock market in AIFC, the company decided to sell the US subsidiary and remove its most volatile risk from its balance sheet. In order to do this in the uncertain market of the time, it was decided to further write down the value of the mortgages servicing rights by a further significant amount to an estimated market sale value. In addition, the proposed sale required a write down in relation to the goodwill established at the time of the purchase of the US subsidiary.

What therefore are the lessons to be learnt from this costly experience? When the mortgage servicing company was acquired in the United States in 1998, AIFC’s short form annual report of that year stated (page 23) that low long-term interest rates in the United States had encouraged
borrowers to refinance their mortgage loans, increasing the run-off in the servicing portfolio. However, the mortgage servicing company’s ability to quickly up-scale its operations and its proven hedging techniques have ensured that these developments have not adversely impacted profitability. Accordingly, AIFC appeared to understand the risks involved. Then in 2000 - 2001, official interest rates in the United States were reduced ten times and official rates fell by 450 basis points. This was considered unprecedented in United States history to that time and was a major trigger for borrowers to refinance their loans. If a borrower did refinance his / her loan, the future income stream for the AIFC subsidiary would be reduced if the mortgage was refinanced with the AIFC subsidiary, or would be totally lost if the mortgage was refinanced with another mortgage company or bank.

It could be argued that the extent to which the rates dropped in such quick succession could not have been anticipated in a computer model based on regression analysis. However, any risk management process should not only provide for the expected outcome but also look at the situation of a worst case scenario. Lessons could have been drawn for the position ten years earlier in 1991 when official interest rates were cut ten times, even though in that year, official rates only fell by a total of 300 basis points.

The key questions are –

• was the mortgage origination and servicing subsidiary a bad acquisition?

• was it a good acquisition that was poorly controlled?

• were the fundamental risk factors in the business fully understood and monitored, both at the local level and at the parent company level?

Lekakis (2002) reported that an independent review had found that the local management had failed to allocate sufficient resources to risk management and the home market audit and risk
management executives had no day-to-day involvement in the management of the mortgage servicing company.

Given subsequent events in the form of the Global Financial Crisis and the significant losses incurred by the United States mortgage industry in 2008, the decision by AIFC to exit this business in 2001 may prove to be a critical decision in the long term success prospects of AIFC. The United States company that purchased the mortgage origination and servicing company from AIFC had its principal asset, the sixth largest bank in the United States, seized by the United States Office of Thrift Supervision and placed into the receivership of the Federal Deposit Insurance Corporation in September 2008. The next day, the holding company filed for Chapter 11 voluntary bankruptcy.

4.4 PHASE TWO OF THE CASE ANALYSIS BASED ON INTERVIEWS
Blaikie (2000) believes: ‘From a qualitative researcher’s point of view, something more is required than simply publishing transcripts of in-depth interviews.’ Accordingly, the data obtained from each of the interviews was cross referenced and compared with each other and with the model for international expansion developed in this thesis, in order to identify points of difference and common factors. This analysis of the interviews appears below. However, the full text of the interviews provides a rich, new source of data and they are recorded in full in Appendix 4 to this thesis.

4.4.1 Decision Making Processes
AIFC is a public company registered under the Australian Corporations Law and its shares are listed on the Australian Securities Exchange. It operates in the banking and financial services sector, it holds a banking licence and its operations come under the regulatory supervision of the Australian Prudential Regulation Authority. The Corporate Governance Statement in AIFC’s
Annual Financial Report 2009 discloses that the Board of Directors’ most significant responsibilities include the review, approval and monitoring of corporate strategy and plans, and the review, approval and monitoring of major investments and strategic commitments. Therefore, the decision making processes concerning AIFC’s international expansion strategy are based on recommendations prepared by management and submitted to the Board of Directors for consideration and, if in agreement, approval. Following such strategy formulation and initial implementation, the Corporate Governance Statement indicates that there is a review and monitoring processes to ensure that the strategy is being implemented as approved by the board. Accordingly, the interviews that form part of this case analysis involve discussions with both current and former executives and directors.

The interviewees held senior decision making roles including chairman; chief executive officer of a large United Kingdom subsidiary; chief financial officer of a large United States subsidiary; the executive general manager, group strategic development; general manager, international banking; chief economist; head of group strategic planning; head of strategy for a major United States subsidiary; head of governance; and head of regulatory operations. The views of some of the interviewees were reflected in Hubbard et al (2002) in the research project looking into what is ‘winning Australian organisational practice’ and in other literature on leadership. But their views on the key strategic decisions required to be made when establishing an offshore business operation, from an Australian perspective within the banking and financial services industry, are not recorded in any other source. Accordingly, the inclusion of the full transcript of each interview in this thesis is an important addition to the current body of knowledge on this topic.

The interviews were open interviews. The intention was for the interviewees to have the opportunity to openly and freely express their views without being influenced or having their focus diverted or narrowed by responding to specific questions.
A theoretical framework for the strategic decision making process appears in Appendix 6.

4.4.2 Analysis of the Interviews

The interview process did not identify any new decision categories concerning international expansion that had not been drawn from the literature to develop the international expansion model set out in Figure 2.16. Those categories were –

- Timing of Entry;
- Country Selection;
- Product Selection, Market Segmentation and Customer Selection;
- Mode, Scale & Speed of Entry and Mode of Governance; and
- Entry Team.

However, the interview process provided a greater depth of understanding of the various elements of the categories, as they relate to the banking and financial services sector, and provides new elements to be added, particularly in relation to the timing of entry. Accordingly, the model has been further developed to reflect these insights. An analysis and summary of the interviews, on which that further development of the model was based, follows below.

Aharoni and Brock (2010) have referred to international business as an academic discipline in its own right. This is appropriate in recognising the specialist nature of this business activity. A key point raised by several of the interviewees is that international business expansion is a multi-disciplinary task and must be constantly focused on the goals and objectives of the organisation’s strategic plan.
A common point drawn from the comments made by a number of the interviewees was that international expansion is often focused on offshore acquisitions and the acquisitions unit is often part of the portfolio of a larger unit, normally the finance unit. There is also a great deal of time and effort that goes into an acquisition and the management involved can become so intently focused on the target, that they can lose focus on the real reason they have devoted many months to the analysis and due diligence on a target company. Accordingly, the focus must constantly come back to the strategic direction and the strategic goals of the organisation.

The interviewees stress that such strategic objectives should be clearly understood within the organisation and that in any international expansion, whether it is by way of acquisitions, organic growth, partnerships or joint ventures, a critical factor is to ensure that there is a clear and unambiguous statement of what is the strategic direction and corporate strategy. By that, one of the interviewees stated that the corporate strategy should be well articulated in sufficient detail and should state the rationale of where and how a company wants to grow; in what segments and markets, and what part of the financial services offering. Accordingly, there must be a clear discussion and understands of the articulation and quantification of what is the corporate strategy. Any expansion or acquisition offshore is only a subset of that corporate strategy. Various interviewees stated, in different ways, that an organisation must have a set of criteria against which it can evaluate the fit of each expansion proposal against the corporate and acquisition strategy.

This internal focus was not a strong element of the international expansion model developed in this thesis from the literature review. The external focus is understandable given the breadth of international business as a field of study, but for the purposes of this thesis, the interviews have identified a gap in the model. Accordingly, it is appropriate to examine further the internal
readiness of a company to expand internationally. This internal focus is relevant to the Timing of Entry category in the model developed in Figure 2.16.

The interviewees saw the regular reference back to the corporate strategy as providing the framework to evaluate an international expansion proposal, to test the rational, to test the assumptions and to obtain a solid and honest view of the company’s internal capabilities and weaknesses. Another of the interviewees saw this internal focus in the Timing of Entry as being achieved through a SWOT (strengths, weaknesses, opportunities and threats) analysis. The SWOT analysis should focus on a number of issues, but the areas of particular interest to the interviewees included the identification of whether the company has a competitive advantage in any financial segment or product. Such an advantage may exist within the home market but further analysis would be needed to establish if this competitive advantage also exists in an offshore market. The analysis should also examine if the company has the human resource capability to undertake such a venture. Here the family heritage of Australian staff may be an advantage in understanding the culture and the market of the country in which they were born, or where their parents were born.

External factor concerning the timing of entry that were discussed included currency fluctuations, interest rates, the share price of an acquiring bank, the credit cycle.

A common focus in the interviews was – what can AIFC offer? Or, where can AIFC add value? Effectively, establishing an offshore operation in the banking and financial services sector was seen as exporting capital and skills; with skills including an Australian attitude based on ‘getting things done’. This applied to – what can AIFC offer – to the offshore market? - to a joint venture partner? - or to the shareholders, customers and staff of an acquisition target? This could include skills in business finance or agricultural finance, skills in risk management, customer
relationship management or process management. Desktop research was seen as an important task in seeking to identify the SWOTs of an organisation. The organisation must then enhance whatever capabilities are needed to tackle the new market competitively. This process was referred to by one interviewee as – ‘rationale preparation’. That is, testing the decision making process; testing the robustness of the corporate and acquisition strategy; and testing specific possibilities against the criteria set in an objective manner; without the influence of a possible acquisition timetable.

The interviewees recognised that in some organisations, this can become confusing if there are too many goals and objectives. In the banking and financial services industry, margins are low compared with many other industries. Accordingly, economies of scale are an important success factor. If an company in the banking and financial services sector does not reach a certain level of ‘critical mass’ its cost to income ratio will be too high and it will either go out of business because its profits will decline from its expenses being too high; or it will increase its lending rates (the prices on the product or service it sells) and loose new lending opportunities (sales) in a competitive market, thus leading to a reduction in income and an even higher cost to income ratio. Therefore, building ‘critical mass’ can be a key strategic goal to obtain economies of scale, and therefore a better cost to income ratio which can be a key to many other financial ratios. If this is the case, growing the balance sheet can be a clear strategic objective, and international expansion can play a significant role in achieving that goal. But achieving such a goal in a competitive environment can involve a reduction in lending margins and an increase in risk. In the banking and financial services sector and elsewhere, there is a matrix of strategic goals which convert into financial performance ratios. A clear understanding of how the international expansion strategy will contribute to this matrix of strategic goals is necessary. Including the return on shareholders’ funds and the earnings per share identified in 4.3 of the case analysis based on published data of AIFC as a key strategic goal.
A key point raised by one of the interviewees was to examine if the margins available in a target market are higher or lower than the margins available in the home market. If the margins are lower in a target market, investment in that country may reduce the return on shareholders’ funds for the total organisation. Accordingly, one returns to the strategic objectives of the offshore expansion and, if an increase in return on shareholders’ funds is a key strategic objective, then the appropriate decision may be to pass over that country and move on to consider other options. If however, that country is still considered attractive, the organisation must consider how the expansion can be structured in order to obtain a required return from less capital. Alluded to in the interviews is the position in many countries where Basel II requirements for capital adequacy have been adopted. This makes it difficult to arbitrage between the capital requirements of different countries. (Basel II is the second of the Basel Accords, which are recommendations on banking laws and regulations issued by the Basel Committee on Banking Supervision.) However, the role of most banking regulators around the world is to protect the integrity of the banking system and the interests of the depositors in their country. Accordingly, many banking regulators will allow banks to gear their balance sheet with tier II capital which, in the event of liquidation would rank behind all other creditors, including depositors, and yet not form part of shareholders’ funds.

The next important point to come out of the interviews was a reflection on the interplay between the law, politics and culture in some countries. The product sale process in banking and financial services is more complex than in any other industry when you consider that the ‘seller’ has to recover the product sold (money) with interest, over time. In Australia, it is easy to take for granted the debt recovery laws which are based on States and Federal statute law and common law. In other countries, lending laws differ significantly to those in Australia. For example, in the United States, most home loan mortgages are non-recourse loans. That is, if a loan is granted
for an amount greater than the value of the property used as security in the loan, and the borrower is unable to repay the loan, the lender only has recourse back to the security and not back to the borrower. This was a major factor in the Global Financial Crisis. In some countries, a court may decide a case after having weighted the national / local interests against the foreign interests.

The issue of resourcing a new offshore operation was also an important point raised in the interviews. Here, resourcing is referring to people, capital, technology and the deployment of financial products and processes. In many organisations, resources are deployed to the parts of the business that are growing the fastest. The interviewees stress that the corporate strategy needs to be structured in such a way that a certain percentage of resources, particularly capital, will be allocated to the fastest growing businesses and a certain percentage will be allocated to areas with growth potential. This may vary from time to time depending on risks factors, economic conditions and the cyclical nature of the earnings from particular business segments. Another important point raised by an interviewee is that an acquisition stops being an acquisition after a certain period of time and it becomes an organic growth business and the holding company / parent company in the home market must sustain the new operation; grow it; and change it.

Another factor was seen as the two-way transfer of capabilities; from the parent company in the home market to the offshore operation in a foreign market and from offshore operation to the parent company. That is, the ability to leverage the best it can in terms of transferring best practice across every part of the organisation. Here, best practice is focused on the development and distribution of financial products and services; the way the organisation interacts with the customer; how the organisation manages financial and operational risks; how technology is improved; and the ways in which the organisation becomes more efficient. Efficiencies were
seen as coming from having a common approach in a number of markets in terms of financial products, services and regulatory frameworks.

The risk / return relationship was identified by the interviewees as being difficult to quantify in the banking and financial services industry. Setting the risk appetite in relation to all financial products and services and in relation to all markets is a complex task. This is a potential area for further research as one of the interviewees stated that there is nothing in banking and finance theory that will determine the optimum risk / return relationship and risk appetite across a complex international organisation. It is the management and the board that ultimately have to make those decisions.

Looking at the mode of entry into a new offshore market, the general preference of the interviewees was to look for an acquisition in preference to a start-up operation due to the time it takes for a start-up operation to make any meaningful contribution to the overall financial performance. There was also a preference for an acquisition to be wholly-owned rather than partly-owned to give the organisation greater control over its own destiny. However, it was recognised that in many markets / countries, local regulatory barriers to entry in the banking and financial services sector prevent a foreign bank from acquiring a majority control of a local bank. The interviewees acknowledged that a small presence in a market can assist the organisation to learn about a country. A minority equity interest in an established bank or finance company may be a preferred mode of entry if the organisation is not fully confident that the capabilities it has domestically can be readily transfer offshore. The question was seen as being - how much capital is the organisation willing to put at risk?

One of the interviewees stated that the organisation should not just look at target markets in isolation but should look at its total portfolio and take a long term view. One of the criteria is the
financial criteria, but not just the return on the equity investment but how much capital does the organisation have at its disposal and how much funding over and above that capital will the organisation need to sustain the expected growth in any offshore market.

Branding was raised as another factor to consider in international expansion. In the event of an offshore acquisition, the acquiring bank must decide if it will use its own name in the local market. This will providing a sense of recognition and familiarity to its home market customers operating in the local market, but may alienate local customers. The decision should be based on an assessment of whether the greater contribution to overall group profits will come from the home market customers operating in the local market or from the local customers, and an assessment of the brand loyalty of the local customers.

When a bank enters a foreign market, it will look at the products currently on offer in that market and at the products it could transfer from its home market. Interviewees addressed the competitive advantage of home market products in a offshore market and the risks associated with entering into products in the offshore market that have significant differences to the products on offer in the home market. An interviewee stated that subprime lending in the United States was not well understood by Australian banks. Subprime lending is where loans are granted to borrowers who have a poor credit history, where the documentation may be less favourable to the lender than is the case with prime lending, or the debt to security ratio may be greater than prime lending. In the United States, subprime loans were aggregated and sold as a securitisation product. Some Australian banks, including AIFC, purchased collateralised debt obligations and following the Global Financial Crisis large provisions have been made against these investments. However, these securities were AAA-rated and this brings into question to quality of the rating process undertaken by the rating agencies. Credit rating agencies are now
under scrutiny for having given investment-grade ratings to mortgage backed securities based on risky subprime mortgage loans.

The interviewees saw the issues concerning the large scale acquisition, or the so called transformational acquisition, and the aspiration to be in a top four market position in every market an organisation enters, as involving too many risks.

There was not uniform agreement among the interviewees concerning the most appropriate appointment of either a local or an expatriate to the roles of chairman and chief executive officer of an overseas operation. A balance between control and local knowledge is a key factor. Possible a local non-executive chairman and an expatriate chief executive is a suitable balance. A chief executive officer from the local market may have divided loyalties between the local community and the parent company. It will however depend on the individuals who are available from time to time. There was however general agreement that the chief financial officer and the chief risk officer should be expatriates appointed from the home market. For these two roles, a matrix management approach was also suggested whereby these two officers report to their local chief executive officer and to the group head of their function in the home market.

The interchange of management between the local subsidiary company and the home market holding / parent company was seen as an important factor in developing a common culture and a cooperative environment. It was recognised that AIFC did not always address is management development and succession planning as well as it should have. One of the complexities related to this matter is where the chief executive of an offshore subsidiary may have a smaller job, in terms assets and contribution to group profits, than a position of less exalted title back in the home market where the organisation is much larger. A practice of always appointing the chief executive from the home market could also have negative implications for the local management
who could see a glass ceiling and the most talented may decide to peruse their career with another organisation.

Issues of culture and language were discussed in various contexts. Ethical standards and corruption can be a major issue in some countries. Language can also be a complex issue. It was pointed out that even between Australia, Britain and the United States, which share a common language, there can be communication difficulties as the same word may have different meanings in different countries.

Although the banking and financial services industry has many unique elements, compared with other industries, some of the interviewees considered that valuable lessons can be learnt from the experiences other industries.

On the question of entry mode, specifically acquisition verses green fields, and wholly owned verses joint venture, partnership or minority interest, the preference was for a wholly owned acquisition if available. Regulatory restrictions or market conditions may prevent this at a given point in time but building relationships were seen as important and this could be achieved through a low risk, low capital exposure minority interest or joint venture. Acquisitions were seen as providing scale at an early stage but the mega transformational merger was seen as too risky.

Another important observation was that South East Asia is not one market but many different, diverse and complex markets. Becoming a niche player in different market segments in different markets, depending on the risk assessments, was seen as a viable strategy building on transferring strengths from the home market.
In relation to unique Australian factors, the limited size of the Australian market was noted. This applies to the potential customer base and to the size of the capital market. Conversely, the Australian mindset that Australia ‘can win’ was seen as a positive in meeting the challenges posed by international expansion.

4.5 CONCLUSIONS FROM THE DATA COLLECTION AND CASE ANALYSIS IMPACTING ON THE MODEL OF INTERNATIONAL EXPANSION

The conclusions and learnings from the case analysis, that are relevant to the further development Model of International Expansion developed for this thesis, are set out below.

4.5.1 Timing of Entry

AIFC’s timing of entry into foreign markets has been based on business needs and opportunities. The need for capital and the opportunity to provide financial services to support Australia’s international trade were key drivers early in the company’s history and up until the early 1980s. The significant changes that occurred in the Australian financial system in the 1980s began a period of significant international expansion. The opportunity to provide financial services to support Australia’s international trade was still an important factor, but the intense competition in the home market from foreign bank entry was the major motivating factor. It also offered a spread of risk across a range of geographic regions.

Prior to the major international expansions, AIFC has considerable experience in a variety of offshore markets, albeit at much smaller scales. It also had a strong domestic business on which it could leverage capital and human talent. Accordingly, its readiness to take on greater international expansion was well developed.
The elements added to the model of international expansion developed in this thesis, following the case analysis, were as follows:

- **Internal Factors**
  - Response to the corporate strategy;
  - Stage in the organisational development phase and the corporate life cycle – the Readiness Level;
  - SWOT analysis;
  - Available resources – Human & Financial;
  - Impact on domestic operations; and
  - Desktop research.

- **External Factors**
  - Stage in the economic and credit cycles; and
  - Currency fluctuations.

The addition of the internal factors was a key finding from the case analysis. Even if all of the external factors indicate that the timing is right for international expansion, if the organisation has not considered all of the internal factors, its prospects of success may be at risk. This raises two additional fields of study which are worthy of consideration within the context of this thesis. Appendix 5 sets out a theoretical framework for strategic management and appendix 7 sets out a theoretical framework for corporate development. Any company in the banking and financial services industry contemplating international expansion may also examine these fields of study to ensure that their internal factors, relevant to the timing of entry decision of when to expand internationally, are considered within a broader strategic and corporate development context.

The sequencing of the decision making process was in question following the literature review. Hill (2005) and Venzin (2009) both believe that the country selection decision should be made
before the timing of entry decision. It is now clear that the timing of entry decision involves two elements: the internal factors and the external factors. Hill (2005) and Venzin (2009) were focused on the external factors such as the prospect of change in barriers to entry. Whereas the conclusions from this thesis are that the internal factors are a critical area of focus for the first strategic analysis and decisions.

4.5.2 Choice of Market – Country Selection

AIFC acquired a number of full-service commercial and retail banks with established branch networks throughout Great Britain, the Republic of Ireland, parts of the United States, and New Zealand. These countries have common factors with that of AIFC’s home market, Australia, including –

- a regulatory framework that allows entry into those countries;
- culture, including a culture of accepting debt obligations;
- language
- legal system, with well tested lending laws that protect the recovery of debts (although there are significant differences); and
- easy communications and access to technology.

Full-service commercial and retail banking operations with branch networks were not established throughout South-East Asia as that market would not satisfy a sufficient number of the country selection criteria. The services offered throughout this region were limited to trade finance and services; foreign exchange; corporate lending, particularly for local subsidiaries of Australian, British, New Zealand and North American companies operating in that area; syndicated finance where local banks shared the credit risk and could influence the recovery process if necessary; and funds management products. Another important observation was that South East Asia is not one market but many different, diverse and complex markets.
The markets in Russia, Africa and South America would not satisfy the country selection criteria; operations in these markets were limited to correspondent banks.

In Figure 4.1, a series of questions is offered to assist a company in the banking and financial services sector narrow the field in the country selection strategic decision category.

**Figure 4.1 Country Selection Criteria Analysis**

<table>
<thead>
<tr>
<th>Selection Criteria</th>
<th>Country A</th>
<th>Country B</th>
<th>Country C</th>
</tr>
</thead>
<tbody>
<tr>
<td>Will the banking regulatory authorities in this country allow foreign banks to enter this market (either open entry or restrictive)?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Question</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>-------------------------------------------------------------------------</td>
<td>---</td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>Will the banking regulatory authorities in this country allow foreign banks to hold a full banking licence?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Will the banking regulatory authorities in this country allow foreign banks to hold 100% equity in a financial services entity?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Are the margins available in this market higher than in the home market?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Is it possible to gear the balance sheet in this country with tier 2 capital?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Are the laws in this country conducive to debt recovery?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Are the values, culture and consumer behaviours in this country conducive to debt recovery?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Will it be easy to communicate with the local management and staff (eg language and culture)?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Question</td>
<td>Answer</td>
<td></td>
<td></td>
</tr>
<tr>
<td>------------------------------------------------------------------------</td>
<td>--------</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Is the projected GDP growth rate in this country greater than the growth rate projected for Australia?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Is the country politically stable?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Is the country risk profile acceptable?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Are there government incentives available to enter this market?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Does the market include an international financial services centre?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Is the level and intensity of competition acceptable?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Will Australian financial products and services in which we have a high level of expertise be acceptable in this market without substantial modification?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Do we have a unique or superior product or service to offer in this market?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Is there a good pool of local, skilled management and staff?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Is the country advanced in computer technology?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Will there be an opportunity to learn from participation in this market that may provide development opportunities for the Australian market and other offshore markets?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Given the responses to the questions above, does entry into this market support the corporate strategy?</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Developed through the case analysis in this thesis.

It would be unusual to get all ‘yes’ responses to the questions above in relation to any one country. But for some markets the organisation will get more ‘yes’ than ‘no’ responses. This allows the organisation to narrow the field. It is then that further investigation into that country is warranted. Such investigation may include research into a possible target acquisition and establishing relationships in that country with well connected local business leaders, regulators and government ministers.

The elements added to the model of international expansion developed in this thesis, following the case analysis, were as follows:

- Local margins;
- Market knowledge has been expanded to provide for an understanding as well as knowledge of the market;
• Growth potential has been expanded to provide for both economic growth and business growth;
• Barriers to entry has been expanded to provide for prudential regulation; and
• Innovative market.

4.5.3 Product Selection

There are a number of key factors in selecting the product or products to offer in a foreign market. These factors included the competitive advantage of a product and the level of local adaptation required. However, when considering what product or products to offer in a new offshore market, the decision will, to some extent, be driven by the market selected and the mode of entry.

The competitive advantage of a product and the level of local adaptation required will vary from market to market and therefore a ‘global strategy’ for the choice of product must be adaptable to the different conditions of each market. If the mode of entry is a ‘green fields’ start-up operation, the new market entrant will have wide flexibility, but it may take some time to reach a desirable economy of scale. If the mode of entry is to acquire an existing business, the product choices, at least in the short term, are predetermined, but an acceptable economy of scale may be available from day one.

AIFC had been relatively conservative in offering new financial products in its home market. In the 1970s, the development and testing of new products was carried out in the home market by its finance subsidiary (Annual Reports of AIFC and its Australian finance subsidiary 1970 – 1980). A conservative, risk management strategy was also applied in the new international markets.
For AIFC, the selection of products and the selection of markets went hand in hand. The opening of AIFC officers in London was to provide AIFC with access to a broader capital market and AIFC’s liability products such as deposits, bills of exchange and convertible unsecured notes were a major focus for raising money to fund the business. In the period up to 1980 the focus was principally on supporting AIFC’s Australian business and individual customers in their international activities. The range of products and services being offered included letters of credit, introductions, foreign currency and travellers cheques. Direct loans were also offered to the offshore subsidiaries of Australian companies, based on the guarantee of the Australian parent company. All of these products and customers were well known to AIFC and understood.

AIFC’s range of products and services expanded significantly in 1987 and again in 1990 with the acquisition of well established banks in the United Kingdom and the Republic of Ireland. These banks provided a full range of banking services to customers unknown to AIFC but well known to the UK and Irish bankers. With this expansion, AIFC had moved into a truly international business model, providing financial products and services to offshore customers not simply offering products and services to Australian customers operating overseas. This model for international expansion was extended further in later years with the acquisition of an existing branch network in the New Zealand and the United States of America.

The acquisition of an existing business with products and services already tailored for the local market removed a number of risks associated with the home products requiring local adaptation.

The elements added to the model of international expansion developed in this thesis, following the case analysis, were as follows:

- Risk assessment; and
- Regulatory approvals.
4.5.4 Mode, Scale, Speed and Governance of Entry

AIFC adopted a range of entry modes into different markets. These included a wide network of correspondent banks, representative offices, branches, merchant bank, finance company operations and full service commercial and retail banks. At each of these levels there is a greater level of commitment, a higher level of capital invested and a closer direct relationship with the customer.

The interviewees also dispelled some of the myths about the value of large scale international expansion strategies in the banking and financial services sector, such as a transformational acquisition and the strategic aspiration to be in a top four market position in every market an organisation enters.

4.5.5 Entry Team

The selection of the chairman of an offshore subsidiary may be dictated by the local regulatory authorities in so far as that person may have to be a local. The appointment of a chief executive officer could be either a local or an expatriate and this process should be flexible, selecting the best candidate for the role. The appointment of a chief financial officer and chief risk officer from the parent company was considered essential, with such roles having dual reporting lines to the local chief executive and to the group functional head in the parent company.

The elements added to the model of international expansion developed in this thesis, following the case analysis, were as follows:

- Key positions – chairman, chief executive officer, chief financial officer and chief risk officer;
- Local advisers;
- Incentive programs – monetary & advancement;
• Culture, values and communication of the entry team;
• Clear roles and accountabilities;
• Two-way knowledge transfer conduits;
• Customer service focus; and
• Risk management processes & discipline.

The role of the chief risk officer is a relatively new role at the executive level within the corporate structure. Some years ago, the major role of this position would be focused on insurance. Today, in the banking and financial services sector, this role has overall management responsibility for a wide range of risks and for their mitigation. Such risks including credit risk, market risk, liquidity and funding risk, operational risk, pension risk (which mainly relates to the future, promised benefit retirement pensions in the UK), regulatory risk, strategic risk (which relates to the implementation of strategic decisions), business conditions and economic risk, legal risk, fluctuations in currency exchange risks, payment system risk, computer systems fraud, e-commerce risk, legislative compliance, business continuity and disaster recovery (AIFC’s annual report 2006, p15).

4.6 DEVELOPMENTS TO THE MODEL ARISING FROM THE CASE ANALYSIS

Figure 2.16 presented the model developed through the literature review. Figure 4.2 presents the further development of the model based on the conclusions derived from the case analysis, with the changes to the model from Figure 2.16 appearing in red for ease of identification.

Figure 4.2 A model of the key strategic decisions in international expansion for the banking and financial services sector – Stage 6 (with changes from stage 5 (Figure 2.16) highlighted in red)

Source for Figure 4.2: Figure 2.16 and the case analysis contained in this thesis.
TIMING OF ENTRY

Internal Factors

External Factors
Stage in the economic and credit cycles. Currency fluctuations. Early mover advantages & disadvantages. Prospects of change in barriers to entry, intensity of competition and current competitive advantage.

COUNTRY SELECTION

PRODUCT SELECTION, MARKET SEGMENTATION and CUSTOMER SELECTION

MODE, SCALE, SPEED and GOVERNANCE OF ENTRY

ENTRY TEAM
Chapter 5

CONCLUSIONS

5.1 OVERALL CONCLUSIONS

The aims and purpose of this thesis are to develop a model of the key strategic decisions necessary for international expansion that may be used as a guide for Australian publicly listed companies in the banking and financial services sector that are seeking to develop their business in foreign markets and, to develop an understanding of the various elements of such a model.

The case analysis confirmed that the model developed in the literature review from a broad range of sources is comprehensive in that it addresses the key strategic decisions that a company in the banking and financial services sector must address when considering international expansion. These decision categories are as follows:

- When: Timing of Entry – a key strategic decision – when to undertake international business expansion;
- Where: Choice of Market – Country Selection;
- What: Product Selection;
- How: Mode, Scale, Speed and Governance of Entry; and
- Who: the Entry Team.

Each of the decision categories is comprised of a number of elements. These elements of the decision categories were expanded by the findings from the case analysis. The most significant of these was an important additional layer for consideration and decision within the timing of entry category. There was a strong recognition that international business is a multi-disciplinary field of study and international expansion is only a sub-element of the overall corporate strategy.
Accordingly, the international expansion strategy needs to be linked back to the corporate strategy on a regular basis. The focus back to the core reason for expanding internationally raised other areas of focus including the decision-making process and to the assessment of the capabilities or readiness of the organisation to expand overseas.

The linking of certain strategic decision categories as concurrent rather than consecutive decision was also important. This was reflected in two ways:

- in the grouping together into one category the mode, scale, speed and governance of entry, where the mode of entry will determine the scale and speed of entry and have a significant influence of the governance of entry; and
- in cross linking in the model the separate decision categories of country selection and product selection, and the category of mode, scale, speed and governance of entry with the entry team.

When selecting a country to enter, a key investigation into the country should be an analysis of the products an organisation will offer in that market. A bank or financial services provider may be attracted to one country because of its low barriers to entry, but if its products do not have a competitive advantage in that market, then the organisation may struggle in such a new market.

If the mode of entry is an acquisition of an existing bank or financial services provider, the scale and speed of entry will be determined by that acquisition and the appropriate governance model and entry team will be dictated by the level of the investment (the commitment of capital and reputation put at risk).

The case analysis also provided a deeper level of understanding of each of the strategic decision categories and the elements within each category.
A further conclusion from the case analysis, as it was with the literature review, is that international expansion is complex and individual circumstances and opportunities will dictate the most appropriate course of action. For example, a bank or financial services company may prefer to only enter a market when it can do so through a wholly-owned entity. Accordingly, it may not devote any attention to markets where there are licensing restrictions which prevent a majority ownership. Sometime in the future those restrictions may change, but only a limited number of licences may be granted to those banks and financial service providers who have actively supported that country (through a minority equity holding in a finance provider) and proven themself to be a good corporate citizen in that country. There is no one right answer to each of the decision steps a bank or financial services company must make when considering moving offshore. The right decision will depend on the circumstances of the time and what the company has to offer the market. What Porter (1980, 1990 and 1996) would call – competitive advantage is a key element in any successful international expansion. The key learning from the research is that a bank or financial services company that adopts a single strategy and follows it to the exclusion of other possible strategic alternatives may not achieve the optimum outcome. Strategies need to be flexible and change as circumstances change; circumstances such as government and monetary regulation and competition in a foreign market are highly relevant to the banking and financial services industry.

The most appropriate international strategy at any one point in time, for any one bank or financial services company, will be dependent on the answers to a number of questions concerning the company’s capital and human resource allocation policy. Will capital only be allocated to the areas of the business that provide the highest return at a given point in time? Will the bank or financial services company retain units that still make a good contribution to total profit but which are experiencing a decline in return on capital? Is the bank or financial services company prepared to invest a certain percentage of capital for the longer term future of the organisation?
Also, will the best human resources be allocated to an international venture or will they be retained to protect the home market where the vast majority of profits are derived? Do older executives from Anglo Saxon Celtic backgrounds see business in an English speaking country as less risky? Do executives from an Asian background perceive the same level of risk in a non-English speaking country? This could be an important factor in diversity within the management of a bank or financial services company expanding internationally.

Maintaining a flexible approach which allowed the organisation to adopt different strategies for different markets was also a key finding, with AIFC’s product offerings and scale of entry varying between markets.

5.2 The Model Developed in this Thesis

A major aim of this thesis is to develop a model of the key strategic decisions necessary for international expansion that may be used as a guide for Australian publicly listed companies in the banking and financial services sector that are seeking to develop their business in foreign markets.

Appendix 1 illustrates the model development by drawing together into one place the model at each of the six stages of its development.

The final conclusion for this thesis is to present the model for international expansion developed throughout this thesis. This model appears in Figure 5.1 (which is the model from Figure 4.2, without the changes highlighted).
Figure 5.1 A model of the key strategic decisions in international expansion for the banking and financial services sector – The conclusion for this thesis.

The source for Figure 5.1 is Figure 4.2.
TIMING OF ENTRY
Internal Factors

External Factors
Stage in the economic and credit cycles. Currency fluctuations. Early mover advantages & disadvantages. Prospects of change in barriers to entry, intensity of competition and current competitive advantage.

COUNTRY SELECTION

PRODUCT SELECTION, MARKET SEGMENTATION and CUSTOMER SELECTION

MODE, SCALE, SPEED and GOVERNANCE OF ENTRY

ENTRY TEAM
Appendix 1 illustrates the model development by drawing together into one place the model at each of the six stages of its development.

Figure 2.1 A model of the key strategic decisions in international expansion for the banking and financial services sector – Stage 1

Figure 2.2 A model of the key strategic decisions in international expansion for the banking and financial services sector – Stage 2 (with changes from stage 1 (Figure 2.1) highlighted in red)

Figure 2.3  A model of the key strategic decisions in international expansion for the banking and financial services sector – Stage 3 (with changes from stage 2 (Figure 2.2) highlighted in red)

TIMING of ENTRY
Secure home base and the willingness to commit sufficient capital, physical and organisational resources. Early mover advantage.

COUNTRY SELECTION
Improvements on the local processes. Level of commitment to host country. Level of market knowledge and understanding. Psychic distance to the target market: language, education, business practices, culture and industrial development

PRODUCT SELECTION, MARKET SEGMENTATION and CUSTOMER SELECTION
Adapted to and valued in the target market. Consistent with local market capabilities and norms.

MODE, SCALE AND SPEED OF ENTRY
Acquisition of complementary assets and capabilities – from internal or external. Degree of opportunity. Risk association. Size of the prospective market. Urgency of expansion. Incremental. Mergers and acquisitions,

ENTRY TEAM
Learning, skills, experience, capabilities, knowledge in local culture, regulations, organisational systems and international management. Consultants

Figure 2.5 A model of the key strategic decisions in international expansion for the banking and financial services sector – Stage 4 (with changes from stage 3 (Figure 2.3) highlighted in red)

TIMING of ENTRY
Secure home base and adequate resource allocation: capital, physical and organisational resources/ full support of the home office. Early mover advantage.

COUNTRY SELECTION
Improvements on the local processes. Level of commitment to host country. Level of market knowledge and understanding. Psychic distance to the target market: language, education, business practices, culture and industrial development

PRODUCT SELECTION, MARKET SEGMENTATION and CUSTOMER SELECTION
Adapted to and valued in the target market. Consistent with local market capabilities and norms.

MODE, SCALE, SPEED and GOVERNANCE OF ENTRY

ENTRY TEAM
Learning, skills, experience, capabilities, knowledge in local culture, regulations, organisational systems and international management. Consultants. Career aspirations, personalities, managerial values & ethics.

Business, Competing in the Global Marketplace, McGraw-Hill; Mahoney, D, Triff, M, Griffin, R, Pustay, M 1998, International business, a managerial perspective, Longman; and Ferguson, A and James, D 1998, Globalisation, Ready or Not, Business Review Weekly (Australia) vol20, no 33,
Figure 2.16 A model of the key strategic decisions in international expansion for the banking and financial services sector – Stage 5 (with changes from stage 4 (Figure 2.5) highlighted in red)

**TIMING of ENTRY**

**COUNTRY SELECTION**

**PRODUCT SELECTION, MARKET SEGMENTATION and CUSTOMER SELECTION**

**MODE, SCALE, SPEED and GOVERNANCE OF ENTRY**

**ENTRY TEAM**

Figure 4.2 A model of the key strategic decisions in international expansion for the banking and financial services sector – Stage 6 (with changes from stage 5 (Figure 2.16) highlighted in red)

Source for Figure 4.2: Figure 2.16 and the case analysis contained in this thesis.
**TIMING OF ENTRY**

**Internal Factors**

**External Factors**
Stage in the economic and credit cycles. Currency fluctuations. Early mover advantages & disadvantages. Prospects of change in barriers to entry, intensity of competition and current competitive advantage.

---

**COUNTRY SELECTION**

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**PRODUCT SELECTION, MARKET SEGMENTATION and CUSTOMER SELECTION**

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**MODE, SCALE, SPEED and GOVERNANCE OF ENTRY**

---

**ENTRY TEAM**
Figure 5.1  A model of the key strategic decisions in international expansion for the banking and financial services sector – The conclusion for this thesis.

The source for Figure 5.1 is Figure 4.2.
TIMING OF ENTRY

Internal Factors

External Factors
Stage in the economic and credit cycles. Currency fluctuations. Early mover advantages & disadvantages
Prospects of change in barriers to entry, intensity of competition and current competitive advantage

COUNTRY SELECTION

PRODUCT SELECTION, MARKET SEGMENTATION and CUSTOMER SELECTION

MODE, SCALE, SPEED and GOVERNANCE OF ENTRY

ENTRY TEAM
## APPENDIX 2

### SELECTED EVENTS IN THE EVOLUTION OF THE AUSTRALIAN FINANCIAL SYSTEM RELEVANT TO THIS THESIS

The list of events relates only to banking and finance and does not include major events concerning funds management.

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>The first cash management trust was established in Australia. Interest rate ceilings on trading bank and savings bank deposits were dismantled.</td>
</tr>
<tr>
<td>1981</td>
<td>The Final Report of the Campbell Committee was tabled. The Commonwealth Government agreed to major Australian bank mergers.</td>
</tr>
<tr>
<td>1983</td>
<td>The Commonwealth Government announced that it would allow entry of 10 new banks, including foreign banks. The A$ was floated and most exchange controls were abolished. The Treasurer announced the formation of the Martin Committee of Review to assess the Campbell Report.</td>
</tr>
<tr>
<td>1984</td>
<td>The Martin Committee of Review endorsed the Campbell Report. All remaining controls on bank deposits were removed. The restrictions that were lifted included minimum and maximum terms on deposits, and the prohibition of interest on cheque accounts. Foreign investment guidelines on ownership of merchant banks were relaxed. Australian stock exchanges and the securities industry were deregulated. The Australian Payments System Council (APSC) was established. Credit Union Services Corporation (Australia) Limited established a mechanism for credit unions to issue cheques on an agency basis.</td>
</tr>
<tr>
<td>1985</td>
<td>Sixteen foreign banks were invited to establish trading operations in Australia – the first</td>
</tr>
<tr>
<td>Year</td>
<td>Event</td>
</tr>
<tr>
<td>------</td>
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</tr>
<tr>
<td>1986</td>
<td>A foreign bank began operations in the last quarter. Electronic funds transfer at point of sale (EFTPOS) was introduced. The Electronic Funds Transfer (EFT) Code of Practice was developed. The <em>Cheques and Payments Order Act 1983</em> was amended to allow Non Bank Financial Institutions to issue payment orders and to formalise agency arrangements for cheque issuing.</td>
</tr>
<tr>
<td>1987</td>
<td>The ‘October 87’ world stock market crash occurred.</td>
</tr>
<tr>
<td>1988</td>
<td>The Reserve Bank of Australia introduced consolidated risk-weighted capital requirements for banks, consistent with the Bank for International Settlements’ proposals.</td>
</tr>
<tr>
<td>1990</td>
<td>The Commonwealth Government announced the ‘Six pillars’ policy preventing mergers or takeovers within the major Australian banks.</td>
</tr>
<tr>
<td>1991</td>
<td>The House of Representatives Standing Committee on Finance and Public Administration (Martin Committee) released a report recommending a feasibility study of direct payments system access for Non Bank Financial Institutions, establishment of a high-value electronic payments system.</td>
</tr>
<tr>
<td>1992</td>
<td>Authorised foreign banks were allowed to operate branches in Australia, but were not allowed to accept retail deposits. Limits on the number of new banks that could be established were removed. The Commonwealth Government <em>One Nation</em> package introduced pooled development fund and offshore banking unit concessionary taxation arrangements. Mortgage originator ‘Aussie Home Loans’ was established.</td>
</tr>
<tr>
<td>1996</td>
<td>The Financial System Inquiry (Wallis Inquiry) was announced. Banks, building societies, credit unions and life companies were given permission to provide a retirement savings account product from mid-1997.</td>
</tr>
<tr>
<td>Year</td>
<td>Event</td>
</tr>
<tr>
<td>------</td>
<td>-------</td>
</tr>
</tbody>
</table>
| 1997 | RBA released new guidelines on capital adequacy of banks following a report by the Basel Committee.  
     The Final Report of the Financial System Inquiry (Wallis Inquiry) was released.  
     Thailand, Malaysia and the Philippines experience exchange rate turbulence, referred to as the ‘Asian currency crisis’. |
| 1998 | The Reserve Bank of Australia releases new guidelines covering banks’ market risk  
     N.M. Rothschild and Sons was authorised as a locally-incorporated bank.  
     ABN AMRO was granted a banking licence in Australia.  
     Australian Prudential Regulation Authority (APRA) commenced operations.  
     The ‘Six pillars policy’ was replaced by the ‘Four pillars policy’ prohibiting mergers between the four major banks.  
     Deutsche Bank takes over Bankers Trust. |
| 1999 | The Payments System Board announces widening of access to the payments system. |
| 2001 | The Basel Committee on Banking Supervision releases reform guidelines on capital adequacy for banks. |
| 2003 | ASIC released a report into the mortgage broking industry. |

Source: The Australian Bankers’ Association
Cultural issues can be a significant consideration in the international expansion of any business. Following are Hofstede’s (1991) Dimensions of Culture that may provide a general guide into some of the aspects of culture for a company in the banking and financial services industry which is expanding internationally. Such cultural issues may be relevant to a bank or financial services entity in its dealings with local staff, customers, regulators, joint venture partners and advisers.

**Hofstede (1991) Four (now Five) Dimensions of Culture**

*Power Distance Index* focuses on the degree of equality, or inequality, between people in the country’s society. A High Power Distance ranking indicates that inequalities of power and wealth have been allowed to grow within the society. These societies are more likely to follow a caste system that does not allow significant upward mobility of its citizens. A Low Power Distance ranking indicates the society de-emphasizes the differences between citizen’s power and wealth. In these societies equality and opportunity for everyone is stressed.

*Individualism* focuses on the degree the society reinforces individual or collective, achievement and interpersonal relationships. A High Individualism ranking indicates that individuality and individual rights are paramount within the society. Individuals in these societies may tend to form a larger number of looser relationships. A Low Individualism ranking typifies societies of a more collectivist nature with close ties between individuals. These cultures reinforce extended families and collectives where everyone takes responsibility for fellow members of their group.
**Masculinity** focuses on the degree the society reinforces, or does not reinforce, the traditional masculine work role model of male achievement, control, and power. A High Masculinity ranking indicates the country experiences a high degree of gender differentiation. In these cultures, males dominate a significant portion of the society and power structure, with females being controlled by male domination. A Low Masculinity ranking indicates the country has a low level of differentiation and discrimination between genders. In these cultures, females are treated equally to males in all aspects of the society.

**Uncertainty Avoidance** Index focuses on the level of tolerance for uncertainty and ambiguity within the society - i.e. unstructured situations. A High Uncertainty Avoidance ranking indicates the country has a low tolerance for uncertainty and ambiguity. This creates a rule-oriented society that institutes laws, rules, regulations and controls in order to reduce the amount of uncertainty. A Low Uncertainty Avoidance ranking indicates the country has less concern about ambiguity and uncertainty and has more tolerance for a variety of opinions. This is reflected in a society that is less rule-oriented, more readily accepts change, and takes more and greater risks.

Holt (1998) states that Hofstede added the following fifth dimension after conducting an additional international study using a survey instrument developed with Chinese employees and managers. That survey was intended to address the problems of Western interpretations and to learn more about Asian cultures. This resulted in the addition of the Confucian dynamism. Subsequently, Hofstede described that dimension as a culture's long-term orientation.
**Long-Term Orientation** focuses on the degree the society embraces, or does not embrace long-term devotion to traditional, forward thinking values. High Long-Term Orientation ranking indicates the country prescribes to the values of long-term commitments and respect for tradition. This is thought to support a strong work ethic where long-term rewards are expected as a result of today's hard work. However, business may take longer to develop in this society, particularly for an ‘outsider’. A Low Long-Term Orientation ranking indicates the country does not reinforce the concept of long-term, traditional orientation. In this culture, change can occur more rapidly as long-term traditions and commitments do not become impediments to change.

APPENDIX 4

RECORD OF INTERVIEWS

The inclusion of the full transcript of each interview in this thesis is an important addition to the current body of knowledge on this topic. The interviewees held senior decision making roles including chairman; chief executive officer of a large United Kingdom subsidiary; chief financial officer of a large United States subsidiary; the executive general manager, group strategic development; general manager, international banking; chief economist; head of group strategic planning; head of strategy for a major United States subsidiary; head of governance; and head of regulatory operations. The views of some of the interviewees were reflected in Hubbard et al (2002) in the research project looking into what is ‘winning Australian organisational practice’ and in other literature on leadership. But their views on the key strategic decisions required to be made when first seeking to establish an offshore business operation, from an Australian perspective within the banking & finance industry, are not recorded in any other source.

The interviews were open interviews. The intention was for the interviewees to have the opportunity to openly and freely express their views without being influenced or having their focus diverted or narrowed by responding to specific questions. Questions raised by the interviewer during the interviews were intended to clarify issues or points raised by the interviewees during the interviews. Accordingly, the questions raised by the interviewer in each interview were different depending on the direction in which the interview was going and what topics the interviewee saw as being most important.

All of the interviewees were provided with a written Invitation to Participate in a Research Project, in accordance with the Ethics Approval granted by the RMIT University, in advance of the interview; and each interviewee signed a Prescribed Consent Form for Persons Participating in
Research Projects Involving Interviews, Questionnaires, Focus Groups or Disclosure of Personal Information. The interviews are recorded below in order of sequence in which they occurred. The order does not reflect an ascending or descending order of seniority of the individuals.

**INTERVIEW 1.**

Interviewer: In terms of the criteria we have discussed, what do you believe are the critical factors and critical decision steps that a company should consider when looking to expand internationally?

Interviewee: One of the things from my banking experience is that if your company has its shareholding basically in Australia, as in this particular case in which I am talking about; the expectation of the return in Australian is X let’s say. If the expectation of the return of a highly efficient, well run company in the same business in the country into which you are going is X – Y, then however well you run that business it will be a drag on the overall shareholder return and will take away from the return on capital. However well you run the other business; you cannot actually expect to run it better than the best companies in the other country. It will always be a drag on the rate of return in the country where your major shareholders are. So for an Australian company, apart from the possible return disadvantages, one of the things you would have to look at is the tax aspect. Here in Australia you have always got the advantage of franking credits, which work against you in terms of overseas investment. Before you start on the whole thing you have got to think pretty carefully. Now the problem then is logically anyhow, that if the rate of return is higher, then you might say ‘that is really why I’m doing it’. If the rate of return is higher then logic says the risk is higher. So you have to have an understanding as to why the risk is acceptable, a higher risk overseas than say at home. Now you may not be able to expand at home. Now that is a separate issue, you may be in a situation where you have to expand and you cannot. You might be constrained by the ACCC [Australian Competition and Consumer Commission] from further expansion so you are bottled up if you do want to expand. You then
have either to go into other lines of business in your own country or take the position that you will
go overseas.

I think before you start the whole thing, the fundamental questions you have got to answer about
the individual countries that you are looking at is - what is the sovereign risk of running a bank in
that particular country? What is the ethical standard, because if you going for a higher rate of
return the risk is going to be higher - why is that risk higher in that country? In large parts of the
world there is endemic corruption. You are then giving yourself a risk of being tied up with
countries which have difficult ethical standards, one that you cannot live with very easily. So the
first thing to my mind is there must always be a clear, open and honest discussion. You should
not be going for a country by default; you have actually got to have a good country analysis to
see if that is a country you are prepared to do business in. Having crossed the hurdle of saying -
‘we are prepared to go overseas; we need at least the same rate of return or a higher rate of
return; if it is a higher rate of return, ok; where is that possible?’ Then you have to look at the
country risk and the things that are related to that as to whether they are risks you can accept.

An example of people going into the United States is a very interesting example of something
that is certainly my experience. You supposedly speak the same language so one of the things
you think you will be doing is go to an English speaking country where you would be able to
communicate rather than going to a non-English speaking country, coming from Australia. You
would think that would be a logical thing to do. But the reality is, and I think it has been shown to
be quite common not only in financial but in other areas, you think you speak the same language,
you use the same words, but you do not speak the same language. There are fundamental
differences at times in what words mean to Australians from what they mean to an American.
You can get the most awful misunderstandings particularly in circumstances where you speak
what you think is the same language but you get different understandings. I think this has
caused a lot of problems in the United States in particularly. You might think you understand the laws but you often do not, so it is fraught with uncertainty and difficulty. How are you going to earn a return on capital; where do you get the best advice?

Some major disasters have occurred. I am thinking in particularly in the resources industry, Western Mining, unbelievable to get so far down the road and find the whole thing just crater on you, due to some ‘misunderstanding’. I think one of the things also is you keep asking yourself is the question, if something is so good in the other country that is for sale - why is it for sale? Why has not somebody there purchased it? Can you really expect to be better at analysing the risks in it than somebody locally? Maybe there are reasons why it is a special case, maybe in that market the ACCC equivalent, the monopolies commission, won’t allow it so there is an opportunity. When I look back, I mean especially now it is a good time to look back, and you look back at the situations regards to Australian banks and some of the ventures that we had a look at overseas, thank goodness we did not pursue some of these exercises which were bandied around by the press. One particular case, we did not proceed with an acquisition, the press gave us a hard time, and the potential target was then taken over by another company. That company which completed the acquisition had to be bailed out recently. It is often quite wise not to go into these things. It is really very difficult with the due diligence to get a proper feel for the risk of the exposure. So the question really comes - if it is so good - why hasn’t somebody else picked it up? Now it may be that you have the circumstance in which the underlying return is higher in that country, and this particular company was not performing to the expected return in that country. It is an unlikely situation, so in broad cost of capital terms, I suppose that is one of the ways you could look at it.

Interviewer: With those dangers in terms of an acquisition, does that suggest then that maybe a greenfields start-up operation might be a better way to go?
Interviewee: I think that the greenfields operation that was started in your time and my time was an outstanding operation. It was taking a concept that was being used here and transferring that into the heart of a very competitive market. I do not know how well it has done now, but my understanding is it has been very successful; it was certainly very successful as it started. It cannot be too long before other people start copying a successful business. There are some funny things, for example, nothing to do with finance, but it is the same concept, apparently there is no such thing as a drive in bottle shop in the UK. You would think -‘If I was in the booze business, that is the sort of venture that I would contemplate doing’; certainly for a few years. Assuming it is successful, I can expect to get a higher rate of return until other people came in and picked it off.

I think it is difficult, first of all, Australia’s got tyranny of distance; there is no question about that anywhere. We cannot go anywhere without flying for around 12 hours, or much more. Then management time is a major part of what should be included in that. It is very easy to find you have a small investment that is talking more time, particularly management time, and a major part of the time you are meant to be spending on the core business. Management time is certainly a big consideration, particularly from here we are. Not like someone in Europe who can go to say anywhere around Europe for the morning and be back. It might be a long morning but it is possible. It is a major trip to go anywhere so management time has to be taken seriously into account.

I think that looking at the ventures that we were involved in, if you buy something, then somebody must have sold it for some reason, and if it is not from a distressed sale, then you have got to be prepared to put the effort in to it to get it operating more effectively, and you have got to put the money into it. I don’t think we ever really put the money into the UK business that we should have done. We just milked it and let it drift.
Interviewer: There was a reason behind that though, in terms of another acquisition that was being considered, a much larger acquisition that would have brought with it more up-to-date computer hardware and software, among other things.

Interviewee: A takeover that would have provided their platform to do the whole thing, so why waste money on it now before the acquisition. But how long do you wait for the right acquisition?

Interviewer: In terms of acquisitions, we talked about the greenfields operations which are smaller and do take a long time to actually contribute a reasonable amount to the bottom line, whereas an acquisition can speed up that process and a significant acquisition can really be a transforming venture for an organisation and catapult it from being in position ‘F’ in the market to being in position ‘A, B or C’. Do you have a view on the very large acquisition versus the smaller acquisition but maybe several of them, and on an acquisition versus greenfields operations?

Interviewer: Well, the major transformational acquisitions that we were involved in, none of which came to pass for a variety of reasons, were such that they were probably so fundamental to the nature of the company that I am not sure in retrospect whether they ever could have been a success. I was of the view that we needed to bulk up our business here; we needed a bigger balance sheet. I think a transforming investment overseas becomes very difficult because the centre of gravity of a company can move too much. If we look at the so called dual-listed companies [two companies which function as a single operating business through a legal equalisation agreement, but retain separate legal identities and stock exchange listings. Dual-listed companies are different to cross listed companies, where the stock of one company is listed on more than one stock exchange] dual-listing, I do not think is a problem, it is a red herring as far as I am concerned, it is the location of the management, the management team. We saw in some of the reorganisations that where we had Australia and a big, for example, UK business, where authority was taken right back to Australia - it does not work. That structure just caused
rifts and resentment in the organisation. You have got to delegate a certain amount. The centre of gravity is pretty important and an organisational ability to handle a large outfit if you have got a large part of the business overseas. A very big acquisition that we looked at, really I think it failed because the guy we were talking to could not stand being taken-over by an Australian company. It was the best thing we did that we could not get into it, it would have been a disaster.

Going back to the other part of your question, the greenfields approach. It so happened that we did have a model there that you could implement and reasonably quickly. It was a structure that was different from anything that had been done. You could expand it fairly rapidly if you saw it was working and I think that is what happened, and I think it was a very effective instrument. I just do not know today what percentage of income from that business comes from that side of it. But when you get to a country like, for example, the UK where the new market for us was in the south, you would be in the same state as those mortgage companies and building societies that Margaret Thatcher, in her time, converted to banks, and actually I think it was Brown who finally made them become banks. But of course they were not banks, and in order to try and compete with banks, these mortgage companies took more and more rubbish, which was ultimately their downfall, and very nearly the UK’s financial systems downfall, because the government and regulators did not check on them. It could be that the formation of the FSA [the Financial Services Authority in the United Kingdom] was a major mistake because the Bank of England did all that monitoring before and then they formed the FSA and some of the things that the FSA let go through was unbelievable, the Icelandic banks for instance.

We had an investment there, so we had a base from which to strike something new. The banks that we had, their strategy was laterally reasonably clear. We would sell of the ones that had no future; their growth would be too difficult. And retained the two where we could consolidate, and
where we had a good brand that had real value to it. We could use that brand throughout the country and then use it with a slightly different perspective.

Interviewer: Are we moving now into the area of product selection?
Interviewee: Going greenfield, you have to have a different offering, you have got to have something that you are offering which is not there already. In the UK, I think you have to be careful that you are not trying to educate a market. You can, over a long period of time, educate a market to something different; but it is a big ask. It has got to be something which is automatically accepted but you need to provide a variation of it. The drive-through liquor shop, it is not buying different booze, it is just a different way of presenting the marketing of it. The business centres that we established in the south of England, they were not predominantly producing anything new, they were just a different way of delivery a particular product. We were not trying to educate the market into a whole new range of products from the start. We had a series of products that the market needed, but we were delivering them in a different way. Different from the way all the other banks around are doing it. It is that type of thing. I think it is dangerous if you think you can go into a new market and try to sell them something completely new. At one time, we considered taking variable rate mortgages to the United States. They did not have such a product and some people thought that would love this. Well why would they like such a product? They had fixed rate mortgages but with no refinancing charges [to compensate the bank because mix between its borrowing and lending would no longer be matched, either directly or through derivatives]. Why would you want a variable rate mortgage in the US? With their fixed rate mortgage, if the interest rate got up you would think – ‘oh lovely, I don’t have to do anything’, and if the interest rate go down you would think – ‘that’s even better, there is no penalty I will take out a new mortgage at the lower rate’. So there we were talking about trying to sell something into a market that had no attraction at all, to the logical people anyway. You have got to be selling something which the market accepts.
Interviewer: So it is a variation on a theme.

Interviewee: It is a variation on a theme.

Interviewer: Looking then at the actual timing of going overseas, a lot of Australian companies determine when they might go overseas based on the local markets is getting a bit tight and their ability to create additional market share in the local market is getting tough. That could well be the major or only criteria for determining the timing of when to go overseas. But going overseas can involve both internal and external factors. In relation to the timing, relevant external factors could be - how is the economy progressing in other countries? Where is that country in terms of the economic cycle? Questions such as – what are the first move advantages or disadvantages in new markets such as China or India? What are the prospects of changing the barriers to entry? In a number of countries, particularly in South East Asia, there are restrictions preventing you from having more that a 20% or a 49% interest and in some countries that may be changed. So, external factors can bring about opportunities.

Interviewee: There is an opportunity because there is a change in legislation and you have your opportunity to go in.

Interviewer: So there are these external factors which can influence the timing decision about when to establish on offshore operation. There are also internal factors such as where the company is in terms of its development internally. If the company’s still bedding down its domestic operations, perhaps had some fairly rapid expansion interstate and is still getting all that under control, perhaps it is not quite ready to do that next big leap. There is also the availability of resources within Australia which can be fairly limited; both financial and human. With all the interplays of those timing factors, both external and internal, in your experience have there been factors which are particularly critical from a timing view point?

Interviewee: The trouble with timing factors is they are normally right outside your control or expectation. One of the biggest problems is the exchange rate. When you think of the gyrations
of the Australian dollar, you can set up on something when you are in what is currently a very good exchange rate with a particular country, and the darn thing can then turn massively against you. Again, we have a very good example where we purchased something at a fairly good rate, and the thing goes against us, it goes badly down and you taking out of the books huge write downs just because of the impact of the exchange rate. Changes in the exchange rate with the US dollar that we have seen over the past, what 15 years, have seesawed; some of the movements have been unbelievable.

Interviewer: You mitigate that in relation to overseas operations, if their debt funding was raised in the country in which the overseas operation is operating. You can get tradeoffs here. Borrow in a particular market might be cheaper but you are taking on the currency risk. But borrowing in the market in which you are lending, the foreign market will be an automatic hedge between the asset and liability movements on the balance sheet when currency risks change.

Interviewer: Yes, it is another one of those sorts of things you check, because I think I am right in saying that depending on the nature of the banking business, countries are saying we have got to have a certain amount of equity in that particular country where you are established. You cannot do it all on debt, so you are going to get some exchange rate impact on the capital presumably; and it can be quite significant.

Interviewer: There certainly will be some impact on the capital and, depending on whether it is a wholly owned subsidiary or partly owned subsidiary, you might be able to limit that fluctuation purely to the component of shareholder’s funds rather than on total assets if you are looking to fund such assets from another market. Funding the majority of the assets from the same currency can limit your fluctuation because your assets and your liabilities will move depending on that change in the currency. So instead of all our assets being, say discounted if the
exchange rate happens to plummet for some reason, the majority of your assets are protected by your financial gearing / leverage.

Interviewee: You raise a point, you mentioned a wholly owned subsidiary or a partly owned subsidiary. The point there, which is a valid and an interesting one, is - whether you should go into partnership with somebody for the start? In certain countries, should you go in without somebody who has got experience in that country? Some years ago, one of the other Australian banks was looking to broaden their exposure and bought an East Asian banking group. Now in that case they did not go into partnership, they bought a bank that had a lot of experience in a lot of countries. That takes us back to the question of - why was it for sale? Indeed, in the end, they sold it, and they sold it to Standard Chartered who was already in most of those countries. For example, I would say if you were interested in going into all those countries you might seriously think of trying to go into partnership with somebody like Standard Chartered, which has got a lot of experience, whose staff has years of training, staff who actually knows how to operate there. Again, why would they want to go into partnership? Unless they themselves needed to bulk up, they may want to bulk up as a bank into a market which they needed a bit more financial clout to get into. For example, they have been in China for years but they are not super large in China and they may want to bulk up in China, or even India for that matter where they have been for a long time. So you might have a bank like that, you might both be interested in explaining, it is not a bad concept from here; perfectly reasonable. Where should we be looking, should we be looking in Europe or America or should we look into the growth markets in South East Asia? Do we fully understand the country risk, the cost of capital risk? There are plenty of risks in South East Asia. Maybe if you were in partnership with somebody who had a long experience there, even perhaps not on a big scale, but been there a long time, that might be a strategy and it would make more sense if they were wanting to bulk up in one of those countries. We are talking about financial services and risk, so we could also talk about insurance and funds management. Here we have companies AXA. AXA had been angling for years to get control of the Asian aspect of
AXA. But it never came about. It got right to the hurdle over a weekend, then the fellow who ran it realised that he was not actually going to get control out of the deal and it was over. The Asian aspects are now in play again. So that is the sort of thing that, I think, would strategically make sense. Try to get into partnership with somebody who has experience in that market, rather than going in cold. I think that would be certainly something that you would be looking at that you would want to explore very carefully.

Interviewer: Joint ventures and strategic alliances inevitably would appear to have a certain life cycle. What would you think are the key things an organisation should look at if they were going into a strategic alliance or a joint venture for the first time?

Interviewee: I suppose the first thing to do is to have a very clear understanding of what it is that you are doing together and have it very clearly defined so you have always got it as a reference to go back to. So this is what it is, this is what we have agreed to do together and then you can structure your management according to that. You have got to get the thing working as a single entity, if its got a single management. I am assuming in this case we are talking about an incorporated venture rather than an unincorporated one, I think a financial institution would have to be incorporated I do not think a financial institution could be unincorporated

Interviewer: I am sure it would have to be and be subject to all the regulatory requirements in that country.

Interviewee: The company’s constitution could define exactly what it is that they are going to do together in that joint venture company. But that seems to me to be one of the key things that goes wrong, when what you are going to do together is not properly defined.

Interviewer: How important do you think an exit strategy is? Should an exit strategy be designed right at the very beginning, is or is that just simply an acceptance of defeat before you start?

Interviewee: It seems to me that exit strategies relate to where you are planning to create your wealth by going in and going out and you are looking for a capital gain. The exit strategy is in
one way or another getting the value by creating something and selling it at the end; it is the private equity or venture capital route. If you are a deposit taking bank, like the four pillars banks here, and supposing they were going overseas. I do not think you would go in with an exit strategy because you are trying to build something. I think it would almost be a misnomer. Now the same would be true with life insurance, it is again a contradiction in terms; I mean this is a long term gain.

Interviewer: What if you were to build into the joint venture agreement that after say five years the partners wanted to buy each other out, there could be a basis for that sale price and that could be agreed at the very start?

Interviewee: I think that is part of the partnership where you have a right to a first bid or to a matching bid if somebody wanted to pull out; like they do in offshore licenses. If one of the partners wants to withdraw, the existing partners in that group have the first right to match whatever it is that an outsider may offer; that is not unreasonable. Partnerships sometimes do fall apart.

Interviewer: Looking at it culturally in some of the countries, do you think starting the alliance or the joint venture with an exit strategy sets you up for failure right from the start or do you think that it is just a prudent way of entering into business in a new market?

Interviewer: I would suspect it is a little bit horses for courses. In some countries, if you had that clause the local company would perhaps see it as a way of exploiting you by somehow creating a false market or getting you into a certain position.

Interviewer: So the focus into the future under those circumstances could be something quite different from the true intention of what the original venture was established to achieve.

Interviewee: That is right. You could get into a situation where you were going for the long term and they were going like a private equity company and pulling out at the key moment. The other party could leave you stranded as there are local ownership requirements in many countries.
Interviewer: Do you have a particular view about wholly owned verses partly owned. We have been talking about the knowledge that you can learn from having a relationship with somebody in the local market. But do you think that overbalances the advantages of having a wholly owned entity?

Interviewer: I think that financial services are different from other business. There have been plenty of examples of successful joint ventures of one sort or another in resources industries and commercial manufacturing. Banking is a bit different and I am not sure a joint venture necessarily would be such a good idea. We used to have joint venture banks here, ARDB [Australian Resources Development Bank] and after a time the owners said – ‘why are we giving this to someone else when we can do it better ourselves, even if it is a smaller part of it. We are creating something which is competing with us for no particular reason’. You would not be competing with yourself in the case of a foreign market because you would be in a country where you were not otherwise operating. I do not know what the experience is with joint venture banks. There must be joint venture banks round the world, are they all 100% owned I just don’t know.

Interviewer: No they are not, particularly in South East Asia. Foreign banks have a minority interest, 19% or 49%, and they rationalise that as a learning opportunity and then waiting for the day when the regulations might change. Particularly in many South East Asian countries, the long term relationships are very important. Having had that long term relationship, they see as opening the door to obtaining a license if those foreign investment restrictions are removed.

Interviewee: Well you do not have any choice do you if you want to go into those countries. Presuming the rate of return is higher, that makes it attractive, and it is adding to, not subtracting from, your overall return and you are reasonably comfortable that the exchange rate movements are not going to ruin the whole thing.
Interviewer: What about personal and executive staffing in these foreign operations. Are there particular positions within an oversee operation, be it partly owned or wholly owned, where you think it would be almost essential to have our own person in those roles?

Interviewee: If you are a minority, this would be part of your negotiation. Hopefully the other party would be amenable, but you might not like it but you might have to take a fairly firm line and say that these are some positions that we need to have. In a bank, the head of finance really is a key role. You would not get the managing director, and maybe you would want the managing director to be a local. You might have a structure where you have a chief operating officer who would be your person. It is interesting in other industries where they have gone overseas, they tended to make sure the chief executive is an expatriate, although the chief operating officer might be a local. One of the reasons for this is that there can be a lot of local pressures on senior management. If you are going to get a break down in the culture and ethics of the company, it could come from senior management being under huge local pressure. The chief executive can be vulnerable to pressures from local society, so there is quite a lot to be said for a chief executive not being from the local society but being an expatriate. He / she do not necessarily have to be an Australian, but someone who is not subject to local pressures. That said, you are not likely to get that positions as a minority shareholder. You might get the chief operating officer, who may have to live with the fact that the politics of the situation could be that his / her boss may be influenced by people whom he / she think should not be allowed to influence the CEO; quite a difficult position that person is in of course.

Interviewer: What about the chairman of the company in a foreign operation? Would you see him / her as a local or someone from the home market of the Australian company?

Interviewee: It would have to be a local. If it was a joint venture company with only two or three shareholders, you may go for an American type structure with a chairman & chief executive as the one role. If you were the minority shareholder, you would not get the chief executive. I do
not think you would have a structure that is like a public company in Australia. I know in some cases they get rid of all the non-executive directors and just kept it as an executive board. I could not see any value in having non-executives on the board if it is a joint venture. If it was a public company and you are a minority shareholder, it would have to be a local.

Interviewer: What about the advisory board approach where you bring in people who may be well known in the local community?

Interviewee: Not in a financial entity. In other cases where advisory boards were established, I can tell you they do not serve any purpose. If you want to get some advice you can get some advice from experts in that particular area. But an advisory board does not really carry the commitment. The level of commitment in an advisory board is insufficient; maybe because there is no liability of any sort. It is quite clear that the whole structure of the operations of a board, as a board, is far more effective than it ever would be if it was an advisory board. I would not have an advisory board; it does not serve any purpose. If you want to have a board, have a board, get people who are committed and turn up and actually contribute to the company as directors, because they have got a liability.

Interviewer: What about a structure where you have got a real board but you then have a mixture of some local business people on that board who bring both expertise in the local market and also the opportunity to provide introductions and open doors?

Interviewee: There are always opportunities, I mean, we tend to generalise, but South America might be a market where you want local expertise. You might go to Chile; you might not go to say, Venezuela at the moment. So there are real decisions; perhaps Central Asia. Wherever you went you would have to be selective. Where is there a good rate of return? Would you go into retail banking? The first thing you could do is operate as a deposit banker, rather than as a lender. This way, you actually have the money and you are sitting on it and managing it, rather
than lending money to people whom we really do not have the skills to analyse properly. You know there are philosophical approaches to the way you need to attack this.

Interviewer: In fact an organisation we both know well is doing just that to a large extent throughout South East Asia. You then have the very point you raised earlier about the currency risk going forward. You may look to provide deposit and other investment products, but profits could be very easily wiped out from that market when you have to repay those deposits in local currencies overseas. So again, it comes back to your ability to hedge all those contracts or to manage the exchange risk, so that becomes a critical factor.

Interviewee: And we have seen it happen often enough. We have seen the impact of exchange rates; unbelievable. We are at a certain disadvantage because we have got such a volatile currency. It could wipe you out.

Interviewer: In terms of circumstances that might be unique to an Australian company versus an American or British or Japanese company that might be looking to expand, can you think of circumstances which may be particularly relevant to Australian companies which may not have parallel circumstance in other countries, or for companies in other countries expanding internationally?

Interviewee: I suppose there are always political ones where country A is persona-non-gratia in country B. For example, you have areas where the Americans are not allowed to operate in the resources industry. So that creates an opportunity for an Australian company. There might be a country Australia has a particularly good relationship with. It could be around trade, for example. Supposing you were well into the iron ore industry and you wanted to get into China and you might establish a business that is particularly valuable in servicing the trade of iron ore. So you could be particularly good at trade financing for a particular country or industry and you might decide that is a niche you would try to drive. It should not be too high risk. If you have a good
idea of what the trade is, and you might, instead of trying to just do general financing, specialise in trade finance.

Interviewer: That gets back to the product selection as well, again finding a product where you may have that competitive advantage on that market.

Interviewee: Not trying to re-educate the market but just trying to have better products and better service.

INTERVIEW 2.

Interviewee: If management presented a proposal to the board in relation to a possible expansion overseas, I would expect, initially at least, that it would be raised at the early stages prior to having conducted a lot of planning or development, but with some thought had gone into the proposal rather than it being raised on a whim. That would be to get some feedback from board members in relation to what needs to be done to expand overseas and the board’s initial reaction to such an overseas expansion.

Some parameters at that stage might be outlined by management and the CEO which, for example, might state what type of financial organisation was being considered. Such as, if it was an Australian bank considering expansion overseas, would they be considering expanding as a bank or as some other type of financial or even non financial entity. It may be some quasi type bank or investment bank rather than a full banking operation. Then secondly some idea of the capital to be spent on the acquisition and for that it would obviously be very broad parameters. In fact extremely broad at this stage, is it a one million dollar or a one billion dollar acquisition, or is it simply organic growth which would pretty much start out as nothing and grow from scratch. Then, I would want to know what part of the world might be considered. That is, what continent -
Asia, North America or Europe. Is it in an English speaking country and what sort of politics is prevalent in that geographical location?

Assuming that the go ahead was obtained at that board meeting, based on a very broad outline, with the board saying - “Yes” that the board does not object at this stage and are backing management and would like you to come back with something in more depth. So, at the next or a few board meetings hence, a more detailed proposal would be put to the board and may or may not involve an external consultant or if the bank had its own expertise the internal expertise of the people of that sort of strategic initiative to be involved to a significant degree. At that stage, I would expect far more detail of the expansion planned, which would go under a few different headings, and which would expand on what was presented at the earlier meeting. This is not necessarily in order of priority, I would want to see the headings of firstly - roughly the amount being spent i.e. millions or billions; either acquisition or start up; and some broad parameters so you can get a feel of how much risk there may be in relation for such a venture. Within that approximately how much capital will be required for the expansion or would it be able to be debt funded to some extent; or totally debt funded; or totally capital funded. I would then be looking at the geographic side in more detail. Which country precisely would the expansion be planned for and then in relation to that particular country I would want to know something about the culture of that country, the ethnicity, diversity, the political system. The type of people who live in that country, how they think and how that will impact on the type of banking operations or similar operations being planned for that country. Social attitudes come in there too, eg attitudes to climate change and the environment, is it an important issue in that country or if not now or is it likely to be in the future and how that would impact on any proposal and future lending operations.
Obviously, as well as going back to point one as to how much is going to be spent, you would want details on what is proposed - is it an acquisition or a start up. If an acquisition obviously the details of whom is to be acquired. Or if a start up how that will actually work. All of this to be wrapped up in a plan which is really a timetable. Even if it is rough at this stage you would want at least a timetable to outline for example acquisitions planned for 6-12 months from now with implementation from 12-18 months and then the financial side of it all set out as well. Which would include returns to be set out on a number of bases, including the internal rate of return and payback period. If an acquisition, then the price to be paid and how that price compares to other acquisitions. Similar acquisitions in that area or in that industry sector perhaps globally and research would have to be conducted on prices being paid at the moment that would probably be based on price / earnings.

So I would also want to know particular country specific matters such as under geographic heading; what are the particular financial constraints; what are the particular financial requirements which are different to Australia? How does that actually impact on the proposal or on the bank or the operations in the future? The attitude of financial regulators; accounting standards and stock exchange requirements if that’s relevant. So that’s really leading into the legal and governance requirements. You would want to know what are the legal and governance requirements in the geographic location specified and how would they impact on this proposal. What would our attitude be to the way they carry out their legal and governance requirements. I would also like to see a sub heading of IT. These days it is a lot more global than what it used to be. However there may be specific country wide geographic requirements or specifications you may need to know in relation to IT. I am assuming when we are speaking that it would be a large country such as the United States. But if, for example, it was an acquisition on a small island, you would want to make sure they had proper IT facilities and you would want to know all the limitations and ramifications pertaining to that. Another heading would be HR, and in terms of HR
you would want to know the sorts of people who live in this geographical spread and the sort of staffing you would be able to expect. The costs of staffing, the types of staffing, staffing issues you would be likely to expect in this country - would there be an anti-Australian attitude. Whether or not they work more or less hours and will this cause a problem, whether we would want to put any expats there. What are the expat requirements and would having the expats there cause any problems with the locals. A lot of HR aspects would need to be considered broadly. You would want to drill down in greater detail. For example, when I was with another bank, I did an acquisition it Fiji and in Fiji one of the big issue was the premises. Therefore assuming it was an acquisition of a bank in Fiji, or somewhere like that, you would want to be particularly informed about the premises and what the arrangements were. Whether or not acquiring a particular bank would lose these premises and the costings of the premises. Also branding - what would you do with the brand if you made the acquisition as there is value in the brand name. In terms of banking, I would suppose over many years most banks keep the brand name for a good while. So one would expect if there was an acquisition in Fiji you would kept the name for some time. The acquisition in Fiji gave that bank a 44% market share and of course that particular acquisition meant that the regulators had to be consulted prior to the acquisition taking place. So we had to negotiate with the other party, knowing that third parties would be involved and that needed to be considered in terms of the planning. How are the negotiations going to take place, who are going to participate in them, and what stage do you involve the regulators; the regulators for here and there. The regulators here would be the Australian Prudential Regulation Authority (APRA), as well as for say Fiji it was the Reserve Bank Fiji. Another time I did an acquisition in Samoa and I had to go over and negotiate major changes to their legislation to allow it take place. I had to speak to the Prime Minister and the changes took weeks of negotiations, going right through the legislation to enable the acquisition to occur. That took place after it had actually been announced that it was going to go ahead. So it is very important to keep the regulators up to speed and on side assuming you are working with them and acquiree. This is all assuming you
had a friendly takeover, as I did in Fiji and Samoa. If it was an unfriendly takeover then I would be rather cautious. In fact very cautious because an unfriendly takeover can be very difficult to execute and I would be surprised if they would have huge success particularly in these smaller countries.

Structure of the start up or the acquisition is extremely important and I would expect that would all be laid out. It may not be laid out as to how exactly the takeover will occur but the possible structure of whether it is friendly or unfriendly or start up I would expect that to be appearing at this stage of the discussions with the board.

I also would like to have some sort of examination from one of the consultants or internal experts on other acquisitions that have succeeded, tried and succeeded or tried and failed. I keep thinking of, and I am sure most people would mention, the Country Road expansion into the States and the ABC Learning Centres. Different industries but for some reason, some Australians seem to think that they can be just as successful in other countries as in Australia. So I would want to have a detailed analysis or study undertaken into the takeovers, acquisitions and start-ups of different companies, and not just in the banking industry, and why some companies were successful and some were not successful. Whether or not it can or not be pinned down to particular aspects - did they spend too much, did they not understand the cultural or geographic differences, the legal differences? So I think that would definitely be very important in considering all of these aspects. Have a look at who has succeeded and why. Then, I would want to know, if it was to be a start-up, what would be the planned rate of expansion - a full financial analysis to be provided setting out planned rates of growth. If it was a takeover I would want to know what would be the payback period. Know the return over 5 - 10 years. I know it is a long way out but I would still want to know a 10 year prediction. To see what the plans are – would the plan be to grow the business significantly or have it quietly going in the background.
Then know the full plan of how it will be resourced, in terms of capital, legal if required, risk management, HR, where is the staffing going to come from, is it even available? I would want to see it revisited regularly against the original plan. By regularly I mean as you move further down the track in relation to the start-up or acquisition, have a review in 3 - 6 monthly or annually. I would want to see, and I mean further down the track in the approval process, a full implementation plan. I think a lot of takeovers do not succeed because of poor implementation plans. Boards and management seem to get very excited about the acquisition itself and I have seen some not do very well after the actual acquisition has occurred because of failure to really follow through with very active implementation plans. In that implementation plan I would want to know are you planning to move in and absorb the operations into the operations of the home market or are you planning to play a more hands off role and if so for how long and why and to what degree of hands off would you want to play. My experience again, I think takeovers really need to be managed well into implementation rather than stop the moment it is announced and goes through. I would want to see it actually being managed actively and being reported to the board annually, first, second and third year, as a separate report to the board as to how a particular start-up or takeover is going against its plan, not just have the results absorbed into a larger part of the organisation.

Another one to note is the legal requirements and whether we have the English system we are part of, as does the UK. The United States has very different laws and a different in how they implement those laws. If it was an acquisition in China, there adherence to laws and attitudes to laws are totally different to ours. Not only that but their business laws are not very well developed at this stage and so the legal aspects of an acquisition in China would be one of the most important aspects of acquisition. I mentioned the pricing of the acquisition and with that would want to look at the pricing of other acquisition compared with pricing of other acquisitions around
the world in determining whether or not it is a reasonable price to pay, and how much it is wanted.

I would also want to look at any other risk factors that we haven't already covered. It might be for example if it is an acquisition in San Francisco there would be a risk of an earthquake and there could be numerous risk factors I haven't mentioned. Another risk or issue you would want to look at is confidentiality and how to keep it confidential. Obviously if it is an acquisition it is pretty important. If it is a start-up it would be equally important between now and when you announce the commencement and you may want, for example, to have a code name for the whole project. Which is to be used from then on and changed after a few months. Say for example if someone is in a lift, they don’t start talking about the acquisition not knowing that someone from a rival bank may also be in the lift. Or for me once, when I was with another bank, I wrote a fax about an acquisition in Papua New Guinea and wrote the wrong number and it ended up going to a different bank and this was very early in the piece, in the first month. So it is very important to keep things very confidential and to know who are the personnel involved. To actually specify them, so the directors know who to speak to if they have to. They probably wouldn’t, but if they wish to they will know there is a very select group of people working on it including assistants. As assistants usually know just as much as anyone else as they are actively involved. So not only senior management but the names of their assistants as well, so I would want to know the names of the whole team involved in the acquisition or start up.

I think these are the main factors in considering an international expansion.

Interviewer: One of the early things you spoke about was whether you would undertake an international expansion as a bank or quasi bank. That is really getting to the essence of the product selection or services you would provide in a particular area. If you go into a foreign
market or a market you are not as familiar with as with your home market, do you think that is an important factor to narrow the number of products available?

Interviewee: Not necessarily to narrow them but I think it is a critical factor to actually know what you are doing, and to know what are the products offered and not to expect that you can go into the market and offer all the same products they offer. Either as a start up or as an acquisition, you need to know exactly what you are doing as you will not have the background and experience of your competitors in the new market. The market you are to enter may offer a wide range of products and services or only a small number of products and services. You need to know why that is the case. You certainly need to understand exactly what products you are offering if it is to be a full serviced bank like in Australia, which is offering an enormous number of products and services. If you are going to do a start-up, you may want to just offer one or two products or services and test the water. I think that’s what many foreign banks did back in the mid 1980s when we had a lot of foreign banks allowed into Australia. Most of them came in with just a few products. Some came in as full service banks but usually went into a joint venture and didn’t actually do it on their own. But those who did come in as full service banks, I can’t think of any that survived. Chase, which was a merchant bank, came in with National Bank. When that didn’t progress, then Chase started up on its own but not as a full service bank and did not do very well. Most of the foreign banks that started up in Australia, I think, have not understood the Australian landscape, not done their full homework that should have be done for a full overseas operation. Most of them have basically not done well and most of them have shut-up-shop and gone home. I don’t know whether their view is that is because they had not done their homework sufficiently but that is the way a number of people would look at it. You can’t just expect, and as a lot of Australians have done very poorly in the past, you can’t expect to go into a foreign country and be successful. Australians haven’t done it very well and the overseas people coming into Australia haven’t done it well here either. Because there are differences, I know there is globalisation and there are barriers coming down, and it should be easier than it used to be but
there are still huge cultural differences. One I can think of in particular is Papua New Guinea where they like to sit around doing nothing, they are not what you would call hard workers. In Western Samoa they wore t-shirts which said – ‘Do it the Samoan way, do it tomorrow’. That sort of attitude does not work very well with Australians we have a very different type of attitude. Therefore you can anticipate some sort of clashes, if you have Australian paid staff working with staff with that sort of attitude. The planning of the acquisition or start-up is absolutely essential and detailed planning to know what you are doing.

Interviewer: You mentioned the capital levels. Do you think there is a limit that the new acquisition or start-up in a new market should be as a particular percentage of the size of the current operation?

Interviewee: If it is a start up then you would probably not have to worry as the capital would be fairly small, if it is an acquisition then – yes, that would be a matter for the board as part of the overall strategy and the board should have a view of what the limit should be. A limit that comes to me is that anything above 10% would be pretty significant for an acquisition in a foreign market. I put that at the beginning as it is something the board has to get its head around. Are they comfortable, for example, spending 10% of the capital of the bank or financial institution or spending 50%? Now 50% to me would be far too high. But – yes, the percentage of capital should be determined with management’s recommendation but pretty much by the board.

Interviewer: In terms of which part of the world, that is the market selection, you mentioned Asia, America and Europe, and also English speaking and the politics of the country. Are there particular places, in your experience, where Australian companies do well and places where Australians do not do well?

Interviewee: I am not sure that it is places, I wonder if it is more the amount of homework being done for those particular acquisitions. Some companies do very well in the States but, in other
industries, Country Road didn’t, ABC Learning didn’t, and in both of those cases, from what I read, I thought the failure was more about ego and spending too much, high debt levels, rather than the attraction of the country. Just really not doing enough homework. Having said that, I would personally think that it is easier to do an acquisition in an English speaking country. However, I have seen quite successful acquisitions in Western Samoa and Fiji but both of those acquisitions were for another bank which was already there. That’s a big difference, not stepping into a new market with an acquisition but just increasing its presence there. The same with Papua New Guinea so the bank already had knowledge of the market place.

Interviewer: That leads into the next question as to whether you would regard an acquisition or start-up operation as the better way to go into a new market?

Interviewee: If it was a brand new market, I personally would suggest a small investment. With the Philippines, when I was with the other bank, we recommended starting off as a branch, just a branch not an acquisition. Starting off as organic growth as a branch and start learning, sending staff over there for 5 years to learn how it operates, how banking works in that country. In the Philippines it is very different due to the political situation and they didn’t allow 100% ownership by foreign banks. So, in the Philippines, you had to own a certain percentage of the financial institution. Therefore, you really had to understand the politics and what led to successful operations over there. I would be more in favour of starting up small in an unknown place. I am not sure if all boards and management would be happy with that because management is often really keen to make a significant step in a country and will often go for a big acquisition. Such as one Australian bank with its operations in the United States and again in the United Kingdom and Ireland. China was another one where the other bank I was with decided to start up as a branch only and in Indonesia it started as a joint venture with a very small interest only 10-20%. Just with a little bit of capital, put in just to learn about the operations there which would help them to learn how to expand. People do not realise that Asia is not one big country it is comprised of
many extremely different countries with extremely different cultures. For example, in Asia, Indonesia is totally different to China. Whereas the United States which is one big country and there is not that much difference between the northern and southern United States.

Interviewer: Although the United States now has a strong Hispanic culture. You mentioned joint venture, do you think they are successful long term?

Interviewee: In my experience they are not, but it all depends on your expectations in relation to the joint venture. I would have thought if you started a joint venture owning 10-20% of the financial institution, then your expectation is to learn about the business, the country and how business is done. Then you may find that you are prepared to invest in a joint venture with the sole expectation of learning about whether or not is worthwhile to invest further and in that sense a joint venture may be an excellent way to go.

Interviewer: In terms of an overseas acquisition where a foreign company cannot own 100%, how do you feel about owning a business that you do not have majority control?

Interviewee: My preference is not to be in a joint venture where you do not have majority control. In fact I am not in favour of joint ventures but in some jurisdictions such as the ones I was familiar with there was not actually a choice. There was a small interest or nothing. Part of getting involved at that level was getting advice from high level locals. Getting in at the ground level and establishing a relationship with a particular well known financial institution would go down well with the regulators who in 5-10 years time may be prepared to let the foreigners expand to even more than 50%. I think in that situation there are very good arguments to enter into a joint venture if you believe that you will have a much greater chance of conducting proper banking operations within the minimum time frame and you have a jump start on another Australian or other foreign bank getting into that jurisdiction because of an already established relationship.
Interviewer: In terms of the mix of having expatriates and non-expatriates, do you think there should be a mix and do you think there are key people that you think should be appointed?

Interviewee: Yes, the takeovers I have been involved in, the best mix was where the number one person would be from the bank that is doing the acquisition therefore would be an expat. Maybe the next person one or two below that person, but you would not have a lot of expats as expats may destabilise the harmony of the staffing. Expats are usually paid more, so if you were to put in an expat to do the same job as a local person and pay them more, that could be quite difficult to manage. It would be much better to put the expats in at the senior level where they are going to be paid more anyway because they are at a senior level. With a plan, if possible, to phase out expats or keep the number of expats to a minimum. It is actually very good experience for Australians to go over there and be in a number one position for a couple of years. It is a good idea to show the local operations that local people can do well and it can be unsettling for them if the senior positions are continually given to expats. Locals need to see a line of progression so they can see that they can work their way up. You actually want to focus on the locals doing well and not give all senior positions to expats.

Interviewer: Do you think there are key positions within the operations that should be covered by an expatriate? You mentioned the number one position, the Chief Executive, and the next person one or two below the CEO. Could you please expand on this?

Interviewee: Yes, the top finance position, the CFO. The top legal position does not need to be an expat, as this role go to a local or an expat who has particular interest and expertise in the local laws and can speak the language. Depending on the size of the acquisition, the Head of Risk could be an expat and possibly the Head of HR. The Company Secretary would have to be a local. The Head of Operations could well be a local or an expat. Or might be initially an expat and then down the track hopefully a local would be Head of Operations. Definitely the CFO should be an expat because of the need to get around all the local requirements and then to
report back in a way that the acquiring company or the Australian operations are used to. It is pretty difficult to teach the local people how to do things in the Australian way, it is much better to have the CFO as an Australian.

Interviewer: Do you see an advantage of having a Chairman as a local or an expatriate?
Interviewee: If it was a full board of directors, then you would want the Chairman to be a local. The reason being you are probably talking about something of some substance. The whole structure of the board is something which sends messages to the local people. If you were to have a strong mix on the board of local people and not too many expats, at least in the beginning, I think it is leading into a better relationship and smoother acquisition.

Interviewer: Going back to the start, you mentioned getting the board involved early and that having the extra level of thinking was an important factor. Do you see any internal factors, in the organisational development of the company that could be important? Do you think that companies start to go off-shore when they feel their local market reaches saturation pointed? Or, do you think there are other factors internally that companies should be addressing? For example, the level of sophistication the domestic market – is this a critical factor when considering expanding internationally?
Interviewee: I think it is important, as to whether it is critical I am not sure. The domestic operations may be very sophisticated, but the company itself may not be ready to undertake an expansion or acquisition in another country. I have seen from a number of companies that they can be distracted by things such as acquisitions and start-ups, when they should first spend more time looking at their own operations. When companies do start to think about expanding overseas, it is because they have got to a certain size and say – ‘where to now?’ Do we do share buy-backs and stay at this size, or do we expand and if so how and where and where is obviously overseas. If a company has a large market share here, obtaining an even larger market shares
in Australia is difficult to do. Any growth in your local market share means that the market share of someone else must decline. To change your market share even one percent is very difficult. So it is sometimes easier to look overseas.

INTERVIEW 3

Interviewee: If I think about my own experience in expansion into the United States and in answering the question around what are the critical decisions that need to be made for a company considering expansion, certainly the organisation I worked for found that it needed to engage some management consultants and in this case it was McKinsey & Company. They were asked to conduct a full survey on the financial services landscape in the United States. What the bank wanted to know is what were the attractive market segments in that market, what were the profit pools available, so in other words, were these market segments capital hungry? What sort of distribution competencies and capabilities did you need? What sort of channels are the products and services to be delivered through? It was a full six months exercise that the bank undertook and in parallel with the external analysis was an internal analysis - what sort of competencies and capabilities did our organisation have that we felt we could contribute or leverage in that market?

A very good example of that is, if I can expand, during my time in the United States, fully 73% of retail payments were still being made by cheque, this was in 1999. But Australia by this stage had a very well developed EFTPOS and debit card system so we felt there were opportunities there to bring those competencies and capabilities to the existing investment we had there and also to add into any acquisitions or markets we decided to get into.
The very critical research that was done, was done by a highly regarded, well respected management consulting firm and from that financial services landscape research came three opportunities –

1. wealth [funds] management;
2. credit card issuing; and
3. small business financing.

If I can take those three target segments in order - ultimately we were unable to identify a particular company in wealth management to acquire that could provide the platform for our expansion in the United States. We did get an opportunity to review a credit card issuer but the due diligence indicated at the time that the card issuing company was not what it seemed and we walked away from that. In respect of the last opportunity, the bank considered launching a direct bank and targeted at the small business end in other words for facilities up to about $5 million US, but again ultimately we found that the cost of setting it up and doing it from scratch was too prohibitive.

So, the key thing is that we did extensive research and that helped us to be fully informed. You can also imagine that the United States was an attractive market. It has a legal system that is not unlike our own, culturally we are talking about operating in a western culture.

Interviewer: But your bank already had operations in the United States at this time.

Interviewee: Yes, but the United States banking system by this stage was rapidly consolidating. Prior to our research, banks in the United States were invariably State Chartered and early in late 1989 and early 1990s the Banking Act in the United States was relaxed so that cross state banking merges became easier. Up until then they were very hard to do, and to execute, but the legislative changes meant that in the United States retail and business banks were stating to buy banks outside their home base. Certainly we in Australia would be puzzled by the extent to which
the banking landscape was so fragmented, because our banks tend to operate nationally and have operated nationally for some time. Certainly in the United States, it was a fragmented banking market and that meant there were opportunities to acquire banks in attractive States. Some of the States had the gross domestic product of Australia. So the individual States had very robust economies.

I think when our bank expanded in that market there was, and always had been, the tyranny of distance. It’s not as easy to get a management team on the plane and to your door within an hour. You know, it took fully 22 hours from where we were operating to get management to interact when it was necessary, in physical terms.

I think the other thing that is important is that there would be an exchange for senior staff. I think the jury is out as to whether you as the acquirer put in your own staff, or a person to lead as CEO. But certainly I think it probably works a little better in the States to put in our own CEO than it can do in countries where there are language differences. But it is important to put key people into key roles and they are invariable the CEO, or the chief financial officer, or chief operations officer, or in banking the chief risk officers. They would be roles that an Australian company should consider filling in the event that the expansion into another country is by way of acquisition.

The other observation I would make is that it's equally important to identify key talent in the acquired company to place in key roles in your own company, if there is to be a shared understanding of how the organisations makes decision. I think if individuals are appointed into the acquiring company, those persons get to understand the operating environment that the parent company works in which often extends to exposure to the economy, the political and financial environment. This is an important element of the international expansion that the
acquired company and the acquiring company exchange and appoint senior personnel between each other. I think it helps those interactions.

When I look at my own company’s expansion into New Zealand, I think it’s pretty much a given that the business environment, legal systems and culture are almost identical so that’s one extreme where you have expansion into a country that has very much like operating at home, you could be operating in another State of Australia. There are great advantages in starting your international expansion in a country where the business model, the legal systems and the business environment are almost identical to your home market.

The examples I have given were examples where the expansion occurred into a western culture. But looking at broader expansion opportunities, the things that it needs to be well and truly understood what are the challenges when expansion occurs in a non-western culture or an area that doesn’t perhaps cherish western values, or where there are differences in business models, legal systems and culture. I think they are all critical to understanding the environment that you are operating in. Expansion into Asia can be complex. The trap that companies often fall into is they tend to brand Asia as being one country or one culture. But, of course, each nation in Asia has its own culture, business model, business environment and way of doing things. So do not assume that if you headquarter an operation in Asia, that just because its headquartered in one country that the business environment, legal systems, the market segments, market segmentations, the taxation systems are all the same, because they are not. I think many Australian companies tend to think that the countries that make up Asia are all the same and they don’t understand the very noticeable differences, particularly in the taxation environments, business environments and business models.
Interviewer: You started talking originally about your experience in expansion in the United States, and then after the detail study you found three segment opportunities. In terms of looking at a market, and what products you might offer in that market, was your approach at that time to look purely at the market to start with and then look at the potential products after you selected a market? So the product selection follows after the market selection.

Interviewee: Yes, but there is a two way approach. In the markets that we were looking at, we found that there were a range of products which had been developed and tailored for that market, for which we thought may well apply in our home markets. So, if you are considering an acquisition, it’s not just a one way thing, how do we leverage our skills, competencies and capabilities into both the new market and the home market? Certainly in financial services, it can be seen as a two way thing, so what products and services can be transferred between markets. This was particularly relevant with the credit card opportunity that we looked at. I can remember talking to the product head who had a look at the way that this particular credit card company operated and he was excited by the opportunity to acquire that intellectual property via an acquisition and bring that back into the Australian market,. I can remember that he was describing to me an example whereby the technology that they had, and which was attractive to us, was that through their 1800 telephone number the first thing that you were asked was to key in your card number and the technology then says - ‘Here is ‘John Smith’ on the phone, he’s one of our gold customers, he’ll jump the queue’, or ‘Here’s ‘John Smith’ he’s in bad debt we’ve been after him. He will jump the queue’. So they had a range of competencies and capabilities that were way ahead of what we had within the country.

Interviewer: Within Australia?

Interviewee: Within Australia. The market segmentation was so well advances that if there was say a layoff, I think this even happened while we were there. There were some layoffs in the steel industry around Pennsylvania, and the first thing that the card company did was to ensure
that no-one in that area went over their limits. They could just do it for cards that were registered in that zip code where the layoffs had taken place. So it was extremely sophisticated technology, it was way ahead of where we were. We were looking in that instance, at the competencies and capabilities of what was referred to in that country as a monoline and looking to acquire that technology and use it in our business in Australia, New Zealand and the United Kingdom.

They had a range of products range, within their credit card business, that were multi-marketed. For example, you could take a photo of yourself, or your dog if you wanted to, and send it in and your own picture would appear on the credit card. It was personalising the card in a way that was way ahead of what we had in our market. The reality was in relation to that acquisition, that with all those technologies they had poor management. Even though their management information systems were giving them all these lead indicators, the irony was they weren’t acting on them. We eventually got a little uncomfortable with the size of their past due loans and various other factors. So we decided not to proceed with that opportunity.

Interviewer: What about the wealth management area?

Interviewee: In relation to wealth management, we identified a suitable expansion opportunity. At that time we had not acquired a major wealth management subsidiary company in Australia and we knew that we needed to get bigger in wealth management. We felt that expansion into the world’s largest and most sophisticated financial services country would give us an edge and some insights into the products that they offer. But in the end, it turned out that we were able to make an acquisition in our own back yard. By this stage the research we had done in the United States, also indicated that wealth management was a path forward for domestic expansion because of changes in superannuation law and compulsory superannuation regime introduced under the Keating Government. We knew that more of our customers’ savings were finding their way into superannuation funds, and so we were able to look at what the successful players in the wealth management space had in the United States and I know that we bench marked that
against the acquisition we ultimately made domestically, and found that they matched up pretty well.

Interviewer: You mentioned occasions where you looking at possible acquisitions but then decided not to proceed. Could you please say a little more about the critical factors that determined those decisions whether the acquisitions were a go or no go?

Interviewee: In relation to the possible credit card company acquisition, it came down to the depth of the due diligence. The conclusion was – ‘we just couldn’t get comfortable with the management’. During the due diligence we interviewed a lot of the senior management and we looked at a lot of things, but we felt that the management perhaps was not of the quality that we were expecting and what was needed. As I indicated before, we found it most unusual that they had all this marvelous technology at their disposal and yet they weren’t acting on what the management information as telling them. We felt that, if we were to acquire this company, it would require a big management commitment from our end. We would have to put quite a lot of management into the acquired company and we felt that would distract us in our domestic market, because we would have to put some first class people over there. That wasn’t to say that we couldn’t have sourced some really good management in that market; it is a very deep market and a deep labour pool. But we couldn’t get comfortable with the management, things didn’t quite add up. We would be given an answer on one thing and then we would find something slightly different. We did our research and it just wasn’t right, so we walked away from it.

Interviewer: That was an acquisition consideration, what about the aspect of acquisition versus start-up? If one is looking to go into a foreign market, do you think there are occasions where an acquisition is better and there are occasions where a start-up might be better?
Interviewee: Yes, I think so. The occasions where a start-up might be better, might be around whether you would like to test the market first before going in to big. In other words when the bank decided to expand into New Zealand, this wasn’t a start up, this was an acquisition of a small finance company, although that in itself I think indicated very quickly to us big differences in the way a finance company culture operates compared to a baking culture. Leaving that aside, there would be occasions where a start-up might be justified and that is where you might want to test the foreign market and get comfortable with it. In this way you could develop a better understand of the business environment and test to see if the product or service would be accepted in that market. So there will be start-up opportunities, but my experience is that you look around for the best and you pay for it, and if you can find the best in the market and are comfortable that you have good management in there and it’s got a good brand recognition, a good reputation, good market share, my preference is for an acquisition (and that’s because I’ve worked for large organisations so it may well be a different approach by a small to medium company). I always believed that my company was not very good at managing small companies because we tend to want to throw our systems and reporting and that sort of thing onto a small company that we have acquired.

Interviewer: Almost bury it?

Interviewee: Almost bury it. I think you really need to look at acquiring a large operation, particularly if it’s one that has been listed on the stock exchange. In other words, it’s used to the public scrutiny, the management reporting, the periodical reporting of financial results, that sort of thing. If you end up buying a private company, they’re not used to that sort of transparency so there are some challenges there. You might want to ask someone else about what their experience was in starting a green fields operation, I can’t even imagine doing it.

Interviewer: As part of the research that you did in the United States, there were three opportunities identified. Can you talk a little more about the process you went through and the
market research that was done to establish that there were these three key products within that market within which there might be opportunities?

Interviewee: The management consulting firm we used had an extensive database. They had poured through annual reports and, I suspect, through their engagement with other clients had gathered certain market intelligence. The other clients were not identified, but the reason we felt we had pretty sharp intelligence is that McKinsey’s had very extensive information. They had already conducted very extensive research and all that had to happen was to refresh it. So they had, and in turn we had access to very good information around who the best players were; who the better managed companies were; what made them successful; what was it about their management style or their operation that contributed to their success. If you receive the McKinsey Quarterly Review, like the Harvard Business Review, there is often a case study. So they had very good information about the financial services landscape. They also had very good analytical capabilities and very good information around the market segmentations. It reflected the depth and breadth of that market, the financial services market. I said before it was a sophisticated financial services market, but it wasn’t sophisticated in all areas. Certainly from a personal level, I used to find it highly frustrating to be shopping and have to stand behind a person who insisted on paying for their groceries by cheque. I always find it unusual that a country as sophisticated in financial services as the United States had a very backward retail paper system. I thought that there were pockets of opportunity. The bank spent six months conducting this research and all the research culminating in a strategy to enter that market which was reviewed and endorsed by the board. So we entered a much broader market with confidence because we knew where the opportunities lay. There was an alternate strategy position, if I can call it that, our bank already had a retail banking operation in the United States and in the event that we were unable to expand in those attractive market segments, retail banking was still attractive. Even to this day, if you pick up an annual report for a retail and
commercial bank in the US, those banks are still commanding margins of 4%. We were looking in 1999, the average interest margin was 4.5%, so it was still an attractive market to be in.

So they felt that if we were unable to expand into those segments I mentioned before, then the alternate strategy position was to roll up around the great lakes; to look at acquisitions in-state or in contiguous states. Expand our banking operation through consolidation. The consolidation in the banking market was probably reaching fever pitch by the late 1990s. Most of the large commercial and retails banks, certainly in the market we were operating in, had been acquired by out-of-state headquartered banks and our alternate strategy was to look at community banks around the great lakes and to add those onto our operation and consolidate them.

Interviewer: When looking at going into a market, and a market like the United States which is quite large and quite diverse, what attracted you towards the great lakes area rather than the east or west coast or into the south?

Interviewee: The great lakes market was an attractive market to operate in.

Interviewer: Could you please expand on what made that market attractive?

Interviewee: Of the 50 States in the United States, it was the 6th largest in terms of GDP. And, it wasn’t just cars, which is what people think it is, but it had quite a diverse market, there were a range of industries including biosciences and education; I think the university was the 4th largest in the United States. If you are looking from our own perspective, it had a GDP that was well and truly larger than New South Wales in Australia. It’s a very good question, why not the east coast or the west coast? It comes down to the opportunities and the bank had examined some opportunities in the north-east but the banks had decided not to proceed with those. Before this study was conducted, the bank had a look at an opportunity on the west coast, but again that was not considered to be a good investment.
There’s one thing I’ll make an observation about, it can be difficult to make an acquisition in the United States. The reason for that was that in the United States, quite often acquisitions are made by share swaps, so the acquirer will offer shares in its company for shares in the acquired company. The beauty of that is the transaction is tax free for the acquired company shareholder, at least there was no taxable capital gains, if the acquirer was a US company. It wasn’t the same if the acquiring company was a foreign corporation. If our company had offered shares in consideration for a bank that it wanted to acquire, that triggered capital gains tax for the shareholder of the acquired bank. So we actually found ourselves being outbid in the market because on an after tax basis for the acquired shareholdings. Also, at the time, the Australia dollar wasn’t travelling too well and the prices for banks in the United States had moved from around two times net intangible assets to almost three and so we were being outbid because domestic banks in the United States were able to use their own shareholders’ funds as acquisition currency and for us to do the same we were going to have to offer cash and that cash, when converted into US dollars, wasn’t worth as much, so it was quite a challenge to execute a further acquisition from the first beach head we’d made.

Interviewer: Looking more broadly towards different markets, you were talking about the relationship between markets and products and you mentioned Asia. I am interested in the mix between market and product in Asia because the organisation that you are involved with had decided to have borrowing and wealth management products in Asia but not necessarily lending products.

Interviewee: Yes, you’re right, the organisation that I work for uses the branches that it has established in those regions to help fund its operations. The customers in those regions find they are comfortable with Australian asset risk. We do offer a range of products in that market, but they are more liability based than asset based. That’s not to say there aren’t attractive lending opportunities. We have tended to restrict our operations in Asia to wealthy individuals who are
often sophisticated investors. To get a retail banking licence in some of those countries means you need an extensive branch network and that wasn’t attractive to us. Our offshore strategy in those markets tends to be a little more selective. We are currently examining what we have here in the Australia market - a very good infrastructure financing team. Its public knowledge that our bank was successful in bidding for the desalination plant here in Victoria. So we have some very good skills in our infrastructure team and of course with all the infrastructural development going on in the Asia region we think there are opportunities in that region to expand through that market segment rather than retail branch banking in those markets. I know that one of our competitors has taken a different tact. Again an opportunistic acquisition resulting from a bank in Scotland having to sell their Asian operations and that enabled another Australian bank to expand their retail operation in Vietnam, an attractive market to them. Our organisation has not quite felt comfortable with the legal systems in some of those countries. We have had some experiences which have been reported particularly in Korea. So we tread quite cautiously in that region.

Interviewer: Are those experiences relevant to debt recovery?

Interviewer: Yes, to debt recovery. There have been instances in relation to loan application fraud where we felt we had a very good case to argue against the perpetrator but the courts didn’t agree with that. It comes down to the confidence you have with the legal systems. There was an instance I recall where a company in that market went bankrupt and the company was liquidated. All the domestic banks received their funds first and the foreign banks were last in the food chain.

Interviewer: Regardless of the security?

Interviewee: Regardless of the security the foreign banks held. It was an experience that taught us some important lessons, you have to understand the market and have confidence in the legal environment. Our legal environment being a derivative of the English legal system, you can deal with confidence and certainty that you have independent courts and you can protect your rights. Whereas it’s not quite as apparent or transparent in some of those Asian countries.
Interviewer: Joint ventures are often a way that companies will expand into a foreign market. It is another mode of entry to an acquisition if you do not have 100% ownership opportunities or a complete start-up. What are your views about joint ventures?

Interviewee: I think the organisation has to be culturally ready for it. I’ve seen instances where the parties to a joint venture believe they should be controlling the joint venture when the purpose of the joint venture was to draw on each other’s competencies and capabilities for the benefit of the joint venture. It can be a very good avenue to expand operations. Getting back to the question of ‘what about starting from scratch of a green fields operation’, if you find that’s too slow or you don’t like that strategy, then perhaps a joint venture is an alternative so you can get used to the market and the country you want to expand in to. It comes down to the competencies and capabilities that your joint venture partner brings to the table. It might be technology; it might be distribution; it might be a range of contacts, a networks. And then what you bring to the joint venture. The key thing to remember is that both parties need to act in the interest of the joint venture as whole if it’s going to be successful. The other key observation I would make is you have to be absolutely clear, if it doesn’t work out, that you have a very good, solid exit strategy. When these things are set up, they are usually done in good faith. But over time - management changes and they don’t quite understand that the joint venture is a body that is meant to benefit both parties. Sometimes relationships degrade and the joint venture dissolves. So it needs to be very clear, and should be made clear upfront, that if it doesn’t work, both parties can trigger their exit strategies or pre-emptive rights however you set it up. So the exit doesn’t end up in court.

Interviewer: Looking at the aspects of the timing of entry into another market, often the timing of entry is driven by factors not necessarily related to the organisation itself, external factors. Also, do you think there are situations where organisations expand internationally when their own domestic organisation needs some work to be done on it, internal factor limitations?
Interviewee: Oh gosh, it’s a hard question. If I look at another industry, say Woolworths, I think they have come to a situation where they have got about as much market share and market power and dominance as they can get. There’s not a lot more they can do in this market. When you get to this situation, and your business is humming along as it is with Woolworths, the eyes start to gaze outside that home market. The timing is often a mix of ‘well we can’t do anymore in this market, the ACCC won’t let us, and we’ll end up with a dominant position in various parts of the market. I look at Woolworths and I believe there’s not much more they can do in this market without running into competition issues. It seems to me that this is the time when they are starting to gaze outside Australia to see whether the capital and the surplus cash flow they are generating can be deployed outside Australia.

Interviewer: Do you think sometimes those companies expand internationally for exactly the reason you mentioned, but the home domestic company is not really ready for an international expansion?

Interviewee: Yes, I think there are some very good examples. Again in another industry, Lion Nathan comes to mind. Expansion into China was quite disastrous. I don’t think they were ready for international expansion.

Interviewer: Was that because they did not properly study the new market or were there internal factors?

Interviewee: I think this is always the management challenge. You must not take your eye off what’s happening in your home market. It is so important to reflect upon your success and why you are number 1 in terms of brand, reputation or market share. What companies don’t quite appreciate, is that there is a lot of management time that needs to be devoted to international expansion. This isn’t related to international expansion but, when our bank had an incident in 2004, there was a large amount of management time devoted to addressing the issues that had been identified and interacting with the Australian regulator and interacting with international
regulators. A huge drain on management time had to go into closing these matters out and address the deficiencies, controls and procedures. The point I am trying to make is that it is a similar call on management time when you make an acquisition and particularly if it’s your first acquisition outside your home market because you need to keep a very close eye on it. Is the operation or expansion landing where you expected it to land? Is that what we expected? International expansion is a large commitment of management time and because of that I think one of the dangers for companies that expand into an international market is they lose focus on their home market and in the end it can make them an attractive take-over target, if the share price starts to drag. It is crucial that the expansion into off-shore markets is tempered by the need to manage the home market particularly if you have good market share and a good brand name.

Interviewer: Do you think there are factors which are unique to an Australian company which might not have the same significance to an American or European company looking to expand internationally?

Interviewee: It is a very good academic question in the sense of reflecting upon the Global Financial Crisis, and what was it about Australian bank management skills, competencies and capabilities that enabled them to keep their banks safe and profitable compared to the experience of US banks and European banks. There are many answers to that. One could hypothesis that the quality of management in Australia banks is high and this might be one reason which makes Australia unique. We can say quite objectively that the big four Australian banks, throughout the Global Financial Crisis managed to keep their AA credit ratings and moved up into the league tables in global terms. Of the 19 largest banks in the world that were AA rated, four were Australian. I did read and interview with James Gorman. I worked with James on the McKinsey review in the United States. He is an Australian and was appointed Chief Executive Officer and President of Morgan Stanley on 1 January 2010. He was interview, and others had been
interviewed about him, and he and those that spoke about James spoke about his refreshing frankness. You know direct talk that didn’t dance around issues. Maybe there’s something about the Australian management style or leadership qualities, leadership methods that put them above the rest. I really don’t know whether you could point to any definitive research that could prove it. It would only be anecdotal, but I think it’s fair to say that the Australian banks have all fared very well in the Global Financial Crisis. I suppose that and our friends at APRA [Australian Prudential Regulation Authority] would say the quality of prudential regulation as well. Well that’s interesting in itself. Australia’s experience has elevated APRA into the G20 and indeed a seat on the Basel Committee [an international forum for regular cooperation on banking supervisory matters]. I think that speaks for the quality of our prudential supervisors as much as it speaks for the quality of the management of Australian banks. We tend to respect and acknowledge that regulation is there and there for a good reason. Whereas my experience in the United States is it’s such an adversarial system that you can imagine the conversations between US management and US regulators where US management is telling US regulators - ‘get out of my road, I know what I’m doing’.

Interviewer: Australia is a multicultural society. Where Australian companies are looking to move into overseas countries, we have people who live in Australia whose family background may be from that overseas country. Say you are looking at the market in China or Britain, there are Australians who families come from those countries and this might give Australia a better insight into those countries than some other country looking to expand internationally.

Interviewee: That’s a very good observation. Recently I was asked to mentor someone who is running for partnership in a big four accounting firm and he was completing his MBA and he asked me to give him some feedback on his leadership and management style. But before I did that, I wanted to find out a little more about him because I thought he might have been the son of a Vietnamese refugee, and he was. He spoke about the tough times, going to Richmond High
School, his parents worked hard to put him through university and he completed his chartered accounting qualification. So he’s the next generation from the boat people who are starting to come through the management ranks and Australian companies and with the big accounting firms. I said to him, you should be immensely proud of where you have got to. I think this country, probably better than most other countries, offers opportunities to people from foreign lands and I think we are very accommodating and accepting. I think a lot more in Melbourne than most I’d have to say. I came from Queensland, and when I first arrived here in Melbourne in 1980 I was just astounded at the extent of multiculturalism I saw here in Melbourne compared to Brisbane. Yes, there are people who move to Australia for a wide range of reasons and who get into management positions. With foreign companies operating in Australia, a transfer here is not a hardship posting. Just the other day I was meeting with a management consulting firm and one of the ladies there had come from Sweden and has been here for four years. She said that she loved Australia and had applied for citizenship. This is a very easy country to live in; it’s a very tolerant society. I think we do embrace multiculturalism very well and that may well be a factor in our success.

Interviewer: Going back to the Vietnamese gentleman you spoke about, if he was working for an Australian company and they thought might expand into the Vietnamese market, do you think, his background would be a positive for the Australian company or a negative, in terms of him being accepted in that overseas market?

Interviewee: It would be a positive, I suspect. If they were to put him into that region, then his skills, competencies, capabilities and everything he has learnt in that culture could be taken to that market and he would know the subtleties around operating in Vietnam and be conscious of that. So I think it would be a positive. You can see a situation where he would be successful in building up that practice or that business because he has had the benefit of a very thorough and
well grounded education and working career here. My sense in relation to that individual is that he would do very well in the big four Australian accounting office in Vietnam.

INTERVIEW 4

Interviewee: I divided the topic into –

- Governance
- Business related matters
- Finance
- Personnel
- Risk management

As the key issues that must be reviewed in building a business case to establish a business case overseas.

In relation to governance, do we establish a new entity overseas or have a branch of the business overseas. We would then look at the level of oversight we would have of that operation. Do we bring in local directors or well known business contacts to provide a local level of oversight into this new market and there may be very good reasons to establish a local board drawing upon eminent business people with local knowledge to get the business to hit the ground running and establish contacts which we would not have in this new market. Even if there was not a legal entity, there may be a good reason to have a governance body, a committee or an advisory board to draw upon local knowledge and expertise. These people will have developed networks in the overseas market over many years where we cannot match their local market knowledge.

Interviewer: Before we move on from the governance issues, in your experience, is it better to have a subsidiary company or branch office, and what are the key factors that would help you decided that?
Interviewee: Taxation would be a consideration, particularly ensuring that you were not double taxed on your overseas earnings. I would see this as the key point.

Interviewer: Would the ability to pay dividends or repatriate capital back to the home country be a factor in this regard?

Interviewee: Yes, this would be a key factor, taking into account the local tax laws and capital and funds transfer regulations. This may be assisted by a separate legal entity structure.

Interviewer: When you are speaking about the level of oversight, are you thinking about the level of managerial control from head office or are you thinking in a broader sense?

Interviewee: I am thinking about in a broader sense. I was going to pick up management control under risk management. Here I was thinking more of an independent level of oversight, where different prospective could be provided into the organisation about how the business is run and providing local knowledge separate to management. The critical factor will be getting the business up and running and a local advisory board could provide a mentoring role for management. If we are left languishing by establishing contacts from scratch. An Australian company will have limited access to local market knowledge and funding for such a venture. There is a need to hit the ground running. They need to have that independent view and have contacts.

On business related matters, there is a need to test the products we will sell into this overseas market. This would include marketing analysis, o what is attractive to the local market and the advisory board could also play an important role here. Australian companies have had a poor track record in developing businesses overseas and we need to learn as much as we can for those companies and apply those learnings in opening our new offshore operation. The research here is very important. A number of these companies were very successful in Australia but when they went overseas to could not duplicate that success. Were they being over ambitious? Did they not have a product that they could differentiate from other local products? Different markets
have different tastes and the products need to adapt to local culture. The Australian tourist advertisement – ‘where the hell are you’ is a case in point where we offend the target audience. Consult with local expertise is essential to use the key local marketing expertise. We need to always have in the back of our find the needs of the shareholders and the return on capital we will achieve from this new venture. We do not have much time to get this right, we need to get it right from day one.

**Interviewer:** You mentioned we need to get it right from day one, could you talk a little more about the time critical elements in terms of getting a return on the investment straight away versus making a modest investment and using it as a learning exercise.

**Interviewee:** There has to be a balance. But we cannot take 5 years as a learning exercise. This would only create frustrations at head office and with the funders and shareholders. We need to have a model that would work. We need to have a project management approach with stage-gates whereby additional investment would only be made on the basis of the success achieved based on the goals and objectives set out in the original business plan. [Future research] That plan should recognize that there will be start-up costs and there will be mistakes made, but the fact of life is it is a tough life out there, we cannot still be developing this model after 5 years. **Interviewer:** Developing this further, do you have a particular preference to buying into an existing business or starting up a greenfields operation? Operating as a branch would suggest a greenfields operation.

**Interviewee:** I think there is significant benefit into buying into an existing business. Here you are able to draw upon local knowledge and experience developed over a number of years. If you buy an entity with established customers and a good reputation, you are able to link into the business connections. One of the entities our organization acquired had been acquiring other entities within their local market and had developed skills in finding an acquisition, bringing it on board seamlessly and then moving on to the next acquisition.
Interviewer: This suggests a learning opportunity in terms of expanding market share within a global environment.

Interviewer: That is correct, they had a number of well connected people on their board and we were able to bring in new products and the two combined provided a better starting point than starting from scratch, rather than be a very small player in a market you would like to expand into.

Interviewer: In terms of an acquisition, do you think it is better to go for a small to medium size acquisition, compared with the size of your company, or to go for a large transformational acquisition? A transformational acquisition could be a big stretch for an organization but could launch the company forward in a big way.

Interviewee: I believe that it is better to go for a smaller acquisition and build on that. However, if a larger acquisition comes up then it is worth considering. But to put ‘all your eggs into one basket’ is a high risk strategy. You can conduct a due diligence exercise on a small potential acquisition reasonably quickly but for a large organization you may not have the time to go into the depth you would like. A smaller entity you have a greater opportunity to see exactly what you are buying.

In terms of other issues such as personnel, you need to ensure that the right people are reluctant to move as they feel as though they are forgotten. They have moved over there and when they are ready to return, is there a position back here? Therefore you have to plan for their return and have positions available so that others can see that when others come back they are moved into good roles. This will encourage others to take on international roles. You do not want to only attract second rate people as a local level you want to attract the best talent and having only a domestic operation will not provide the broader international experience that the best talent is looking for. If the focus is on acquisitions and that focus is on smaller entities, there could be better opportunities with a larger international organisation.
What we have found is that it does not suit a lot of people who are entrenched in local life. It may sound attractive but Australia is a long way away and we have not been able to attract many people to come here. If it was another part of America or the United Kingdom, a transfer may be more attractive. Younger people can be attracted to come to Australia as part of their career development, but for senior people it is hard to attract them here.

Interviewer: Some people believe that Australia being a multicultural society when looking at South East Asia different points of view. People from China, Vietnam and Malaysia may be ideal to go back to the country of their parents’ birth and work for an Australian company operating in that country. They would fit in well knowing both the local culture and Australian culture. It appears to be unclear whether this works or not. One thought is that they have a much better insight into the local market than someone whose family background is not from that market, and physical appearance can be an immediate acceptance factor in a local market. Another thought is that because they have been away from the overseas market they have not gown up there and are seen as outsiders just in the same way as one from an Anglo Saxon Celtic background might be. Do you have any thoughts on that?

Interviewee: Yes, I think that when people are educated and socialised here they find it difficult to go back to a different life style, they generally have no business contacts.

The next point I was going to cover was tax related issues but I covered that off the local entity structure discussion, dealing with the payment of dividends. Having a local tax paying entity paying dividends back to Australia.

Interviewer: Is that to avoid a normal level of tax or an excessive level of tax?

Interviewee: It is to avoid duplicating tax.

Interviewer: Do the double tax agreements between countries avoid the duplication of tax?

Interviewee: The double tax agreements do not cover all of the countries or circumstance that we may need to address.
Interviewee: Local licences will have to be obtained and the acquisition of a local entity that already has a licence can save a good deal of time. It can take a long time to obtain a licence and you can slip in and out of favour in obtaining a licence in some countries. Understanding the local regulations and laws is essential and there has to be an appreciation of the impact the local regulators will have on a local entity, ensuring that the local entity follows ……The penalties can be severe including major fines and suspension of licence.

There needs to be an assessment of the operational risks including technology, back-up systems linked to the Australian operations. These things cost money but cannot be neglected as the risk to the organization is too severe.

Interviewer: In terms of the expanding regulatory issues, and foreign investment restrictions where it is not possible for a foreign company to own more than 49% of a bank in many countries this means that it is only possible to enter certain markets through a joint venture or minority equity holding. A joint venture often involves only two or three partners whereas a minority equity interest could involve a number of shareholders. What has been your experience in relation to minority equity holdings? Would you be prepared to enter into a minority holding or would you only go into a market where you could obtain a controlling interest?

Interviewee: I would prefer to stick to a wholly owned subsidiary company operation. Moving to a minority interest could be a viable exit strategy where you were leaving a market and unable to sell 100% of the equity. For a new investment, a controlling interest gives you the level of influence you need over the board and the oversight process, and can drive the entity in the direction you like, setting the risk appetite.

Interviewer: If you were preparing a matrix of the various countries you were looking at entering and one of those countries was limited to a 49% ownership, would you rank that restriction as a major negative?

Interviewee: Yes, I would see this as a negative in the country selection.
Interviewer: Could there be any offsetting factors where you may accept a 49% interest because of other considerations?

Interviewee: The size of the market, the potential profitability, the level of dividends you could pay back to the home entity, the quality of management and your ability to work with the management

Interviewer: In a joint venture, the requirements of the parties may vary over time. What do you think are the key success factors for a successful joint venture?

Interviewee: I think the key factors would be the brand, the reputation, and ensuring there is no damage to that brand, the markets they are able to tap into, and their projections. Being able to tap into the level of expertise and each party being driven by the same factors. To develop ways of ensuring that you are working together and looking at the other joint venture partners and their reputation, not just of the entity but also of the individuals involved.

Interviewer: Do you see advantages and disadvantages in buying into an overseas entity that has a small number of shareholders with one or two others compared with acquiring a minority interest in a company with a broad and relatively large shareholder base such as a publicly listed company?

Interviewee: Of these two options, I would prefer to acquire shares in the publicly listed company as there is a potential to be held to ransom if some equity holders hold out seeking an unrealistic price knowing that we are keen to buy-in. I think there are benefits to slowly increase our holdings across the marker rather ….

Interviewer: Do you think greater difficulties may come from a small group of large shareholders or a large group of smaller shareholders?

Interviewee: It could be easier to pull together a small number of larger shareholders but it depends on the individuals and the circumstances. It is not a one rule fits all situations.
Looking now at what you had asked before we started the interview about factors that impacted on Australian companies compared with American, European and Japanese companies. We start from a very small base and we have experience in dealing in a very small market. United States companies can develop substantially before they need to look overseas for further growth. In Australia we become big fish in a very small pond but a United States company could become a relatively large fish in a relatively large pond before they start moving overseas. Thus they have greater access to funding. Because Australian companies are starting from such a small base, our time is limited and the risks to the organisation are proportionately greater. It is all around looking, entities that have failed and entities that have succeeded overseas and drawing lessons from their experiences. The development of the business plan must take all of these factors we have discussed into account.

Interviewer: When we move into a foreign market, why should the local people work to help us?

Interviewee: We have to demonstrate to them that we appreciate their skills and experience and appropriately reward them financially, recognising they are people of eminence and capability in their own market and ensure that we touch the human ego.

Interviewer: In terms of product differentiation in a new market, would you see yourself going into a new market with the full range of products you are offering in Australia.

Interviewee: It would be a matter of recognising in that market what products they have and looking at what products we have. It may be that we have more developed rural products based on a model of staffing the rural finance unit with individuals who grew up on a farm and who studied agricultural science. They have a greater insight in the customers’ business. In the United States, farmers were dealing with city bankers who did not understanding farm businesses and the impact of fluctuations in rain fall, product prices. In a number of families, the eldest son took over the farm business but the farm may not be large enough to support more than one
family. Other adult children in the family may love the farm life but they have to find alternate employment. Being a rural banker can be very suitable for such people. To implement a model such as that can differentiate us from the local players and it is around such a model that we would then build products around which may not be greatly different from the competitors.

Interviewer: In looking at a foreign acquisition where you have acquired control, do you think there are key positions that you would want to fill with your own people rather than a local?

Interviewee: Most definitely. An independent view of what is happening at the local level will give the home board considerable comfort. A chief financial officer who has a reporting line back to the group chief financial officer in the home market and a risk officer with an independent reporting line back to the group chief risk officer. Although they would work closely with the local chief executive officer. By having those people in those position there is a local level of oversight that would assist in having key issues or concerns or feelings of unease escalated. Internal audit can also be sent over to play an independent review role in the local market.

Interviewer: Do you think the chief financial officer and chief risk officer should be sent for a given period?

Interviewee: They could be people on secondment to the new market for a period of two or three years. But you must assure such people that they will not be forgotten, there will be good roles for them when they get back. Another approach could be to send people from the local market to Australia to gain an understanding of how the Australian company operates and what is expected of them. This will also give them a number of contacts in the head office and assist them to raise issues back at head office after they have returned to the local market.

Interviewer: You would be happy then with the chief executive officer being a local?

Interviewee: Yes, there would be significant benefits from the CEO being the same person before as after the acquisition. Being able to tap into the local market and will provide an assurance to
the local customers that notwithstanding that an Australian bank has bought their local bank, the
CEO is still writing to them, and is interested in their business.

Interviewer: What about the role of local chairman?

Interviewee: That is a good question. All of the other board members could be locals, but there
could be significant advantages in having a chairman who is the representative of the parent
entity. Possibly an executive director from the Australian board, thereby ensuring the acquired
was heading in the required direction and having that close oversight of the CEO role.

INTERVIEWS 5

The first thing you wanted to talk about was strategic direction. For offshore expansions, whether
it is by way of acquisitions or organic growth offshore or partnerships or ventures, the key, before
you even embark along that track, is to ensure that you have a clear and unambiguous statement
of what your strategic direction and corporate strategy is. By that I mean the corporate strategy
should be well articulated in sufficiently detailed and should state the rationale of where and how
you want to grow, in what segments and markets and what part of the financial services offering,
either concentrate in or a broad brush over all of them. Where is it incrementally that you want to
grow over time. Unless you have this clear and well articulated statement of strategic direction
and then put the ‘meat’ behind it in the form of corporate strategy, then you run the risk of looking
at things either domestic or offshore which are attractive and may well, within broad parameters,
fit your level of risk and therefore you may go for it. What I am saying is in order to expand
offshore by whatever means the management or board feels it can be done, initially the first thing
to have is a clear discussion and understands - the articulation and quantification of what your
corporate strategy is. Because any expansion or acquisition offshore is only, in the first step, a
subset of that corporate strategy. Unless that is there your rationale will not be there or if it is
going to be there it is going to be very fuzzy, and in time fuzziness will result in management
making mistakes or lack of commercial judgement. So that is the first thing you have to do.
Once you have the corporate strategy articulated, and within that corporate strategy you have articulated your expansion acquisition strategy offshore, then before you do anything else you have to put down on paper after discussion, interaction, research of the particular markets you are looking at, you have got to put down what I would call a set of criteria, and most good organisations do that, a set of criteria that you are going to use to evaluate the fit of that expansion proposal against your corporate and acquisition strategy. If you do it that way, it does three things –

1. it impose more rationality into the process;
2. it provides you with the means to better communicate both internally and externally your thinking process; and
3. it is the framework within which you test ideas and opportunities, be they external ideas or internally someone has good ideas.

It gives you the framework to evaluate, test the rational, test the assumptions and then what you have got, to the best of your ability if you have done your research about the market place, is a solid and honest view of your own company’s internal capabilities and weaknesses. We just do not jump into an offshore acquisition because some investment bank comes to us or some idea comes up internally. Initially, once you have got those three steps in place, the next thing you start doing, and this make take a few years, I know in the case of the organisation I worked for it took two or three years, is you use all of that to actually become familiar, to understand, be it from afar, with the way the target market actually works or does not work. Then you may be able to go into a new market and take up an opportunity which the domestic players in that market could not or would not for a while. The way that is usually done is that you take what I have just talked about and you actually design a decision tree. That decision tree can be used by senior management and most importantly is used by whatever units are involved ultimately in acquisitions. Because you never say to an investment bank or even your own internal acquisition unit, that you think there is target A, B & C and just ‘go for it’. There is an inevitable issue that an
acquisition unit, even though it is internal and with all the good will in the world, once in gets into the frenzied quotes of a possible target or targets, unless you manage the process properly, that acquisition units becomes very much focused on the excitement of the chase or the research. That becomes the end vision, as opposed to regularly come back to the corporate strategy. The acquisitions, or overseas expansion, must always be viewed as a subset of the corporate strategy with defines the frameworks, the criteria, the markets and customer segments. What I am searching for, in terms of an offshore market or acquisition, is something that is going to provide a good fit within that rationale. Sure, I am going to go down the track of looking at a range of options but you can do a lot of that by desktop research. That is what a good company would do. An analogy would be if you were a super athlete and you were going to compete against the ten top super-athletes in the world, you would already know then, their strengths and how they train. You do that desktop research and then you enhance whatever capability you need to tackle them competitively. It is the same thing. So there is an issue – call it – ‘rationale preparation’. That is, testing your decision making process; testing the robustness of your corporate and acquisition strategy; and testing specific possibilities against the criteria you have set. If you go through that process vigorously and honestly you may still get it wrong perhaps but you are more likely to get it right. At least you will get it right in terms of establishing that this is an appropriate target because I have done my homework properly and had the opportunity to look at the acquisition entity. This way, I am more likely to come up with a fair market value, not an inflated market value which ultimately, if you do buy it, you will has to recoup.

The next point I would make, which comes off that, is if all you have in your organisation are loose, open ended statements of intent, I am absolutely certain that the end result would be a poor decision somewhere along the track, no matter how attractive the new market place may look, especially offshore. The poor decision may be that you have got the wrong target; paid too much for it; or you may have paid a fair price but do not have a clear idea how you are going to
enhance that organisation in order to achieve your objectives and ultimately your returns. It has to be looked at in the same way as a company that expands rapidly from organic growth. It is useful, in-fact imperative, for the board or the CEO to hold the rains in a certain way. We are not just riding the horse and saying there is the finish-line lets go for it. That is the point I am making because that will ultimately determine whether there is internal rigor, internal honesty and internal drive. For any strategic initiative, it is ultimately the leadership that believes in what they are doing and will sustain that belief throughout the organization. So you have got a lot of acquisitions, especially offshore ones, where some of these things are done well and you could get some things that are not done properly. Often, through a change of management, or leadership, or some doubts, or a change in focus from the original intent, the drive to do it rigorously fades away. You may get away with that type of reversal domestically for a short period of time, but if you are dealing in a foreign market then if you have one or two stumbles, you are gone, so to speak. There is an issue of how you manage not just what you manage. How you manage, communicate, how you provide the leadership, how you keep on testing, what you articulate, how relevant is it now, if it is no longer relevant to what extent do we have to change our approach in terms of fulfilling those objectives and those returns we have set for this acquisition. So it is not a matter of just doing it and saying ‘terrific,’ we have acquired it for a good price, we have had one or two years of reasonable growth and returns, and then you forget about it. Because, what a lot of corporates forget, it is not just about where the acquisition is, whether it is offshore or domestic, after a certain period of time, people call the integration or implementation period, the first two or three years, that entity’s activity becomes part of your group activity. So you have got to develop over and above what you had articulated before, you have got to develop robust organic growth strategies for those entities in their markets. If you do not, if you just keep on relying on what had been articulated or tested 3-5 years prior to that, you will lose sight of the fact that you are now in an organic growth phase. An acquisition stops
being an acquisition after a certain period of time. It becomes an organic growth business and you have got to sustain it, grow it, and change it.

It is about corporate strategy, subsequent acquisition strategy, doing your desk top research of target markets, screening against criteria that you have set down to test that strategic fit and then continue to monitor these possibilities. Once you get to the stage of identifying a possible target, you have got to do the rescreening again, especially if you get to the stage of due diligences, because most due diligences, especially if you look at the last decade or so, most due diligences are performed in a relatively short time frame and are performed basis of information and data provided to you by the seller or investment bank acting on behalf of the seller. That is part of the picture and you have got to look at it and go through that whole process rigorously. But that is not the total picture which comes to the next step. Once you have acquired it at a certain price, with certain intentions, with certain strategic initiatives in mind, the next thing you have got to do is get hold of the organisation and make it part of your group. Introducing your risk management, your financial discipline, your board overview and your management performance overview. Those things are a given, you have got to do them properly and do them within the shortest possible time frame. Having said that, it is like moving into a house you have seen pre-auction, visit two or three times, you have walked around, been given the specifications and all the information the seller wants to give you. Now you are in the house, it is your house and the first thing you had better do is walk around again and have a look again. That is exactly the same as an entity, if you buy something whether it is a bank or a wealth management company, the day you move in as the new owner, even if you have some of the old staff around, the fact is that you are the new owner, you take hold of the new organisation's future and direction, you have got to then say - when we you did the desk top research and when we did the due diligences, there were certain pluses and minuses we came across, there were certain risks that we came across, certain governance issues we came across, there were certain people - talent issues we came
across, about which we formed conclusions based on limited research. We are now in the organisation so we need to re-do all of that again with full knowledge because you are there you can demand anything you like. If you miss that step, it is a step you will never recoup. That is important because what you are doing is re-establishing the rationale and the robustness of the initiatives you believe will enhance the value of the organisation. You need to re-visit your due diligence plan and your implementation and integration plan. All good organisations will always do that and they will not assume that what we wrote a month ago is exactly how we are going to do it. We now have full knowledge, we may not understand the new market place as well as others, but definitely we do have full knowledge of this organisation, at least access to full knowledge. Lets re-test, re-visit our plans, our initiatives, our integration plans, the strengths and weaknesses, how we are going to improve the weaknesses and build on the strengths. And use all that in a relatively short period of time to put together the new business plan for this organisation. This new business plan is then communicated, discussed with the staff of the new organisation and taken back to our principal board. At the board, you may need to say to them - if need be – that in the due diligences we flagged something as a possibility where we may be able to grow. Now we have had a closer look, three months down the track, we believe we were optimistic or perhaps that opportunity is not as rosy as it looked. This way the board is informed, and you adjust your growth and profitability parameters and design your new business plan which is now the new document that the target users and the parent users to overview performance. The first year of ownership is critical with respect to better understanding of competitive environment and the key value drivers of the acquired business. Especially in relation to the cultural imperatives and the detailed talent reviews of the senior management level and lower down, that you have to undertake in a reasonably short time. Any improvement of a business is done by management and its staff. If everything you want to do is clearly understood in terms of its strategic direction, and you have not got the management capability, or the staff, or the process capabilities to underpin these changes, then it cannot succeed, or it will take longer. It is
absolutely essential that is done. The next thing I would say is that there is a tendency, whether you are expanding domestically or offshore, that you tend to look at the target as being less than commercially adept in terms of its capability. You tend to believe that the target has not got the people, technology, marketing capability that the parent company / the acquiring company has. So there is a natural tendency to want to impose what the parent company looks like, whether it is a bank or a wealth management company, on the acquired company. There is a tendency to seek to make the acquired company a mirror image of the acquiring company. The comment I would make through experience is this - it is very rare that a target, especially if it is offshore, will be totally the same as your domestic operation. Inevitably there are unique features within offshore markets which make the business different. Even if it is essentially operating the same business as your domestic operations and there are commonalities of laws, prudential requirements, liquidity requirements, and how you go about selling through your franchise to your customers. Now what I am saying here is in essence that, at a board level it will be similar. At the board level the strategy and the initiatives that the acquirer wants to overlay on the target are probably appropriate. But they have got to be partly modified, tailored to the target market you are now operating in. The reason for this is that if one does not do that, two things will happen. One, there will be a tendency to look at the target’s performance and the way it interacts with its customer base and the way it performs its back office processing, purely from a mindset of what you see in your home market. That is not likely to be, once you get down to the detail, the correct approach. There are plenty of examples where companies have tried to transport a brand name, a technology, and other business processes across to a target. In some cases they probably had to do that as the target may have had a poor brand name; less than adequate technology; outdated back office processing systems; or inadequate management decision processes, and so it did require a change. That could be one of the rationales for buying it, because if you enhance those areas you would enhance the value of that organisation and enhance the parent company’s bottom line. So change was required. The key thing is that once you are in the market place,
once you are the owner of this new entity, you have to be careful how you introduce the changes and how you twig the changes here and there to fit the bill in terms of the target you have acquired. Hypothetically, the acquirer might be the leading wealth management company in Australia. It acquires a target that has, as part of its businesses, a wealth management capability offshore. But that capability within the target entity offshore may be miniscule. You can apply best practice across to this small operation, but it must be done in a way that it fits. When the target grows, at some time in the future, it may well be the largest wealth management company within in that target market. Then perhaps these two operations would be somewhat similar and processes and practices could be transferred more effectively.

Another thing is the inability to ultimately see a target as an entity where you have to put down on paper organic growth strategies as you would in your home markets or other offshore markets that you have been in for a long period. I think this is one of the issues that can colour the way the home company staff or management look at their offshore companies. By that I mean there is still this tendency for companies who may have acquired something 10-15 years ago, to look at them as acquisitions when in fact they should look at them as just another business in their portfolio, which is only going to grow if you develop an organic growth strategy which takes over from the original acquisition strategy. They need to be really smart in the way they go about articulating and implementing their organic growth strategy. By organic, I mean the growth opportunities within that market place and customer franchise that the entity offshore is servicing.

Interviewer: You mentioned the decision tree process in terms of evaluating the target market back to the corporate strategy. What elements do you think may exist within the decision tree? What are the individual questions that a company should ask itself when beginning to plan an offshore expansion? How would you differentiate one target market from another? Could you expand on the elements of the decision tree?
Interviewee: The decision tree really comes about once you have done some desktop research. The key thing about the decision tree is that if you are looking at the target market, it may be growing faster than your home market, it may have certain competitive characteristics, most definitely it will have differential growth opportunities in terms of the range of offerings the financial services company would provide in Australia. The key is to ascertain those aspects, those differences, those opportunities, those risks and once you have got that in your decision tree, you would then start articulating questions you would ask of yourself and the target, if you got to a position where you were either talking to them or you were in a due diligence stage. It is the relevancy of the questions, it is the relevancy of the enquiries that you need to make before you actually engage the target party whether it is through an intermediary or directly. The reason I say that is the acquirer may well be a bank that embarked off-shore post-deregulation [of banking and finance in Australian which began in 1983, following the Campbell Inquiry. Foreign banks could obtain a banking licence in Australia and non-bank financial institutions were allowed to offer a broader range of products and services; thus increasing competition in the Australian market] and basically said we know what we are good at. We are essentially a commercial retail bank with very good capability in business banking; we believe we are very much focused on shareholder value; and manage our balance sheet and capital rigorously. Having said that we confirmed our appetite to grow offshore; we want to grow offshore in particular markets; in particular market segments, and so those things we attribute as being part of our criteria in essence and they become part of our decision tree, because they have been developed by gaining an initial understanding of offshore market; offshore opportunities; offshore gaps; and weaknesses of offshore entities. You could sit down in a room with a whiteboard and write these down as your decision criteria but they have got to be based on a solid understanding of the target market and the customer based offerings, and so that is something that you do as a precursor and you build that into your decision tree.
Interviewer: How do you establish what your target market might be and what the offering might be?

Interviewee: The target market may have different risks to your own market but they are risks that you feel comfortable with; it is a commercial judgment. Some entities have said I am quite happy to expand into Europe, the United States or Canada but I am more cautious about expanding into individual countries in certain parts of Asia. That is not saying there are not growth opportunities, perhaps even more solid growth opportunities in that part of the world where there is a larger population growth. It does say that the risks involved, whether they be the regulatory risks, or the legal framework, or how business is transacted culturally in those countries, that you understand those risks, that you have researched those risks, and, without making a value judgment, I am less comfortable with the risks in a given country. Another company may be comfortable with that level of risk. It depends on the way you do business, the way we understand and manage risk, the way you become happy to outlay capital to underpin growth in that environment. There are risks we understand but are not prepared to take.

Interviewer: Do you envisage the decision tree as like a matrix and having various columns and compare countries by growth rates, culture, legal systems, and regulatory framework?

Interviewee: It is not about making value or moral judgements, it is about making judgements in terms of - if I became an acquirer of a particular company in a particular country with their legal, cultural, and growth parameter frameworks, how would I manage it? How would I manage it within my risk appetite and the risk management capability I have? Can those capabilities actually cope with the differences, complexities and so on? It is no different to some extent from saying that company A is a good company performing well. Company B is also performing well but within a stated higher risk profile than company A. Hopefully company B would expect a higher return on that investment, given its estimation that the risk profile is higher. But there is a real temptation, when you go offshore, that you may see a new target that, at a very broad level,
is not that different in terms of its operations and its offerings to your home base. But when you look at it a bit more closely, there can be major differences. Let me put it another way. In Australia, if you look at the portfolio of banks at the moment, 50% at a minimum are mortgages, residential house mortgages which are well secured, the margins are reasonably attractive, and the default rates are minuscule in comparison to other countries. If you take the same activity and put it in the US, UK or Taiwan, and look at the other parameters, they are all different. The question is, is it still the same activity? It is still a mortgage, still the same bells and whistles you have the capability to provide in your home company. But the risk profile is different. The default rates are different, the average repayment period is different, the ability to secure that loan to the same extent as in your home country may be different, the legal system that underpins the offering is different, and your ability to take control of the property is different. What I am saying is that if you have ticked yes to growth, yes to opportunity, yes to there being a target that undertakes the same business we do in Australia, but from the risk perspective we have identified these differences and then it becomes a commercial judgement. If these differences are not differences you feel comfortable with managing from a day to day risk perspective, or even if you believed that you could manager such risks but the return was not sufficient to meet your cost of capital, which may be different to the cost of capital of the target that you are buying in another country, then you say it was a good opportunity but you walk away. Risk / return is not easy to quantify. It is even harder to quantify what commercially, from a risk perspective, are you comfortable with? It is a bit like someone skiing down a slope. One person will come down at a heck of a speed. Then you get someone else coming down slower and doing acrobatic contortions, jumps etc. It is what you are comfortable with; there is nothing in theory that will determine that for you. It is the management and the board that ultimately have to make that decision. An investment bank has a different risk appetite to a commercial bank. You are not making value judgements about the activities, but their own management frameworks, their own systems, their own way of managing, reflects the risk spectrum of their activities. If you look at
wealth management and commercial banking, they are two activities that lie under all our major banks. I think it would be a sad day if, because of the inflow of funds that come into wealth management, the board and the senior management of those entities believe that the risks are the same. The risks are totally different and in some cases the risks in wealth management can be horrendous compared to mortgage banking. That is a decision that management has to make, but you have to live with it and articulate your risk appetite at the time and reflect it into your decision tree. If you have done all that, irrespective if you are at the desktop stage, or the early thinking stage, or due diligence, and you are not comfortable, you have got to walk away. A lot of companies do not walk away because the return, at least on paper, looks fantastic. But they forget that ultimately, once you are managing that business, all of those things that have been done to get you to that point are important but, the key thing that is more important is how your key staff and management are going to manage this business going forward. If they have not got the capability or risk appetite, or the risk appetite well beyond what the parent company may believe it should be, the likelihood is that you are going to hit some troubled waters.

Interviewer: We have been talking about going offshore and focusing particularly on acquisition. What are your thoughts on other modes of entry into an offshore market?

Interviewee: But even if you do begin by acquisition, after you have been there for three years that is not an acquisition that is organic growth.

Interviewer: But what about other forms of initial entry?

Interviewee: It can be a partnership, a joint venture, a stake in an entity for a period of time. You do not have to acquire it [100%].

Interviewer: For a company expanding offshore, is there a preferred mode of entry into the new market which might be, in your experience, better than any other?

Interviewee: I do not think there is. The reason I say that is because it ultimately comes down to what your strategy is. You can go in with a small stake of an offshore company. You can go in
via a management agreement, it may not even be an equity interest, and decide to provide management capability to the offshore company and in return get some revenue in the process. It ultimately comes down to what your strategy is. Does it say that I want to be in countries A, B, and C with a very small presence to learn about the countries? That may be appropriate if you have never been offshore. If you are less than confident that the capabilities you have domestically can be readily transfer offshore and want to have a learning phase, then that is appropriate for you and that learning phase could be for a number of years. That should be stated in your corporate strategy. If your strategy document is a bit more expansive then, what you are ultimately talking about at the nth degree is - how much capital am I willing to put at risk? So if you look at it as most good companies do, if you look at your portfolio of businesses, inevitably your home portfolio is the one that is generating a lot of the bottom line at an average lower risk. But your corporate strategy may say over and above that, that you want to be in X and Y markets. So you have made this decision in relation to these markets, in these particular activities and with these capabilities you believe you have. You go to the board and the board confirms that the thinking looks rationale, there may be some doubts but our risk appetite can envelope that new market. But then they ask the question in terms of capital allocation. How much are you willing or asking us to commit to this new market, venture or activity. This is where management, in order to answer this question, will have had to do a far more rigorous examination of the strategy. Not just the target market but a look at the total portfolio and take a long term view and say our activity in our home market and this segment is currently (say) 20% of our revenue basis, it is solid but it is a mature market so the growth rate is going to be steady and is not going to achieve the type of return we are looking for. Therefore your first step is to look at the allocation of some of our future capital into this new offshore market and you have to quantify how much capital and the process you go through before you even look at the target. One of the criteria is your financial criteria, not just return on equity investment but one of your financial criteria is how much capital do I have at my disposal and how much funding over and above
capital will I need to sustain the expected growth in that market. You have to have some parameters around that in your corporate strategy. Lots of companies, when they take an expansion, acquisition, joint venture proposal to a board, the things they mention in the financials include the type of returns we are going to get and the capital requirements. They will say, in terms of the price they have to pay to enter a market - this is all we can afford at this point; and there is usually a range. There is usually a range because there is some flexibility of how much is going to be equity funded and how much is debt funded. But it is a finite range that you define before you start looking at a target.

Interviewer: The amount of capital you have got to invest sets the parameters for your mode of entry in terms of the magnitude or size of entry into the offshore market.

Interviewee: if you do not have that, then you will be looking at everything that looks interesting. A lot of investment banks and acquisitions units within entities look at everything, they have the models, the estimation procedures, but you have to ask them does this fit your corporate strategy. Is it within our affordability range for the next five years?

Interviewer: For a number of corporations, their corporate strategy they will say they want to be in the top four in each market in which we operate.

Interviewee: If a corporate strategy says we want to be in the top four or I want to be the biggest, that is what I would call an aspirational statement. A number of good leaders or good boards usually, at some point, have those aspirational statements. Such statements do three things, it makes you look further ahead; it broadens your range and vision; and it keeps a certain level of internal enthusiasm and momentum. But you cannot go from an aspirational statement to a target market and a specific target. When you are articulating your corporate strategy, it is then that you develop the subsets of the overall strategy. These subsets include the expansion or acquisition strategy and inherent in all of that are all the parameters, the market, the risks,
financial returns, capital and affordability factors, management and talent. All of these are embedded in your decision tree and due diligence process. They are the things you want to find out before you make any ultimate decisions. If you have an acquisition unit and they were very numerate and very enthusiastic, you cannot just say to them - go to country A or country B and find something for us to acquire. You have to give the expansion or acquisition unit the parameters - this is where we want to go; this is why we want to go there; these are the boundaries; these are the financial constraints; and preferably with some time frames. Then, you say to them - you now know the ‘no go’ areas, because we do not like that market; we are not comfortable with certain risk profiles; or even if we want to go there we cannot afford it. That becomes in essence the questions that they have which you will put on the matrix, a decision tree and even when they are doing their desktop research. It would be unusual to get all ticks along the whole matrix. But for some markets and entities you will get more ticks than crosses on the matrix, and this allows you to narrow the field. They are the ones you then look at again and after doing more research, you narrow the field again. Ultimately, you narrow the field to a point where you have a short list and you are in a position to make contact directly or through an investment bank. All the decision framework which you do, always need to keep up to date and it is always updated when you update your strategic plan, your operation one or two year plan, because things change. You may have been able to afford something in year one but in year three circumstances may have changed. Your intent remains the same but some things may have changed and your ability to apply capital may have diminished, the price may have gone up, the debt funding market may have changed.

Interviewer: Do you think this is a two way street? You articulate the corporate strategy first and everything must fit into the corporate strategy. But what if part of the corporate strategy was that you want to control your investments and therefore we will only undertake acquisitions where we have a wholly owned operation or at least a majority holding. You then look at how to expand
within that strategic framework and then you find that in many South East Asian countries you
cannot acquire a majority holding. Do you then simply discount the possibility of being in Asia or
do you go back and rethink your corporate strategy?

Interviewee: You go back to your senior management and board and outline that these are the
facts of life. If we see China as a growth market we can only get up to this level of equity and we
do not know if that is going to change or not, in the foreseeable future. So you go back and have
that discussion and decide if this is still an appropriate market for us for the next 3-5 years. The
board may say, if things do not change, the answer is - no, or perhaps the answer may be – yes,
in which case the restriction concerning wholly owned or majority owned operations will need to
be reviewed. The corporate strategy is not a static thing, although you want it to be reasonably
consistent over time. If I may give an example, let’s say a corporate strategy is enunciated and
re-enunciated over time, it is enhanced, refined and you get two or three chief executives who
follow the same direction. So you get continuity of the corporate strategy, that is a good thing but
that could change. The next chief executive or board may want to follow their own direction and
that is fine. Many companies have had less than satisfactory experiences in certain offshore
markets and the board may say that it wants to pack our bags and come home. Some boards
may initially ask - why did we fail? What is it that we can change in our approach or strategy?
Initially you have to ask the question and you revisit the strategic and business plans on a regular
basis. They may not change the whole thing, and they should not, but they may change aspect
of it.

Interviewer: But the corporate strategy should change if circumstances change?

Interviewee: The corporate strategy must change because this is what we are going to do in the
median term in order to grow the bottom line and our business for our stakeholders. If our market
place, consumer appetites, technology and regulatory framework are static, then I would say OK.

But the thing is that all the external things, all the key things that go into a corporate strategy, the
competitive environment, the regulatory framework, the consumer appetite, all of these things will
change. Your market places changes, everything changes and that is why the strategy planning process, if you do it vigorously and properly, is not an easy process. As you know from experience the last thing a lot of staff and management want is change. They feel more comfortable without change however the reality is everything is changing around them and if that is the case your corporate strategy must also change in order for it to be relevant and have the right criteria and have the parameters defined, articulated and communicated.

Interviewer: You mentioned earlier success factors. Could you expand on these?

Interviewee: The obvious one is to emphasis the well articulated corporate strategy and how important it is to link everything, whether it is an expansion acquisition, investment strategy or new venture, within the framework of that strategy. Because if you do not, your thinking could be less than robust, hopefully it is rational. You have got to make it as robust as you can, to me it is a given, that unless you do that at the very start, success is questionable.

The other thing with success is that success is invariably, whether domestic or offshore based, on how good the capabilities of an organisation are relative to the current competitive environment and opportunities that exist. So a key to success, especially in acquisitions, is to grow and enhance those capabilities you are going to need in order to acquire successfully and manage that target successfully into the future. Again it is not a static thing, capabilities must develop and grow, whether it is in the risk management area, customer interface, technology, efficiency or financial discipline. Management and the board should continually be driving hard at those things, even in the absence of reasonably opportunities because, even in the short term, it is those things that are going to drive the performance of your current portfolio of businesses. So capability building is a key factor in success, not just in financial disciplines but the whole spectrum of capabilities to make a company successful.
The other thing is that a lot of companies, especially if they are in the expansion or acquisition mode, are companies that have grown to a certain size, a certain level of profitability, a certain balance sheet capital quantum, so they have internal resources, the question then becomes - how do you allocate those resources? Whether it is capital, people, technology etc. There is an issue with a company once it is grown to a certain level or size, and it has certain strategic ambitions, it has to ask itself the question - how good are we at resource allocation? And that is an area most companies do not do well. They do not do it well in terms of the way they allocate their capital, how they approve capital expansion plans across the various businesses. They do not do it well especially in terms of their people talent across their businesses. It is unlikely that a company is going to be successfully, in an ongoing sense, offshore unless, it has these capabilities. Resource allocations are a whole subject in its own right, but essentially if you look at the key elements of resource allocation, they are all embedded in the rigorous plan but the question is - how do you decide whether you are going to allocate capital into business A, B, C, or D within your portfolio of businesses, some of which may be domestic and some offshore? What is the criterion that you are using? It may be in some companies that the head of that particular business or division is a mate of the CEO. Does he tap the CEO on the shoulder and say, my business is going well, my rate of return is good, and my bottom line is fantastic, give me more capital?

Interviewer: Is it the current rate of return or is it growth potential? Some companies have their divisions bid for capital based on the rate of return they will produce for the company. But what about future growth potential which may be the category for an offshore expansion?

Interviewee: It is actually a combination of all of those. The question is - what rate or priority do you put on each alternative? You must look at growth and capital returns, hopefully on a risk adjusted basis. Let me give you an example, there are a number of US companies, and a few in Australia companies, who, in the lead up to the Global Financial Crisis grew certain activities; wholesale market based activities at quite a pace, in excess 20% per annum. The bottom line
looked good year-on-year, but the risks also grew exponential. The question is getting back to the corporate strategy and what is it that we are going to do; to what extent are we going to do it; and what are we not going to do. You have to be specific and this applies equally to an offshore target as it does to a domestic target. Let us say, 20% of your business is wholesale institutional banking and you believe you are good at it, with your risk adjusted rate of return being superior to the relative return on your core business in commercial and consumer banking and / or wealth management. So every year you go to your CEO or board and ask for more capital, because you are going to grow your segment of the balance sheet by 20%. The question is - do you provide resources, people, capital, technology and other resources, to a business that is growing rapidly because your corporate strategy says I will allocate more capital, more people etc to the fastest growing business. Or, do you say our corporate strategy does not say that, it says - at the core, we are a commercial retail bank and whilst we have got wholesale banking, wealth management activities, servicing company activities (like payments), at the end of the day we must support the core business. That has got to be articulated. The nature of the articulation is to say in relation to the non-core businesses, I will not allocate up to X% of the group’s capital towards it for various reasons - comfort levels, commercial judgement, risks factors, the cyclical nature of the earnings of that particular entity. Once you have gone offshore or into a new market you have got to articulate, within that corporate expansion strategy, how much you are willing to allocate. I say that because there are lots of businesses that are good businesses that companies have acquired but what happened is that they have not articulated the capital allocation issue in specific terms and what tended to happen is either too much capital has gone to certain entities or too little, and if its too much or too little they both impact the growth and profitability. I still do not think that aspect has been done well by many companies; it is a key success factor. How you allocate capital and how you monitor the way capital is utilised are critical. Unless that is not done very well then success may not be optimal and may be sub-optimal going forward. That is
one issue that very few companies talk about because they say it is something we do internally, it is part of the plan. But I suspect that if you looked at their plans it is not explicit.

Interviewer: With capital allocation being a critical factor for a company expanding offshore, it would also be a critical factor in terms of the timing of such an expansion.

Interviewee: Capital and funding availability is critical. Most institutions do not grow just by capital. They keep regulatory capital at a certain level but there is debt funding. You have got to have a process behind which that is looked at. In some companies, the plans are approved and it gives you the growth parameters, expected profits, revenue flows, risks and so on. But what the plans of some companies do not say is how much capital, even notionally, will be allocated to underpin that balance sheet going forward. To me that is inexcusable because if a boards going to do anything, it is going to allocate capital. It has got to say this is the capital we are going to allocate and it has to be specific within the plan. There must be a capital plan behind the strategic plan. The problem is, in most instances, even if there is a capital plan and a resource plan, when the month-on-month performances are related back to the board there is no reference back to the capital plan, apart from half yearly results and yearly results. That is an issue because ultimately, that is all a company has got – it is those resources and they are scarce.

Interviewer: Are there any other success factors?

Interviewee: In undertaking the integration or implementation plan most companies transfer resources to the new entity to fill those gaps that were identified and opportunities identified pre-purchase. But there is the issue that those resources or capabilities are really ongoing. There is usually not enough emphasis put on how to grow the people, the management, and the talent resources within the target. Because it has got to be a self sustaining experience. A lot of companies just transfer people from the home market, or if there is a good person offshore they will bring that person back to the home market for a stint. That is a bit naïve in essence because what you are saying is that you are feeding the requirements of the business from one or two pools, when in fact you should be looking at all the businesses and recognise that you have to
grow the talent base and the management decision making processes within each of the entities and keep on enhancing that talent pool. If that is not done, then you will have periods of wanting to do things that are offshore or domestic, but you will not have the quantity of resources. I know some HR people say - we will just go to the market place and buy them. Which you can, but then you buy them at a certain price, with a certain lack of the practical experiences of the businesses you are currently managing and they need time to get to understand the business. What I am saying is that a critical factor is how you manage any crew, the management and people talent within those organisations.

The other success factor is an even flow of development. Any good organisation has to leverage the best it can in terms of transferring best practice across every part of the organisation. There are lots of attempts, models and so on but I am not sure if it is highly successful in many organisations. But if something is best practice, there should be an even flow across every part of the organisation so long as it is relevant to that particular business. By best practice, I mean the way you develop and distribute products and services; the way you interact with the customer; how you manage risk; how you improve technology; the way you become more efficient. Companies do it sometimes in bursts, suddenly say that the plan this year requires best practice and then they do it or talk about it. But, there are very few companies who do it rigorously or on an ongoing basis. Some of the reasons why a lot of offshore acquisitions and expansions have failed is in essence either there is no flow of best practice or uneven flow.

Interviewer: There can be a presumption that the acquiring company has all of the answers, but the acquired entity can have a high level of expertise in certain aspects and the flow of best practice should be both ways.

Interviewee: In some areas it may well have, but it is doubtful that on an ongoing basis - 5, 10, 20 years that will be the case.
Interviewer: What about best practice in relation to a specific market or the market segment?

Interviewee: What it also does within a large entity, whether domestically or offshore, it creates silos if there is no best practice across the group. There is normally an initial burst of goodwill but what you need is the practical ongoing transfer of best practice so anything that can be done to improve that, clearly will add to success and in lots of cases not transferring best practice detracts from success.

Interviewer: Are there any other success factors?

Interviewee: Other success factors are your financial discipline and your risk management. An acquisition’s lack of performance or indeed better performance will impact the parent company. If certain parts of your investments across your portfolio are doing well and as a result the total group performance is doing well, there can be a tendency not to put too much pressure on the parts of the portfolio that are not doing as well. The issue in terms of success is down to good financial discipline and risk management. By good financial discipline I mean good performance monitoring and analysis within each of your different businesses. To look at that not just as a monthly event but to look at it in terms of how it is impacting on the individual entity and how it is impacting back on the total businesses. This links back into the allocation of resources. After an acquisition there is normally an allocation of resources, especially to an offshore acquisition. Then, there is a bit of jolt for different reasons and you get a period of semi-starvation which may flow across the whole group and in certain areas which are not considered to be performing or are not considered core businesses. What tends to happen in many companies is that you acquire a company and you develop a 3 year plan to build it up to a certain size and level of profitability. But halfway through the process you start starving it. Not by intent but by circumstance because you do not quantify what the impact is of this acquisition on the total group. It becomes a two way thing between the parent company and all the subsidiary companies. The old age thing is - a well performed parent company provides the opportunity and
ability to enhance other businesses in the group. There has to be a focus for the group as a whole and each element must do well for everyone to have the opportunity to do well. If there are parts of the group that are not doing as well as expected, then we have to make some adjustments, but it cannot be categorical adjustments which tends to happen. The well performing parts of the group keep on commanding more and more resources which basically means there is less and less for the newer parts of the group or offshore targets. Because you can starve someone to a certain stage and they slowly become less competitive in their own market; and that is the issue.

Another success factor is, I believe, subject to rigorous analysis, there is a need through communication to ensure that there is a continuity of strategy within an organisation and especially towards a target. I say that because if you do not have that continuity you will get this short term focus within an organisation. People look at their own patch and they tend to go very short term. Hypothetically, post Global Financial Crisis there would have been a tendency for everybody to become more efficient and have different expectations of the business. But they lose sight of what was their median term plan and I have seen it within some organisations that if a group as a whole does not perform, or the investment community believes it is not performing to the level that it should, then there is a tendency for the home businesses to blame to offshore businesses. The problem in essence is that it starts to detract from the original intent of why you went offshore; the parameters and returns you expected from your offshore acquisition. Now that starts to feed on itself and you get somebody or a number of people on the board or in senior management who lose confidence in the original strategy. In essence the strategy collapses from within and not necessarily because of what is competitively happening in the market. So continuity in organisations, lucky enough to achieve continuity in terms of the board’s and the CEO’s direction, then I think that is a success factor especially if you are expanding. The myth that new CEOs come to the board and the first question they are normally ask is - what is your
new direction? There is no innate wisdom in a new direction necessarily and I think there are organisations lucky enough to have had 1, 2 or even 3 different CEOs who have had specific tactics that are different but there is continuity of strategic direction.

Interviewer: One builds upon the other rather than darting off in one direction and then darting off in another direction and really never becoming good at anything.

Interviewee: That is the thing, you lose confidence in your corporate strategy and once you lose confidence organisations tend to focus on the short term and they are all over the place. That clearly will affect the home market and in particular the offshore market. Especially in Australia where the offshore market is not performing as well as the Australian market. That is a fact it just builds on that uncertainty.

Interviewer: Thank you for all that. Could you please expand on the factors that may be unique to an Australian company expanding offshore compared to a company from another industrialised country?

Interviewee: I honestly do not think there is necessarily anything unique with respect to Australian companies grown offshore. If I look at the Australian companies that have grown offshore, it has either been because they are resource companies like BHP that go where the resources are, or it has been companies where there is a common approach in a number of markets in terms of products, services and regulatory frameworks, especially in the western countries, and this applies in the financial services industry; so there are commonalities across geographies. The uniqueness of Australia being a small but growing country, and the lack of opportunities domestically which force companies to go offshore - I am not sure that stacks up except for certain activities like mining, certain segments of financial service and there are other things where Australians have gone offshore, like property development or on the basis a unique invention in medical research. What we are saying is that the international expansion has been
developed on the basis of something unique or something in advance of what is available in the world and that idea has been taken offshore.

I do not think there is anything innately that says you are going to get better business management offshore. One could argue that, on average, we are good or slightly better so I do not think there is anything unique about Australia as a country or its size that would impact on offshore business expansion. It is probably more with how rigorous, or how well thought out, or disciplined an entity is.

The final point would be in relation to structure. I believe that some people think you just change the structure and you have changed the problem or fixed the problem. I would say that you have got to ensure that you have an organisational structure that is conducive to promoting success in a target. Especially if it is offshore because certain structures can, and it is not so much the higher level, but at the operational level, the decision making structure can actually impede good decision making.

**INTERVIEW 6**

Interviewee: I believe a really good thing to start with is the old SWOT analysis. You do not have to do it exhaustively, really opportunities and threats is where you should start and then your strengths and weaknesses. Talking about a bank in Australia which is a limited market, where you have got a market share that seems to be at or near where you thinks is ideal, it is all about risk management, you do not want to have a 50% market share because you are actually exposing yourself to a market risk, you want to keep your exposures to the market under control. You have got regulators restricting you from having a dominant market share anyway so there is a limit to how big you can be in a certain market; this is one of the threats to your growth. The opportunities for us to grow in this market, the Australian market, are going to be limited by the
way which the market itself can grow. To grow market share organically is hard in banking, you can do it quickly and easily but that usually leads to disaster, it means you have not got your risk framework right. If you have got a tight risk framework, that will help you to go beyond the boundaries of Australia. I think that is fundamentally where Australian banks need to go. Then you have to go looking at different markets, and logically the next place for us is to look at New Zealand, because it is close, it is a similar country, with similar laws, a similar kind of government and regulatory structure, one that we are comfortable with and that is not a bad place to get experience for the whole international concept. You have got to have the ambition and the capability to want to keep growing, which gets into your strengths, and you have got to be able to look forward.

You have got to come right back to examine the strengths, weaknesses, opportunities and threats of both the economy as well as of your organisation. In banking, regulation is an important aspect: how good is the regulator? What sort of competence do they have in regulatory oversight? Stability of government is another important factor. Also important is the legal system, including the common law. Here in Australia, we understand common law and how common law works. There are also the laws arising from legislation. In Australia you have recourse loans. In other words, if you are a bank and I get a mortgage off you and I lose my job and I cannot pay you back, and I owe you (say) $100,000, you sell the house and if you only get $80,000 for the house, I still owe you $20,000. I still have an obligation for the $20,000 (which makes me take the loan seriously). There are products like mortgage insurance, which incidentally I think is one of the most terrible products ever invented because with mortgage insurance, I am the customer and I pay the premium on the mortgage insurance. But if the scenario I paid to protect happens, and I fail, I still owe you, the bank, $20,000. Then you, the bank, go to the insurance company and collect the $20,000, so you, the bank, are ok. But then the insurance company pursues me, the customer. I have paid the premium for this insurance,
yet I get pursued by the insurance company for the shortfall; I think it is a disgraceful product. But without recourse, you are very exposed. So you look for countries which have a similar legal environment. Certainty of title, because in banking, you have two exit strategies. You look at the capacity of the person to pay back whatever you have lent to them or you have a ‘plan B’ which is the security: and that is prime banking. If I go back to Australian banks, we knew this was the way we did banking; we probably did not know there was any other way to do banking. So in some ways we were probably a bit naive but we knew what we knew and if we saw something similar, then it would be ok.

In the first place having been to NZ and developed an opportunity over there, there was a strategic decision that said: we have limited expansion opportunities in Australia; we have got access to capital, so we can expand; what places could we expand into within our risk profile? In other words, within our kind of prime banking, in a legal environment and regulatory environment that we are used to and comfortable with; where we can trust counter-parties with whom you borrow money from in the inter-bank market. Was speaking English a big deal? Probably not, but at the time it was one of the factors. The two obvious places that came up were the United States and the United Kingdom. So we are capable and we have a good banking operation in Australia as our base. We are ambitious and we have had this idea and we have been looking, and that is really important, you have got to be looking to develop an understanding of the market and get known there. Then you get luck. One of the ways banking acquisitions work is that you get a phone call from a regulator, saying there is a bank here that is in trouble, do you want to buy some bank assets? Yes we are interested, we have been looking. The foreign regulator would say: ‘Well you’ve got to give me an answer in 48 hours’. And they were joining on the spot and that is what happened sometimes. But they were ready, they were looking and they knew the assets. It is a combination of factors, that gets you into an economy but is it a good time to buy assets? What you do is you buy assets cheap and then you sell them when they are
expensive. That fundamentally is how you add capital value. Those assets were purchased for an unbelievably reasonable amount of money such that the return on equity on the original investment they made is very high. Fabulous investment but they were on the spot, they were there, they were looking in places they knew they could operate successfully; an interesting combination of strategic planning and opportunity.

Coming back to non-recourse loans, we were lucky in that sense as well that we went to the United Kingdom not the United States initially. The United States has non-recourse loans. A mortgage with a US bank or financial institution is a different product to what we offer in Australia. Because they had the Glass-Steagall Act, they did not have national banks, so they set up secondary mortgage companies like Fannie Mae and Freddie Mac. They have thirty year mortgages, non-recourse loans, and the way the product is set up: you pay a commission or a fee up-front which is, about 3% of the mortgage value. So it costs you, on a $100,000 mortgage, $3,000 to buy a mortgage off a mortgage company. That is a fee which has to be paid up front and that gives you a thirty year mortgage and you have got to lock in your interest rate which cannot be changed. So, if you, say for example, get a mortgage of $100,000 at 7%, and then interest rates start declining, you can refinance at any time, you can walk away from that mortgage for no cost to yourself. All it costs you is the cost to get a new mortgage, which is 3%. So if interest rates come down from say 7% to 4%, which is a difference of 3%. You can get another mortgage, which costs you $3,000 on $100,000 to get a new mortgage, but you save $3,000 a year. So you pay off the first mortgage you got, in one year. So that is what happens, you get this massive re-financing going on which makes the whole industry unstable. Not for the originators, because they have made the $3,000 when they sell a new mortgage, but for the mortgage servicers, because they have bought the mortgage servicing rights and they miss out on that income, because the person abandons that mortgage and gets another mortgage. So, the whole way the industry is set up is flawed, it is risky, because it is non-recourse and property
values can change, and we were lucky we did not go there first. We went to a market [the UK] where they had recourse mortgages which we understand, where you could do prime banking. Australian banks do not understand sub-prime, they never did, and so we knew what we were good at, and we knew we were good at prime lending, which is having two exit strategies. You know sub-prime lending base on limited income, limited job prospects and you do not have any exit strategies. The person has not got the capacity to repay the loan and it is problematic that the actual underlining value of the asset is going to be sufficient to repay the principal. So, you are at risk before you start on both your exit strategies. We never understood, and still to this day do not understand sub-prime lending. You do not want to get into sub-prime lending. Where can you not do sub-prime lending? In a market that does not have that kind of product. So when we went into the UK, that was what it was like, it was a prime lending, well regulated, common law, vibrant, successful banking industry, and a good environment.

What could we bring to a new market? That is where you do your SWOT analysis and what were our strengths? What were we good at? We were good at business banking, we thought we were ok at retail banking. So what we could take into this foreign market, which was the UK, was our business banking skills. You need to understand your own human resources capabilities so you could take people with these skills who had also the capability of working in a foreign market, and that is a risk too, because 50% of expat appointments fail because you have the added dimension of the family, and whether the family can transfer or not. You need to export your skills. What are you exporting? You are exporting capital, you have access to capital because you are a well run bank in your home market, and you have skills so you need to understand what you are good at. In our case it was mainly business banking. So that was a skill we could take over to the UK. But then you have to exploit that skill, and how well you exploit that skill depends on how much you are prepared to have a go at committing some capital to put at risk to growing that business; growing it properly and carefully, by exploiting the skills and exploiting
geographical holes in the market. Going where the money is, and in the UK the money is in the south. You have got to look at the potential in the market you are entering for you to be able to grow well and successfully. That was clear the case in the UK. You can talk about access to capital in the market you go into and you may need to tap into that and broaden your shareholder base which was another advantage of going into another market so you can open up your share registry with UK investors which gives you even better access to capital and you become better known as an international player which gives you better access to debt markets as well. It works in your favour in a number of financial markets, but at the end of the day it is about exploiting what you are good at into a market you are confident you can succeed, if you have done your homework right.

Interviewer: We are talking about the key strategic decision that needs to be made when expanding internationally. Could you expand on any other factors should be addressed?

Interviewee: You cannot kid yourself that you can do it just by sending people from your home market over to the new market for stints of 2-3 years. You need to transfer skills, in our case it was business banking. In addition, you need to hire some top quality locals who know the market, who have grown up in that market, in this case the UK, who are well connected, who know how the local industry works, who know the regulators and they are respective of the regulators. You need both head office and local market people. But you need the local people to run the market, and one of the pitfalls is not doing that, because you do not trust locals or you think they will all go native on you and they will not listen to what you are saying: big mistake. You cannot just have head office people going over there and running the place, it does not work, you have got to have people who are natives, if you like, of the country, who have knowledge and experience of the market place and have the capability to grow the business. The locals need to understand what the parent company is good at so they can leverage those skills, so they are tied into the strategy. But the strategy has to be clear. It can be geographic or skilled based. So
the geographic strategy would be expanding in the south of England. Or it can be skilled based, in saying where we need to expand in the south is through business banking. That is logical so it can connect. Then you go about hiring people with those skills in the local market who are attuned to your strategy and your culture and your values. They are the other things which are important: culture and values. So one pitfall is not employing sufficiently skilled, senior manager to run the place in the local market, that is a key to success. Another key to success is actually understanding how the locals think, and being able to communicate with them effectively. I first came across this in Ireland with the Irish banks, where you need to understand your own culture. Australians are direct, we tend to absorb information, analyse information, think about a problem, come up with a view or a solution, make a decision and then want to implement the solution. When you say to people, ‘This is how we see the situation, and we want you to do this’, and they say ‘yes’. There is a risk you might think they are saying ‘ok, we are going to do what you have said’. But that is not what they are saying at all, as we learnt. In Ireland they are saying ‘yes, we understood what you have said, and do we agree with you? Not so sure? Are we going to do what you have said to do? No, no intention. So, it takes you a while to realise that, because you have to follow up, and you have to go down and say: ‘Have you done what we discussed? ‘Well, no?’ ‘Well why haven’t you, you agreed to do it’. ‘No, I said I understood what you were saying.’ So, unless you have those follow up conversations you do not actually get anywhere. That is the same in the United States. People in the US may say things and they may not necessarily mean what you think they said. They may do something else, so it is a question of can you rely on what people say to you. To really understand how business works, to me makes the US a much more difficult market than the UK because of the non-recourse loan situation. You are not really sure who is backing who and how you can get your money back. The US is a much trickier market to be successful in. These are matters you might not necessarily know when you are saying ‘let’s go offshore’. You can learn this through bitter experience.
The next thing is do not risk the whole bank. Do not bet the whole bank, do not risk the whole company by investing too much. Take off chewable chunks, if you like, and then build on your experience and grow. One example of a really success in that area is Westfield. Their expertise is in running shopping centres, which they developed in Australia but then they went offshore and did it over there. They stuck to their netting, and they have succeeded in the US. They have succeeded in taking their model offshore and making it work in different markets, and being quite narrow in their focus. Being narrow in your focus and sticking to your netting and sticking to your strengths is really important, and not thinking you are suddenly better than you where before, because you are probably not. So one of the potential weaknesses you can have is hubris, believing that you are fantastic. We are all human, we all might have particular skills and a way of doing business, but you have got to stick to it and work hard at that model and be relentless at actually honing it and making sure that is what you do, and not straying from it. That means prime banking and it means understanding what your skills are and developing your business within that very tight envelope.

Interviewer: You mentioned earlier the English language and the English legal system being common to what we are familiar with here in Australia. A lot of people talk about the Australian expansion into South East Asia, and that is quite a different market, the languages are different and the cultures are different. What would you say to someone expanding into South East Asia, just because of the geographical proximity?

Interviewee: Geographical proximity is not enough. Those cultural differences are significant. For a bank which had expanded into the UK, a logical next place would be to go to some of the European countries, who have similar laws, similar recourse lending, similar regulatory environments, but different languages. So language is not a first order priority, it is probably a second or a third order priority. But having similar language is a great advantage. Coming back to Asia, again it depends on an understanding the strengths, weaknesses, opportunities and
threats, you really have to do your homework on the local market, knowing how you can succeed in the local market and understanding the regulatory environment and the legal environment. You have the language barrier so you have to overcome that, but fundamentally it is about the regulatory and the legal environment. What restrictions there, can you actually be successful in that market going forward? Again, whether you can rely on what people are saying to you, and again, the concept of legal title which we are familiar with in Australia. If a bank lends money to a person, and your practice is to have a mortgage over a title: is it a real title? Is it actually recognised by the law of the land, or not? Is there such a thing as a legal title? Are you just doing it on a hand shake? It is also about understanding the custom that you are dealing with and who is backing them, how they build their business. It is a different mindset. What I would say is, for an organisation like an Australia bank, it would be much harder to do business in Asia because the mind set is so different. It is not just prime banking, where you have two exit strategies. You probably need two exit strategies but they could be different ones, because you may not have recourse lending and you may not have clear title to an asset. How are you going to get your money back? Can you rely on what people are telling you? It is much more difficult for an Australian with a western way of thinking to succeed. Again in those sort of markets, hiring capable locals who understand your strategy and who are well respected in the local market, is probably even more important than it would be in somewhere like the UK type market which is more understandable to an Australian person. I remember the Australian Institute of Company Directors had a conference in Shanghai and there was a guy from a firm of architects, a prominent Sydney firm of architects who designed the swimming pool for the Beijing Olympics: the unique design, called the bubble or something like that. This guy talked at the conference and he said: ‘people ask how did I get into China and how did we get to be successful in China as a firm of architects. We lived in Sydney and my son went to a local grammar school and he used to bring this Chinese student home, to stay on the weekends or summer holidays and we got to know him really well. I happened to say one day that I was going to China and he said -
‘you should meet my father, he is up there’. I said that it would be nice to meet him. Well he turned out to be the Mayer of Shanghai. Because of that family connection, which is so important in China, I had this introduction into a person who could make things happen. That is how we got their first architect job in China. From there he was invited to design whole cities. This is what they do in China, they will provide a tractor plan for thousands of hectares and ask them to design a city: suburbs, CBD, public transport, everything. For an architect these would just be wonderful assignments. He had to be confident and good at his job, but without the personal contact, he would have found it difficult to succeed in China: because that is the values of China.

Interviewer: That is a terrific little introduction to an aspect of international expansion which may, or may not, be unique in both Australia and the United States. Australia is a multicultural society and is that advantageous for Australian companies expanding overseas? There are some different points of view about whether or not people within Australia, who have a family background from Europe or from East Asia, who are part of the local domestic organisation, can be plucked out and sent back to their country of heritage to work for the new expand international operation there. Some people suggest that can be a real advantage, and others suggest it can be a disadvantage because they are not really connected into the local market, notwithstanding with their cultural heritage, they are too far removed. What are your views on this?

Interviewee: It could work and it could not, it depends on the individual and how well they are in tune and the culture and values of the country they are going into. I should have said before, it is important to have a two way stream, you know how I was saying I would take Australians with the expertise and put them in the new market, in that case we were talking about the UK. It is important to do the other thing and take people with potential from the new market and put them in the home market so they can learn the corporate culture and skills in this market. Then go back to their native country and hopefully develop and succeed. You need that, it is good and rich to have that sharing of culture. Coming back to your question, it would depend on the
individual, just because they happen to be of Chinese heritage and speak Chinese, that does not mean they will succeed in China. If they grew up in Australia they might not understand the Chinese culture. They may not have the right set of values. There are a whole lot of factors you have to take into account. As a generalisation, I would say it would depend on the individual. They have to have the right skills, values and culture, and if they have not got those, they will not succeed.

Interviewee: Another aspect which is important in moving into a foreign market is the mode of entry into that new market. You have had direct experience, both in growing a green fields operation and in acquisitions. Do you think that one is better than the other? Are there situations which could vary and make one better than the other in certain circumstances or is one always better than the other?

Interviewee: I think realistically the only way you can get a meaningful beach-head in a new country is to acquire something. I do not think you can do it from green fields. You have to start with an acquisition. It does not have to be a massive acquisition, but I think it has to be a meaningful acquisition: one with a sufficient capability and platform for you to grow on. The business I started used the businesses that had already been acquired to distribute the financial products we developed. It would not have worked to just start that business up on its own without the existing distribution network being there. It could only work given we already had a footprint in the country. I think it is really important to start with an acquisition. It is really important when your looking at that acquisition to look at its capability; what are its people like; what are its systems and processes like; what is its market share; where is it is footprint geographically; what is its potential to grow? You have to look at all those things. But you have to start with an acquisition. It does not have to be a big one and it is better if it is not a basket case, because you want something that is successful: or at least has the underlying foundations for success. Otherwise, you are just putting your energy into fixing someone else’s mistakes and not
leveraging off the platform so you can grow. It is going to slow you down in your growth aspirations.

Interviewer: In terms of acquisitions, you can have a friendly acquisition or an aggressive take-over.

Do you have any views about whether you should always go for the friendly acquisition or can an aggressive takeover be successful after a little bedding down?

Interviewee: If you are going into a market for the first time, I would say it always has to be friendly. I do not think you could be successfully doing a hostile acquisition if you did not have any presence in that market. If you were entering a new market: it has to be friendly. Secondly, if you have already established a presence in that market, I would still say that 99 times out of 100 it should be friendly. It would be a very rare occasion where a hostile takeover could succeed. You would want to know the target company extremely well, to make sure you are actually paying fair value for its genuine net worth and not taking over a whole heap of trouble. You have a much better chance of finding out about any problems if you are doing it on the friendly basis because your due diligence would be so much better than if it is a hostile acquisition. You do not want to pay too much for the assets that you are buying. In banking, that is especially important. Once you have got a presence in a particular market, the bigger you are in that market and the smaller relative to the overall mass of your business the target is, the more possible it might be to do hostile takeovers, because you have got less at risk in terms of the overall capital base. In banking, I think hostile takeovers are fraught with danger and risk.

Interviewer: What is it that we as Australians could offer a bank or a financial institution in another country to do a friendly acquisition, for an organisation that is not in trouble? You mentioned earlier that sometimes a regulator would come to you and say an organisation is in serious trouble will you bail them out. There can be a lot of dangers in that, you can spend a lot of time cleaning up the mess. But if you look for an organisation that is in reasonably good
shape that has potential to grow: what can we actually bring to the table to make the other party really sit up and want to do the deal?

Interviewee: Access to capital, which is not unique as other companies are going to have the same thing, but that is critically important. Attitude, capability and skills, but having the right skills is not unique either. Skills to do business in a certain way could be unique. One thing that I think Australians are respected for in other markets, and I have learnt this through living overseas, is their energy, their can do attitude, and their attitude to customer service. They actually seem to have a genuine interest in the customer, they believe in trying to please the customer, and they think it is important to please the customer in ways in which the customer gives you return business: it is a mutually beneficial arrangement. There are a lot of countries where that fundamental understanding of why it is in ones best interest to give good customer good service just does not seem to exist. Getting that positive attitude across is something which Australians can do and they work hard. For example, in the UK, Australians were liked because they were prepared to work hard, they had a good positive attitude towards customers, they were diligent and intelligent and all those sorts of things; compared to the locals who did not want to work hard and often did not care less about the customers and did not really try to help them. This was because they knew, their experience told them there was another customer behind them anyway, so if you lose one customer it does not matter because there will always be someone to replace them. Whereas in Australia, we have a relatively small population so you thought every customer was important and we did not want to lose anyone. So your initial approach was different. It is part of an attitude and a thing you grew up with, simply because there were not as many customers around, you would try to make them all a successful transaction or interaction. Even though Australia has a small population, some of the larger Australian banks are large on a world scale and so having the knowledge and skills to run a large bank, and access to capital are things that are an advantage in other markets. Knowing fundamentally how to run a sound bank, which Australia does well. Australia’s had some experience with banks going bust, so it knows
how you can blow-up a bank as well, but fundamentally the systems have been sound for a long
time: there is a level of confidence. People have come to an understanding that with this can-do
attitude I am talking about, Australian’s get things done. Because they have this confidence in
their own ability to succeed if they stick to the rules, which other countries do not necessarily
have, which is interesting. You could call it arrogance, but it is not actually arrogance, it is
actually knowing that if you do things in a certain way what the outcome will be, it will work. You
could say it is soft but it is actually being prepared to chance your arm, so to speak: which is
being prepared to take risks. But it is calculated risks because you understand the exposure, you
do your thinking, you understand the strategy, you know where the risks are and you take extra
precautions to cover the risks to insure that you will be successful. That comes back to winning,
Australians like to win. Everyone likes to win, but Australians know, they think they know how to
win. Do they know how to win more than in other countries? In sporting analogies probably yes:
and Why? Again, they have just got the confidence to think if they keep trying at whatever sport
it is they will win. They believe they can win, it is a mind set. They believe, which is a strength,
that so long as you understand the risks, you do the thinking, you take action to cover off on your
risks, and having that innate confidence, that you can win, in a business sense I am talking about
now. This sets Australians apart, I think, from some other cultures. They do not actually think
they are going to win, until they have won, and this causes them to keep pressing on. The British
actually want to win, but they do not believe they can, and I am not certain how that impacts on
their motivation.

Interviewer: Talking about the British market and the unique Australian factors, following on from
what we have just been talking about, the class structure in the UK is still alive and well. Is that
something which for somebody who in the UK is young, bright, intelligent and ambitious, but not
necessarily part of the major social structure, might find they have a better opportunity for
advancement within an Australian owned company rather than in a British owned company?
Interviewee: Possibly, I think the class structure is breaking down, so I am not sure that the old rules apply. I think there can be very strong and significant class divides in some industries and some companies but I think that is gradually dying out. I think they are becoming much more merit based. The philosophy is changing, if you succeed on merit you should be promoted on merit. I think I have seen that coming more and more. Having said that, there is a question of horizons as well, and I do see a lot of people in the UK having lower horizons. They just do not have the same ambition, or believe that they can achieve the same things as others. This tends to be a function of their experience in the background, compared to Australians who do not have those same class barriers, who do not see glass ceilings and think, if they are ambitious, they can go to the very top of an organisation. They do not have limited ambition that some British people do. It is not a function of opportunity or class stopping people getting on, it is their own perception of their own capability or potential, which is a product of the class system that limits people now. I have seen people from working class backgrounds who have the capability and were given opportunities to actually go a long way and break through those moulds. So you can do it but it is probably an exception to the rule.

Interviewer: Is that something about an Australian company operating in a market like the UK that might make the Australian company seem more attractive than other UK banks?

Interviewee: Yes, to some people, because it is merit based, so people understand that if they perform well and they succeed, they will actually do very well. That is part of the promise the employer makes to its people. That is another advantage of having your strategy right and your culture right: you can sell that to people when they join you. These are the people in the new country, you are employing in the new organisation. When they join you, they are joining your culture and your values and what you stand for and your strategy. They become your greatest advocates because that is why they joined you, that is what they want to do. You do not have to persuade them like the people who are in the organisation to change their mindset. What I found when I was hiring a lot of people in a start-up business, they joined that business because they...
believed in what we were trying to do. They became an action strength and motivating force for the organisation to succeed because they did not have any hang-ups from the past or any baggage, they were actually all on board, and more positive than even you might have been in terms of wanting to succeed in that direction.

Interviewer: You mentioned earlier how important it was to have a mix of people from both the home market and from the local market, who had a good knowledge of that market, in the structure. Do you think there are key positions within the structure which you would always reserve for people from the home market and positions you would always reserve for people from the local market?

Interviewee: No, you have to obtain a balance. If you are going to have a local chief executive officer in a bank, you might want to have the head of risk being somebody from the home market. Or the chief financial officer, somebody who is a direct report to the CEO, someone in a very influential position who can keep their finger on what is going on within the organisation. Or if you had an expatriate as a CEO, you might want to have some very senior people reporting to him/her that are locals, even in the risk position or the CFO position, or it can be a combination, it does not matter, but you need that balance.

Interviewer: So the CEO you would not necessarily say would always be from the home market?

Interviewee: No, but my preference would be to have the CEO from the local market. Because then you are actually setting up an organisation that is going to look like a local market and be part of the local market much more so than if it is run by a bunch of expatriates. That starts from the top, culture starts from the top, so that person, whilst their local, he/she need to be immersed in the culture of the parent organisation. It is important to get that socialising thing right. My strong preference would be, most of the time, to have a local as the chief.
Interviewer: What about the role of the chairman, which might be a non-executive chairman if we follow the Australian corporate governance model. Do you see advantages or disadvantages of having that as a local or a home market person?

Interviewee: I think that there is a strong advantage in it being a local, someone who is experienced in the industry and understands it; who is well connected with the local government regulatory industry environment. This is very important. But talking of boards, and subsidiary company boards are important, one thing I think has improved in Australia with boards, is having people on boards who actually understand the industry and have the experience in the industry of the board on which they are serving. There used to be a model for major public companies where the people you would look for would be non-executive directors who were former CEOs of major public companies, but it did not matter what industry they were in, in fact it was preferable they were not in the banking industry. I do not think that model is as effective as a model where you might have some of those people but you would also have a majority of people who actually are from the banking industry. They may not have been CEOs, they do not have to be, but they are experts in some aspects of banking; business banking, wholesale banking, risk. They are the sorts of people you need people with industry expertise as non-executive directors on board. Coming back to a board of a subsidiary in another country, I think it is really important to have people from the local banking industry on the board, the financial services industry, it could be broader than banking, on that board, who are well respected, capable locals. If the subsidiary is significantly large, they could sit on the main board as well so they get to know what the strategy of the main board is, and they get responsibility in that area as well. That is really important, because in my experience, the boards I mainly dealt with had more of the former type persons, people from other industries, who did not understand banking and, I think with the benefit of hindsight, the board would have benefited from having more people with banking experience who understood the industry. I did not have to explain to them what was going on for them to give me
advice. They could give me advice because they are actually across the fundamentals, they were more capable to give you good oversight.

INTERVIEW 7

Interviewee: The prospects of a domestic financial services institution expanding off-shore without having a depth of understanding of off-shore markets, I see a range of considerations that need to be evaluated. Certainly the legal system of the country involved in terms of corporations act or such statutory obligations that need to be complied with. Licensing requirements would need to be understood to commence or acquire an operation in an overseas jurisdiction. The nature of corporate prudential regulation in that particular environment. Particularly the prudential side in terms of what capital might need to be held, what liquidity rules apply, what sort of permissions or approvals might need to be sourced from the regulator before business activities can be undertaken. What the workplace environment is in the particular country, so what rules and regulations surround employing people; duties and obligations of being an employer. Taxation, what the taxation rules both on the operating side directing in direct taxes from the operations and what taxation implications there are for repatriation of interest and dividends back to the parent entity. This is important in determining what free cash flow may potentially be generated over time, and being able to pass back to the parent entity. Developing a complete understanding of the legal regulatory system and the nature of regulation and strength or otherwise of regulatory practices.

The next category would be the competitive landscape in that particular country, based on the perceived strengths of the parent entity looking to go offshore. What particular skills, expertise and business model, would they seek to apply within another jurisdiction, and based on today’s players in that market segments or a number of market segments. To identify who they are and do a comparative analysis of their strengths and attributes, market share, product profiles etc.
The general nature of competition, how cosy or how stringent the competition is, to get a sense of whether the particularly skills and attributes the parent entity are unique in that market. How those skills could be deployed successfully into the overseas market. Is there a ripe opportunity there that is not being exploited or not being exploited well by the current players in the industry that our parent entity could exploit. Perhaps a bit of a subset of that is whether there are any existing players in that market place who are ripe for acquisition or strategic partnering opportunities should that be the viable way of entering the market either to get scale at an early stage or to acquire knowledge and expertise in an existing market position to expand from. That is looking not only at who the competitors are but their relative strengths and susceptibility to takeover or partnership. Similar is there an opportunity to do a pure greenfields start up. Are there any particular factors that would prevent such a greenfields start up, being regulatory or competitive factors. Needing to explore what would it take to start from scratch, do a comparison analysis, the length of the investment payback period and other factors that would lead to the attractiveness or otherwise a greenfields versus a partnership or acquisition.

Interviewer: Whilst we are on this topic, based on your experience, would you have a particular preference one way or another for an acquisition, a partnership or a greenfields operation in an offshore market?

Interviewee: Based on my experience the greenfields operations have been less successful than the other two. One would have to have a very long time frame in terms of generating acceptable returns to go down the greenfields route and I think the general feeling in the market these days is that investors are looking for shorter term returns and pay backs and are less inclined to support multi-year strategies that maybe cash negative over that period of time. The acquisition route certainly has advantages in terms of an immediate market position in a particular market, and the acquisition of existing skills and the ability to assess how well those skills are working a given market today. There is less risk in the greenfield situation where you have to go and buy your own management team, systems and the other ‘tools of the trade’. At least with an
acquisition you can ‘kick the tyres’ and make your own assessment, through activities such as due diligence reviews, of how well the physical, human and other resources of an entity are operating.

Interviewer: Sorry, just to clarify, are you saying there is less risk in an acquisition or less risk in a greenfields start-up?

Interviewee: I am thinking about the risk of the ultimate financial success of a venture. There is more risk in a greenfields that you are starting from such a low base, with an untested combination of the different resources to operate that entity and therefore the confidence that you have picked the right teams, the right products and the right way to make it all happen, that risk would be higher. The risk of not being successful based on those factors is higher in a greenfields. I am not saying it is a given that with an acquisition you just walk in and it will be successful, but at least you have a live operating model that you can add your skills and parent entity input into and hopefully improve. It is most likely you would be paying in an acquisition price for some synergy benefits or efficiency benefits of some type.

Interviewer: The greenfields would have a greater success risk but an acquisition would have a greater capital risk.

Interviewee: Certainly, what we are talking about in that context was more from an operating success perspective. To pull off a successful entry into a new market is going to be more risky with a greenfields entry than with an existing operation. The greenfields has less capital and financial resources risk from the start up as compared to an existing enterprise where you will have to pay some sort of goodwill or premium to get in on top of the value of the entity you are buying.

Cultural aspects are certainly very important when you are looking at an entry into a new market, particularly if it is an existing operation. The parent entity will have a certain culture, a certain set of values and ways of doing things. It would be a big challenge but it would be very important to
get a reading on the culture and the underpinning values and behaviours that apply within a potential acquisition offshore to see whether there can be a cultural fit or a cultural clash that may undermine the value of any acquisition that you make. If there cannot be some sort of harmonisation of values or coalescence of values between the acquiree and the acquiror, it is likely that the new operating entity offshore will not deliver the financial outcomes that were sought. If the motivations are not the same and the value drivers and performance incentives are not aligned one with the other, then you will get a suboptimal outcome.

Interviewer: Do you have a particular view about acquisitions, being a friendly acquisition or a market takeover, whether in your experience one is better than the other?

Interviewee: My experience is only with the friendly, not with the hostile takeover situation. But there are probably different strengths, there can be a range of outcomes that can derive from a friendly acquisition, it is not black and white between friendly and hostile. At least with a friendly one you have the board and the senior management of the new entity generally on side with the board and management team of the parent entity. Whether the hearts and minds of the staff necessarily go along with the management and board of the acquired entity can be debatable, especially if it is tied up with some sense of national pride if you are going from a locally owned operation to a sell-out to an overseas entity that can be a challenge for the in-coming owner to deal with. At least if there is a friendly atmosphere, the right things are being said by the acquiror to the acquiree, proper staff engagement happens through the process, the benefits to the staff and communities they serve and potentially the country in which the acquisition takes place, then there is a pretty good chance that you will pull-off a successful acquisition. Whereas in a hostile situation you have probably got the local management, board and staff offside to start with and you have to claw back from a position of aggressor and victim to get people working harmoniously for a common good. The cultural side is something that is critical, but less able to be grasped as compared to financial matters and regulatory and legal matters. It is difficult,
irrespective of an acquisition situation, to get a proper read on the pulse of any organisations employees. There are a lot of things that sit below the surface that may only emerge through some stress situation which an overseas takeover could be an example of.

We have talked about the legal and regulatory environment, competitive factors and cultural factors. Next we move to economic factors. It is important to get a sense of economic conditions, today and into the future in any particular country you are going into. We are coming out of the Global Financial Crisis and the GFC has shown up some inherent weakness in the financial structuring in certain countries: Greece, Spain, Portugal and Iceland. A few years ago you might not have thought they were countries that had national economic risks to them. We need to have a good appreciation of whether we are going into new economies or risky economies in terms of where they might be going and what their currencies might be doing: the strengths and weaknesses of their economic fundamentals.

Interviewer: What would be the strategic analysis you would look at in terms of what countries you would go to?

Interviewee: Based on the experience in this organisation, the accepted approach has always been to look at countries that are quite similar in terms of legal, monetary systems, competitive landscape, type of customer, so that the ability to readily deploy what you do in your home country to those other countries is easier than going to countries that do not have those sort of similarities. Which is a ‘sticking to your knitting type thing’ where going to such countries will give you greater confidence of the portability of your inherent skills, operating model and business model. But whether those countries have the growth prospects that one would like to see would be a counter argument. Does China, India and certain countries in Eastern Europe have stronger growth prospects, stronger need for financial services, are they open to financially innovation and are they receptive to an Australian operation going in there. These matters
certainly need to be explored. The challenge in some countries is the lack of certainty around key aspects of the legal and regulatory systems they apply: the rule of law. Even now, some countries have ways of doing business that may not sit well with the cultural values the parent entity wishes to maintain. The Rio Tinto, Stern Hu situation is very current right now. Acceptability or otherwise of giving and receiving bribes in a certain country in order to further the commercial interests of the parent entities is a big issue, in intertwining politics, financial issues, competitive issues, morality and integrity. They are all difficult issues to evaluate. There is no one crystal clear right and wrong answer in any of this. For each individual organisation it is how they place values on those certain elements within their overall performance. The careful, cautious way of overseas expansion is to go to countries you know, you understand and can get a good read-on in terms of the way business is done. This is against assessing whether you make a plaint in some new and developing economies where some of those certainties about the way business is done is not quite as clear cut or as acceptable as you would like, but ultimately the country selection is a big commercial judgement.

Interviewer: Do you think language is a critical factor? Or, is the fact that the English language has been adopted in many countries as an acceptable commercial language makes this less critical? Also, how important is the English common law system as a base for the legal system in a country?

Interviewee: From my experience that combined English language, English as the commercial language of business around the world, and a common law based system that can be relied upon to protect commercial interests and support the value of one’s investment is very critical.

One of the things you would need to do is your exploration or assessment in determining who the key advisors or key sources of intelligence will be on how a particular country operates across the different dimensions we have talked about. Finding a highly reputable legal firm, possibly a
highly reputable investment bank, trustworthy people in business (maybe not even in your own industry) who you can consult with. You cannot do too much in delving into and seeking input from as many different sources as possible. Just relying on a fly-in, fly-out quick ‘kick the tyres’ assessment of a country, industry segments or potential takeover targets, is unlikely to generate the depth of understanding you need to have a proper assessment. In terms of putting a proposition up to your own management team and board, you have got to have checked all the bases, ticked all the boxes. Knowing who you can deal with, what advisors can be trusted, is all part of the complex web of assessments that need to be done.

Interviewer: You spoke earlier about acquisitions and we moved on to country selections, in some countries it is not possible to acquire a wholly owned subsidiary, it is only possible to obtain 49% of an entity. If the regulations in a particular country limited you to 49%, would that turn you away from such an acquisition?

Interviewee: Not totally, it is not the desired approach if you had your choice. But if, through means other than straight shareholdings, you had the ability to exercise the requisite level of control over how the operation was conducted in the foreign country, I think you would still be able to work within that limitation of shareholding. Control, in an accounting a legal sense, is judged not just on shareholding but on means of influencing decision making and other means can be used in conjunction with the shareholding to achieve business and commercial aims.

Interviewer: A certain level of confidence can come from the management team that are appointed to an organisation. Within a wholly owned subsidiary, you have complete freedom to appoint your own staff, within a partly owned entity you do not have that flexibility. Are there key positions within the organisations that you would like to appoint people to?

Interviewee: If you had a choice, yes: and which of the key positions? In a financial services company the three most important roles are the chief executive officer, the chief financial officer
and the chief risk officer. But there are other important members of a leadership team: technology, human resources, and strategy. In terms of holding the key leavers, I am assuming that the CFO has treasury under him/her, the CFO holding the levers around financing, sources and uses of funds, the accounting and reporting aspects, and budgeting. The CRO has the key leaders of risk profiles, credit limits and dealing with counter parties. If there was an ability to have those three positions, either selected solely by the 49% shareholder, which is probably unlikely, or at least in conjunction with the majority shareholder, they would have a meeting of the minds, they would go a long way to allaying concerns that the 51% partner in the engagement would not be moving the business in a direction that is counter to what you would like as the substantial minority shareholder.

Interviewer: Even within a wholly owned subsidiary, if it was an offshore acquisition you would have current staff in existing roles and there is a certain dynamic which occurs between having local staff and staff from a foreign country coming in and taking over the organisation and then take over key roles. In terms of an offshore wholly owned subsidiary, would you have the same three positions as the key roles and do you think it is necessary for all three to come from the home market?

Interviewee: I think you would always want to have the CEO or managing director of the enterprise and a minimum of one of the other two. It would be important to have a strong degree of influence at the local executive committee table where the group direction, group strategies, key objective of the group as a whole, of which the offshore entity is a part, where all conveyed and used as a framework for decision making. I do not think you can just have the CEO and one other on an executive committee of maybe seven or eight people. That would be a struggle, if you just had two of eight it would be difficult to ensure the right influencing across the executive committee. Three or four of eight would be a good balance of group versus local. I think it is critical to have the people at that executive committee levels, not to say you would not have
some other people sourced from the home country within the structures at other levels, the teams and down below the executive committee level. From my experience, there have been problems if the executive team is largely left intact following an acquisition and in the influence from group is at a third or fourth tier level. There just is not the ability to influence and provide the necessary feedback to home base. It may not be deliberate, an entity that has been taken over does not normally wish to stop information from flowing back. But it may not just have the depth of understand of the objectives and the ways of doing business that the parent entity would wish them to have. By being at the executive committee level, debating key decisions within a framework of what the parent entity wishes is why you need those representatives of a group there. They would be there, not just in roles of emissary from group, but in real roles in the acquired entity. Such people come with a background of what is successful in the parent entity and what should be able to be conveyed to, and implemented at, the acquired entity to both benefit the local entity and the group as a whole.

Interviewer: What about the role of the local chairman in the foreign market?
Interviewee: The role can be either ceremonial or an active contributor. If the chairman is a person who is a well experienced and a well regarded business man or women in that particular country, he or she can certainly provide an excellent mentoring and counselling role to the CEO, particularly if the CEO has been brought in from the parent entity. Getting the CEO known around town and meeting the ‘moves and shakers’ and working out how business is done is important. Potentially being a source of introduction to businesses back into the local entity. A chairman can obviously open doors, can be around at important meeting with government regulators etc in terms of representing the interests of the broader group and resolve issues that arise. I think in the experience here, it has been the case of finding the right person that can deliver on those activities and be an excellent source of information and intelligence to the parent entity board and chairman. To do the role effectively and the ability to understand the parent
entity board’s position on matters is important and being open and willing to share intelligence from the acquired entity country back to home base and internally assist the process.

Interviewer: We have covered a range of issues, but are there any other key strategic decisions that an organisation needs to make in terms of expanding offshore?

Interviewee: It is probably not always done, but I always think you should think about what your exit strategy might need to be. You go into a new venture like this with high hopes that it is going to be successful and you will be in there for the long term. But there is always the risk that it might not quite work, for whatever reason, there might be a Global Financial Crisis or whatever that might de-rail things. So, if that was to happen, how could value still be rescued from the venture? You need to at least have some working hypothesis of what might happen if things are not as successful as you had planned and to ensure you have not blown your whole investment in a venture that has not quite worked out. One of the reasons this organisation has gone offshore is where there are certain market segments that are potentially more advanced in terms of product or system or the business model. Having a good understanding of how those things work by acquiring an entity in that particular jurisdiction and importing that expertise back into the home base could be a benefit. Rather than just be a one way street of parent entity to acquired entity it could be the other way. It could be the human capital as well as the products and the systems that are in that other market.

Clearly, before you launch into this a complete understanding is needed of how such a venture would be financed and the ongoing capital and cash requirements that may need to flow from the home entity. Will share issues or placements be required by the home entity to fund to expansion, would you need new funding lines, how that impacts on capital ratios. Gearing, leading on to earnings per share analysis, how dilutive or otherwise, over how long, such an acquisition would be. When all the permutation and computations of how the thing could pan out are done, you would certainly need to have your shareholders, rating agencies etc. all
appropriately briefed and sufficiently supportive of that, if it is a major strategy. Supportive to progress rather than to think you can do it without getting those key pillars of support lined up behind you. Because irrespective of what you think the value of this deal might be, if existing shareholders or potential shareholders disbelieve you because they do not understand it sufficiently or they doubt your ability to pull it off, or for whatever factors you could destroy more shareholder value than you could potentially gain by attempting to expand into such a market. There are a lot of people that you need to have influenced and briefed along the way in order to pull off a strategy on day one that is going to be positive in terms of value.

INTERVIEW 8

Interviewee: If I am thinking about an offshore expansion, the first thing I would want to do is I would want to make sure that anywhere I am going to be expanding to has a set of laws or some sort of structure that gives me confidence that I can go in there. I understand the rules of the game, not going to basically end up doing my money because of fraud and corruption. That would be number one. Number two, I would want to see some sort of link between where I am operating now and how the economy I am thinking of going into has some sort of relationship with Australia. I suppose the obvious area I would be looking for is somewhere that is important to Australia’s growth, so the obvious areas are in Asia. Now there are two ways you can do it: you can try and go up there; or you can also think of how I expand locally in a sense by making myself more Asian friendly here. There will be an Australian context, maybe I need to have branches that cater specifically for Asian, or specific country in Asia. So follow the investment path. The first way I would do it is look to see if there is a linkage between Australia and country x and if there is, what are we doing up there. I think there are two way relationships. Number one, the simplest and easiest way is do something that you make it easier for us to go to them in terms of customers. Then start to think about how do I then also start to look at the way the people in the country we are talking about would find it easier to invest in Australia. So you do
not have to be all things to all people. You might decide if you are looking at the market, how competitive is the market up there, and if it is the land of the gorillas, you probably do not want to compete with gorillas up there. You do not necessarily want to be a full service bank or funds manager, but you might want to have a niche and a niche might be saying 'ok if you really want to invest in Australia, in real estate and you want currency exposure, then I will set up something that makes it easier for you to do it'. So they are the ways I would look at. You also have to look at: can I actually do something like that up there, because unfortunately when you get up to Asia, you have got to do joint ventures and when you are doing your joint ventures you obviously have to look very carefully at the partner you have. Presumably you would prefer to have 100% ownership, but it may well be the case you can negotiate a 50% - 50% or a 51% - 49% depending what the government policy at the time, the more the better. You bring your expertise and they bring your local knowledge, and then you joint venture from there. I would start with fixing up my local platform to have more focus towards that expansion and then as a second leg I would say: 'how can I help customers at the other end of the Australian investors’ trade, coming back the other way?' Now I know the literature says that you should basically be pure Australian, because your shareholder base looks at the Australian proposition and if they wanted to go and buy something somewhere else then they will go and buys something somewhere else: you should be a pure player. I am not sure if I agree with that, I think you can diversify, you may decide that it is not Asia; you may decide Asia is highly linked to China and you do not like China. So you might think you want to go somewhere else in terms of your international expansion. I think you do fundamentally want to be in an economy that is linked back to our economy and also where you might think there is a lot of growth potential. Growth potential is very important. I do not favor expanding into New Zealand, not withstanding that all the Australia banks have done that. The reason I would not want to go to New Zealand is because it is an economy of four million people, it is not growing very fast and is very dependent on agriculture, 10% of the economy. That is not what I want. What I want is something that is going to be growing at 4% -
5% and has a lot of expansion. Everyone is talking about Asia but you could look at the Middle East: there are a lot of people. Instead of setting up as a bank, you could going in and set up as a funds manager. There may not be direct trade links, but where is all the money around the place and can I basically help take that money and help them diversify. You do see a lot of funds managers globally who want to have more commodity exposure, but which they mean Australia. You can look for somewhere that is going to be growing fast, has lots of money, looking for a place to invest. You building on your niche, your knowledge and you are helping Australians going to them but also how someone could come to Australia. I think they are the ways to look at it. I am sure there are lots of other angles, but they are the ones I would start off with.

Interviewer: You talked about understanding the laws and the structure and therefore understanding the rules of the game and then we went from there to look at the links between the home market and the foreign market, and look particularly at Asia. In your experience, do Australians understand the rules of the game in Asia? There are a lot of different country factors which are quite different.

Interviewee: My general comment, I think the answer is ‘no’. I think a lot of people get burnt because they think they do. You might be setting up in say Taiwan. You go through the Asian crisis and Taiwan was one of the few economies that did not get hurt. You look back and say: ‘I want to be position there’. Then what happens is you think you know, and all the locals know some big name who is about to fall over and they ‘pass the parcel’ and you are the little guy. You know this big name, you take it on [refinance] and then it all goes sour. So you are in a good economy but you do not really understand the local culture enough. You also need to know the rules and so my perception is that, particularly in Asia, given the rules about joint ventures etc, I would be much happier being a funds manager. I would prefer to take their money and invest it, rather than to lend them my money; because I am not sure, particularly in China, whether a mortgage is a mortgage and if something goes wrong can you get your money back. So my
general rule is lending of money over a 20 year period I am not so sure about that but I will take their money and invest in Australia.

Interviewer: So the country selection and the products being offered in that country are decisions that are directly linked to one another, you would tailor one to the other, and they may vary from country to country.

Interviewee: Yes, for example, I would be reasonable happy to be a banker in the United States, because the rules are fairly straightforward. One worry about the US would be its growth potential and what might happen. You can look around and wait for a while. The commercial properties in the US have serious problems and there are a lot of state and regional banks that are going to fail over. So you might, wait a year or two and find something really cheap. The rules are no problems it is the economics that is the worry. It is a combination of the legal structure and then the economics, but if you cannot pass the legal structure then forget about the economics. If you want a good example of something like that, then unfortunately it is somewhere like Argentina. Which for many years, its economy used to look exactly like Australia. We talked to some Argentinean people recently and they are trying to fix it up. They are the new opposition for the current president and they are going to be running on trying to get the standard livings of Argentina back something like it was in Australia 50 years ago. At present, it is a good economy, it has a large agriculture sector so an Australian rural bank would be interested, but the corruption involved is crazy. So why go there? If you just do not believe them and do not trust them, then just do not go there.

Interviewer: In terms of the timing of when you might expand overseas, do you think there are particularly critical factors from both an external viewpoint and an internal viewpoint? From an external viewpoint the economic cycle is obviously important and you have touched on the
economies of both the home market and the overseas market. But are there any other external factors? Also, what are the internal factors? The literature covers the external factors fairly well, but the internal factors are not covered so well. Have you got any thoughts on what might be the internal factors which would encourage you to moving forward or expand in the international market?

Interviewee: If I think I have a limited life span and I cannot do much because the competition is so intense. If I feel that I am not going to do very well in this environment or if I have got a problem such as my cost of funds are higher than everybody else because of government policies or because I am rated single A and the big guys are a AA. Then I have to look for a new market. I have to looking for a new opportunity. It may be that in my local market, my ROE [return on equity] is never going to be any good. Therefore, I am looking to do something that will boost my portfolio of companies that have an ROE that is good. I may use the local structure to actually build essentially a new business that is actually ok and it becomes the most important business. What is important for me is: can I see a local environment where my ROEs are such that I am limited and no sustainable. Then I can make a choice. My choices are: I can dress my company up and one of the big guys will take me out at a stupid price; or I can basically try and do something. It may be that because of the cycle or structure of the competition that the big guy is going to have economies of scale and I cannot compete. So it can either be a direct funding issue or they do have economies of scale and scope. That means that I cannot compete with them, I cannot get an acceptable ROE. Rather than just exiting the business and selling it, I might say: ‘how can I turn that business into something that has got a higher ROE’ and maybe I switch industries. But if I am not going to do that, I am looking for other alternatives. If you are a small building society or a small bank, you may think that you could buy a small bank in the middle of the US, the corn belts in agriculture. I think it is: how important is the prospects of the business as you go forward?
Interviewer: When looking into these new markets, do you think an Australian company should be looking towards a developed country or a developing country? Looking towards a developing country may provide more risks with greater growth potential. Looking towards a developed country may be less risky but with higher competition. Is there any more within the dynamics of this that one should consider?

Interviewee: What I would really like is a developing economy that has a good structure behind it. If I was going to pick an economy like that anywhere around the globe, I’m going to Latin America and I’m looking for a small moderate size economy that is developing and has got a really good legal structure. Chile is the obvious example. Chile used to be like Argentina and the rest, it went through this massive reform structure in the ’70s and the ’80s and it came out essentially like a Switzerland of Latin America. Now from a big banks point of view, Chile’s probably not big enough. But if you are a small niche player, Chile is big enough. I also get very nervous in a general sense of going to economies that are growing super fast. I think what you are saying is there is a trade off, not so much in competition, but structure, in terms of a good legal structure. The rules are written down, everyone knows what they are, verses growth potential. But, there are also opportunities within developed economies. There will be some regions, probably outside the capital cities, that will have growth potential. You could look at buying a US bank that is in an agricultural area. An area that is going to feed China, rather than go banking in China. That can lead you to different and unexpected places like the mid-west of the US. You do not just have to look at all the economy. If the economy is only growing 2% or 3% but, if it is large and diversified, there will be pools of profit and pools of growth that you can develop.

Interviewer: Coming back to the legal system, are there countries that you are familiar with, through your experience, where the rules can vary depending on whether or not the legal system might be dealing with a local or with a foreigner?
Interviewee: I think a lot of the Asian economies are like that. I think China certainly has that issue. Indonesia is one economy that, for an Australian point of view, should be really good. But I always feel nervous because whatever we look at a bank there, the shareholdings include a blind trust; this probably means a politician is holding part of it. Indonesia has a very bad reputation. I know they are trying to fix it, but they have a very bad reputation in terms of rules. I think typically some of those Asian economies in the past anyway have been a bit dicey

Interviewer: Do you think language is an important factor?

Interviewee: I am not sure I subscribed to the school that says if they do not speak English and not Anglo Saxon then you do not go there. If I was going to be fair to that argument, it is that if you cannot speak the language then you probably cannot understand the nuances. I think language parse is not an issue. I would have no problems with going to places like northern Italy. Northern Italy is not Italian in some ways because it is more Germanic and Swiss. Or I would be happy to go looking in the Netherlands. In that sort of environment where there is a good structure, you can get good locals. As long as there is a good well established set of laws etc. If it is a developed economy and you have identified a pool but they do not speak English, I do not think that should stop you.

Interviewer: In looking at what might be unique Australian factors, compared with looking at say United States, European or Japanese company in terms of their international expansion, one potential factor is that Australia is a very much multicultural society, as in fact is the US. In your view, if you take somebody from your Australia operation, whom you have train and develop in Australian, who is say first generation Australian but comes from an Italian background or a Vietnamese background, and you move those people into operations in those countries which is part of their heritage, is that an advantage or are their potentials for that to be a disadvantage?
Interviewee: I must admit I have not thought of that before. If I thinking about it, if the person is fluent in the local language then maybe it is an advantage because then you have someone that can speak locally, that understands the dynamics, and you can speak to them as well. The only issue that I would have is that if they are third or fourth generation they would have probably lost it. I probably would be looking at an Asianising of the Australian economy. I think we are getting a bigger, so therefore you can use that as a possible tool that would help you. I do not necessarily have a great problem with the idea that you would talk to someone in a different environment that could speak both languages. I am not sure how I would trade-off. If I use the Italian example, a northern Italian who happened to be fluent in English, would he be better than an Australian who comes from a first generation who speaks fluent Italian. I just do not know. I do not know which one would help. I think it does help to have a cosmopolitan view in terms of that. I think Australia’s been reasonably successful, believe it or not, in terms of multiculturalism. It is very positive and does allow you to have a broader perspective but beyond that I think it is hard.

Interviewer: Do you think there are other factors which are unique to Australian banks or financial services companies that companies in bigger economies may not share?

Interviewee: I am not sure if there is anything unique in terms of the culture. I think Australia is very well positioned if I look from offshore looking at Australia. What I would see is a system of legal structures that work; I see quite a multicultural environment; and I see it quite attached to Asia. If I did not want to go and play in the Asian rules, because I was not sure exactly how it worked, I could see Australia as being attractive to a small bank sitting somewhere in the middle of Europe. I think Australia could look very attractive in that sense. Whether Australia’s got anything specific to itself that is different to everyone else, I am not completely convinced about that. I must admit I have not thought a lot about that. It might mean that Australians are more inclined, and certainly the French, where I lived for four years, are more inclined, to think outside
the square a little bit more broadly because of the multicultural experiences. So not quite so: it is
either the French way or no way. There is not that sort of issue. But I am not sure that I would
rate it as one of the really big drivers in terms of what is great about Australia or what I could be
looking for.

Interviewer: We spoke earlier about joint ventures. In your experiences, would you say that joint
ventures are not desirable because you should never enter into a joint venture without an exit
strategy? Or they are only ever short term. Or the interests go in different directions.
Interviewee: I think that is probably right. I cannot give you a specific example because my
career has basically been in the Australian Treasury and the bank, and the bank has not been
keen on joint ventures. I think their argument has gone along the lines, and to me it makes
sense, that if you are going to put up the capital you want to be able to control the outcome. If
you are putting the money in, at least if you are going to fail, fail because of your own
incompetence, not because of someone else’s incompetence. I think the problem you have,
particularly up in Asia and some economies elsewhere, is the local government does not want to
grant majority shareholdings. It is really hard to use your expertise. Now if you want to get in,
again it might be one of those trade-off functions, if you want to get in to a structure that you think
is legally ok, maybe Singapore, although there are issues about that on the politics side, and the
government will not let you go in other than a 49% share, then to me that is a trade-off against
what you would like to do. You have to trade-off the growth opportunities against the fact that
you cannot completely control something. It would depend on your negotiations. I would want to
have 60% – 40%. If I only have 49% of the actual capital involved, I would want to have 60% of
the ‘this is how we do things’. I think it is true that a lot of joint ventures ultimately get unwound in
the course of time and one partner decides that they just want to go in a different direction,
unless there is a legal structure that says you cannot. I do think that if you are in a structure
where you have to have a joint venture then you do need an exit strategy. At the beginning you
think it is a great opportunity, then you start to find problems but you only have 40% of the say and not 60%: then how do you get out? I would share the view that you have got to be cautious about going in to a joint venture. Do not just go in with the view that I can sell one more x to the Chinese and then there is so much money I am going to make so I only need to be 40% of it. I just think that is very naïve.

Interviewer: In terms of starting operations in a foreign market, one can look at the scale of which you go in. You can have a greenfields commencement or you can look to do an acquisition. Do you have a particular view on those?

Interviewee: I do not have a strong view, but what I do think is you have to know the local environment. Some of the government facilities like AusTrade do actually have a great number of good local connections. Greenfields is safer and slower but you do not get much bang for your buck, because you have got to grow it. To me more important than either of those two: do you understand the legal and economic environment? Whether you do a takeover or grow it from scratch, to me it is not as important. If I had an option I would takeover something because I want to, particularly if I am the CEO of a small Australian bank, get some money back at some stage.

Interviewer: If you are looking at a takeover prospect, it can either be a friendly takeover or a market takeover. Do you have a particular view on one versus the other?

Interviewee: I do not have sufficient expertise in that area, but in terms of human dynamics I do not like hostiles. If you cannot convince people, they can do a lot of damage to your brand, take out the best people and leave. So I would always prefer to do it non-hostile because I think that is more revenue enhancing for everyone.
Interviewer: Whether you do a joint venture or an acquisition, once the new structure is settled down and you are operating, putting employees from the home market into key positions can be a critical factor. Do you have a view on that?

Interviewee: Yes it is, and I think you have got to be careful. I will use the example of Japan. My reaction about Japan, in terms of the way a few things have happened, is to me it is quite often very important to have a head person as the local and you have the drop-in person that is second-in-charge. I think that is important because you need to, in a lot of these cases depending on the culture, have a local, a face that the locals understand, recognise, can talk to, he can talk to them and so it sounds not as threatening, and that I think is very important in a culture which is not the home culture so it is a different language. We put a person in the backroom who controls the actual nuts and bolts and dollars and cents of the operation.

Interviewer: When you say the head person are you thinking of the chairman or the CEO?

Interviewee: The person that I was really thinking of was the CEO, the person who is managing the thing. The chairman would probably be local, and I would have the deputy and I would probably be able to out-vote the chairman. Parachuting someone in whose is foreign into the chairman or CEO’s role can sometimes do a lot of damage in terms of local perceptions that the organisation is not what it was, particularly if it is a takeover. You are trying to keep the brand, trying to leverage the brand and the goodwill, and you just drop someone in who is different and I think that could cause some trouble.

Interviewer: What about the appointment of the chief financial officer?

Interviewee: A CFO would be a good person to have as you home market person understanding what is going on.
INTERVIEW 9

Interviewee: When an Australian bank & financial services entity is looking to expand overseas, there is no argument – the efforts should be focused on Asia.

The experience of Australian banks in the United States has not been favourable. There have been large write-offs. Trade relations between Australia and the United States are not as strong as they are with other countries and we do not know the US market well enough. There will always be a place for a small operation in New York and/or Los Angeles, principally for treasury operations in US dollars, but there is no value-add that we can presently bring to that market.

Continental Europe is too fragmented. The United Kingdom provides better opportunities but the level of trade is not significant compared with Asia.

An Australian bank & financial services entity expanding internationally should look towards countries with which we have relationships. Selecting a country to go into should be based on three relationship building blocks –

1. strong trade flows with the country;
2. strong people migration flows; and
3. investment from that country into Australia and from Australia into that country.

Building on such relationships can give influential individuals in the other country an incentive to support our success. Otherwise they will just use you for their own benefit, like pressuring the bad customers of their local banks to refinance with you.

Interviewer: Asia is not one but many different markets.
Interviewee: That is correct, an Australian entity should do a desk-top survey, a market survey based on the trade, migration and investment statistics. At present, China, India, Japan, Singapore and Hong Kong would be my order of preference. From these countries you can service Taiwan, Indonesia and the Philippines. Tokyo, Singapore and Hong Kong are large capital and foreign exchange markets and you would have an operation in these centres for treasury purposes.

Before going overseas, there must be a strong appetite in the home office for such a venture. There must be full support from the board, head office management and the home market management. There must be a willingness to invest capital, based on a country risk assessment and a bank to bank risk assessment in the new country, and a willingness to assume the risk profile. Management in Australia need to be alert to trade finance opportunities, business migration and two way investment flow that can identify customers for the overseas operation. Infrastructure needs to be developed in Australia that will support two way services. Many Australian cities have large communities with strong links back to their country of birth. A branch in Australia located in these communities can be a valuable source of market intelligence and relationship building. Dealing with the one bank, or with related banks, in China and Australia can have many advantages for a customer who operates in both markets and reduces the risk for the bank. The skill competencies of both the staff selected for the overseas operation, as well as the Australian staff, need to be enhanced.

Australian banks cannot compete with local banks on their territory. Issues of language, loyalties and business practices are major difficulties to overcome in a foreign market.

The first step in entering a new country is to hold discussions with the Ministry of Finance and the Banking Regulator. In Asia, they will normally welcome a foreign bank establishing an operation
in their country. Commencing operations as a Representative Office can ‘test the water’ with minimal risk and provide valuable experience. The next level of expansion would be either –

- an equity shareholding in a merchant bank or a full service bank;
- or converting the Representative Office into a Branch.

However, a majority or 100% shareholding or a Branch operation is not allowed in China and a number of other countries.

A 12.5% interest is not worth the effort. You may be given one board seat and the opportunity to place some of your management into the organisation, but you will not control board policy nor executive or operational decisions. You become involved in financing businesses you do not know and you do not have the opportunity say ‘no’ when local relationships are involved. However, the regulations may change in the future and you have a much better chance of being allowed to increase your equity level above 49% if you have an established relationship with the country, the regulators and an existing merchant bank or full service bank.

Interviewer: Is it a balance between the short term returns on the investment and the long term strategic direction?

Interviewee: Yes, you have to take the best of what is available at the time and this can open opportunities. It can be very valuable to obtain a foothold and gain experience.

The regulators will allow a Branch to offer a broader range of services than a Representative Office and you can control your own destiny. Branches can be established in Singapore, Hong
Kong, Japan, Taiwan and South Korea. To establish a Branch in Seoul, South Korea, the level of capital required is in the order of around $US12M.

The competitor analysis is critical. How can you provide a better service to your customers than your competition? Asia is complex, the languages and the cultures, and they are tough negotiators – they will use you for their own purposes.

Interviewer: Is your preference for Asia associated with the growth potential in that market?

Interviewee: Yes, the growth prospects for Asia look better than for Europe or the United States at this time.

Interviewer: In terms of the timing of entry into a market, are there actions a company should take in the home market first, to ensure that it has its house in order before commencing an offshore operation?

Interviewee: You need to obtain support at all levels of senior management for the venture, particularly in relation to the allocation of capital. There will always be a need to preserve capital and to allocate capital to the areas that will provide the greatest return. However, the corporate plan should include a capital plan which allocates a certain amount of capital to area providing immediate high returns and a certain amount to areas of potential future growth.

Interviewer: Some executives believe that to be successful, you need to be a major player in a market, say a top four player in terms of market share. Do you believe that is essential for success in an overseas market?
Interviewee: To do this you have to have a wide branch network and offer competitive products. Being a top four player in an overseas market is not only not essential for success, but it is not desirable as the risks are too great. Fringe players in concentrated areas can be very successful. The overseas operation can also direct business to the Australian operation by covering both sides of the trade, migration and investment flows.

The key to success in a foreign market is relationships and building trust. Becoming directly involved in local lending without fully understanding the credit risks is very dangerous. Audited financial statements are not always available as we expect them to be in Australia and you need local knowledge.

Interviewer: Some executives believe that a common language and culture are critical to success in expanding internationally. Do you agree with this?

Interviewee: Language is not a limitation. We are inexplicably linked to Asia.

Interviewer: Do you believe that there are any factors that are unique to Australia that we should consider in this context?

Interviewee: If you look at an Australian company that has been successful internationally in any industry, it is because they have a product advantage and take that advantage to where there is a market demand.

**INTERVIEW 10**

Interviewee: The very first strategic question to be asked is: what is the market that you are going into? It is not just in terms of what it represents by way of products, by way of competition,
by way of customers, but what is the culture of the market that you are going into? The reason for that is that in the context of a bank, I think that culture is inordinately important particularly when you are transporting into that market your own capital, your own expertise. A lot about banking is part of the social fabric and as a consequence of that you really need to understand the culture that you are going into because you will add to that fabric. But a lot of what you are going to do when you land yourself in that new market is to ‘float with the stream’ and to steer, rather than to try and change the social fabric. So your number one question is: what is the culture of the market you are going into? The reason I say that is as important as it is, is just with our experiences as we launched the into the United States we also had the experience of two other markets, the United Kingdom and New Zealand and the culture in those three markets was very different and that is why it is such a strategic question.

The second question I would ask myself is: what are you actually transporting in? When you are looking to expand you are going to take something from your core domestic market and what is that which you are actually taking in there. It is not enough to just analyse a foreign acquisition, a foreign strategic investment simply on the basis of the investment arithmetic. In other words, I can buy an asset for X and it will yield Y and over the period of its life we should be able to get a shareholder return of Z. It may prove to be the case that there is a good investment return on that investment and one that is superior to what you can get in your domestic market, but if it is done devoid of asking yourself what it is that you are going to take into that market, then I think it is not being done strategically. As I go down into that a little bit further, you will export capabilities and what you are seeking to do in exporting those capabilities is to employ them in that other market. Where you have done strategically, you have answered your question about the culture of that market. You will employ those capabilities in that market and the sort of things that I think are transferable and transportable in banking and finance are:
(a) risk management (and I will come back to that);
(b) an understanding of customers; and
(c) an ability to get a higher relative share of a customer’s total business.

It is an ability to actually really deeply understand and to mine the customer base. The other thing that can be transported is a way of doing things and that will be broadly described as business processes or the discipline that you apply in your banking endeavours. It is the way in which you glue together your banks so that you have got the best of both worlds in terms of your ability to deliver services to customers at the interface and then to support it at the support service level in the most efficient possible way, so that you can actually deliver an overall net result that is satisfactory. You are asking yourself what are you transporting in because you presumably have the ‘best of breed’ practices in those areas: risk management, customer services and how it is that you would hang the business processes together so that you can actually take those in.

You inevitably take those things in through people. So you would then ask yourself the next strategic question which is: how am I going to merge people from my organisation in the domestic market with people in the local market and what are the horizons in relation to people? What is this going to mean from a people perspective both taking skills and capabilities but doing it through the vehicle of people and then how would you have the people that you put into the foreign subsidiary work with local people and bring back skills, learnings and experiences back into the home market. That then gives you your strategic framework. What you are actually asking yourself is: what do I know about the market I am going into? For my part it is as much about the culture and the fabric of that market as it is about its competitive dynamics. What am I going to put into that investment in terms of capabilities; what am I going to transfer in and am I very clear about the capabilities that I am transferring; how am I going to transfer those in? They
will invariably transfer in through the stream and through the vehicle of people and not only how am I going to transfer those in but, how I am going to make sure that if I go in through the vehicle of people, are my transfer capabilities two way. When I prove the capability of whatever I build or acquire offshore, then how can I pick up things in those new markets and how can I transfer those back in and improve the domestic business that I have got. Those would be the three central strategic questions that I would ask.

I think there is one last strategic question that I would ask and that is: how big ultimately would the foreign venture need to be so that it achieved competitiveness in its own local market? It would need to be something that, if you did take in capabilities, if you did understand the culture, that you can actually enhance. You would not buy something if you could not enhance it and achieve a superior market position. How big would it need to be to be sustainably competitive and to outperform in its local market? On the basis of that strategic question, if you did some modelling around how big it would need to be: what would that ultimately do back to your domestic organisation? As an example for an Australian company going into the United States, if you look at Australia, the aggregation of the Australian equities markets they are about 5% of the global equities markets or were when the market fallen in the Global Financial Crisis. That is just a proxy for how big the US is relative to Australia. If you were then to buy a US subsidiary and would want that US subsidiary ultimately to be of a size and degree of competitiveness in that market place, would its size, in and of itself, dwarf the domestic organisation? Would the foreign organisation then ultimately, some years down the track, be the organisation which by size started to actually control the domestic organisation. So if you want you could potentially end up with a reversed takeover of your organisation where your foreign subsidiaries were bigger than your domestic businesses. Then where would control of that organisation actually lie. The strategic question would be how big would you need the acquired or the foreign entity to be? If you were to model that out: what could the ultimate ownership control and dynamic look like for
the organisation that is actually making the foreign move or making the foreign acquisition? If you have to apply resources in that local market to grow: do you have sufficient resources back in your domestic market to grow it? Or would you have to raise capital in that local market and, if you raise capital in that local market so that you get local entity to be a size where it has a competitive position, does it ultimately, in a market that is infinitely bigger than your domestic market, become so big that you have to finally consider moving your head office, moving your share register, moving everything to support the resource required to grow the offshore subsidiary to a size where it becomes itself competitive. That is a big strategic question, even if you understand the culture of the market you are going into, even if understand the capabilities that you are putting in, even if you understand how, through the vehicle of people, you are going to transfer capabilities. At the end of the day, you become so successful in your endeavours that the offshore entity becomes dominant and successful in its local market, does its size then dictate actually where the overall organisation is run from and, as a consequence of that, may you potentially defeat your initial objective which is to find growth horizons outside of a country. Then those growth horizons are ending up themselves so successful and so big that you actually have to think about the domicile of your head office, share register and where it is that you actually run the company. I think if you look at what is happening to one Australian bank that has a strong strategic focus on East Asia, might they have to face one day listing on the Shanghai stock exchange. Might they have to one day face listing in Hong Kong because their Asian operations become so big, so successful and yet the growth dictates that to find the capital in those markets. Ultimately needing to move their head office there and needing to move their share register there. So you defend the purpose which was initially to find growth horizons that augment what you are doing in your domestic market and give you that additional pizzazz potential, that give you the sizzle in your growth, but they start out as a fledgling operation and then they become the main game and you potentially lose the control of an Australian domiciled,
Australian owned offshore entity. The offshore entity becomes so big that it becomes the main game.

Interviewer: It is not just a matter then of looking at the strategic intent for today, it is a matter of looking at the strategic intent considerably out into the future and how that might shape the direction you go in as you go along the journey then.

Interviewee: It may be the thing that dictates which market you choose to go into. As an example, if the world was an open place and you were looking for where next to go. If you chose New Zealand, and Australia is bigger than New Zealand, it might give you a growth horizon and one which ultimately, if you had 20% of that market place with the organisation that you bought or with what you acquired, it would be equivalent to a seventh State operation in Australia. But if you went and bought a bank in sunny Michigan, if you then had 20% of the Michigan market, that may well be equivalent to just about all of Australia. And if your growth horizon said, ‘I didn’t just want to be in Michigan, I wanted to be in a number of States in the United States of America’, you would surely dwarf the domestic operation. You would ultimately have to think about where you access your growth capital, your scarce growth capital and you would probably have to go to the local market for capital. If that is the case, people would want to see local boards, would want to see local control and then ultimately, say ten years hence, you have achieved superior growth by going to another market but in actual fact you have unwittingly lost ultimately control of an Australian domiciled, Australian registered organisation. So you have to ask yourself that question. The strategic question would be: are we prepared to re-domicile our head office and the place that we register this company, if we find that in our endeavours we are so successful that we start to outperform the organisations in the market that we go to and we are doing that because we are employing superior wit, intellect, product, business process, all those other things that I have talked about in terms of what are you actually going to transfer. You are successful in your original strategy but you need to continue to grow. There will come a time when you cannot fund that growth domestically. You will find that because Australia is
mathematically so small relative to the rest of the world, you are likely to have to fund that growth from offshore markets. That growth will have to come ultimately from raising share capital in those offshore market places, particularly in banking because banking is a capital intense business, notwithstanding the gearing, which will mean you will have to consider where it is you are going to actually domicile the organisation.

Interviewer: This raises a fundamental question. Is an Australian company domiciled in Australia with its head office in Australia, fundamentally disadvantaged in running a broad international company or ultimately will most international Australian companies find that they have outgrown the home market and will have to then become a domiciled company in another larger market? Or is it possible to continue to be an Australian domiciled company while running broad international operations in a number of different markets which may over time dwarf the domestic market?

Interviewee: At least in concept and theory there is no reason why you could not have an Australian based head office with a broadly based global business. You need to consider a couple of things in saying that. One of them is time zone. Interestingly, Australian is at the beginning of a day and trying to run that operation is difficult if ultimately the economic power of the world stays in North America and in Europe, but I think that is a point to debate and discuss. You would have to wonder how practical it is, and having been on the receiving end of this, to sit in a geography that is actually not the centre of the world and to run a global empire because it is inordinately difficult. You get windows of opportunity in a time zone sense that is actually not wide enough to truly run that global operation. The issue of proper work / life balance for executives arises because you would need to have people working in the Australian organisation that are prepared to work rolling shifts of 24 hours a day to cover those time zones. You would wake up in the morning at 5.00 am and you could get on the phone to New York because they would still be open; you need then need to work your domestic market once New York closed;
and then be on the phone to London at 3 or 4 o’clock in the afternoon through to 10 o’clock at night when they were open. So the normal working day for a chief executive running a global operation out of Australia would be on average 18 hours. It is just physically not possible or healthy for a person to work that continuously. But Australia has wonderful accommodation, first world technology, all of the business supports you would love to have in place in a vibrant healthy way. Yet, how practically possible is it to run a global organisation out of Sydney or Melbourne. You could move the head office to Perth to be in a better time zone but it is going to be a real challenge because you would no longer where there is a lot going on in terms of capital market activities.
APPENDIX 5
A FURTHER FIELD OF STUDY – STRATEGIC MANAGEMENT

The case analysis in this thesis identified that, according to a number of the interviewees, international business should be considered as a sub-strategy of a broader strategic framework. That is, some of the strategic goals of a bank or financial services entity may be to achieve an annual compound growth rate in cash earnings of X% and to obtain a broader spread to geographic risk. Both of these strategic goals may be achieved through international expansion. However, a number of the interviewees, in different ways, warned of the dangers of the international expansion activities, which could involve an offshore acquisition, becoming the focus of attention in their own right and there could be a loss of focus on the reasons for such action. Therefore, according to a number of the interviewees, the international expansion activity should be referred back to overall strategic goals on a regular basis. Accordingly, it is relevant to this thesis to briefly consider a further field of study: strategic management.

The discipline of strategic management gained strong attention in the 1950s and 1960s with Drucker (1954), Selznick (1957), Chandler (1962) and Ansoff (1965) making valuable contributions to the development of a strong theoretical base for this field of study. This field of study is relevant to this thesis and may have implications for the development of a clear strategic framework for a company in the banking and financial services industry. Drucker (1954) developed a theory of management based on objectives which evolved into his theory of ‘management by objectives’. His other seminal contribution was in predicting the importance of intellectual capital and the ‘knowledge worker’. He said that knowledge work is non-hierarchical and could be carried out in teams with the person most knowledgeable in the task at hand being the temporary leader. Selznick (1957) introduced the idea that a company must match the internal factors of an organisation with the external
environment. It was from this idea that the SWOT analysis was developed focusing on the strengths and weaknesses of an organisation having regard to the opportunities and threats from the business environment. Chandler (1962) originated the phrase ‘structure follows strategy’ in highlighting the importance of organising the various functions of management to work within one consistent long term strategy. It follows from this point that an organisation then sets its structure, direction and focus. Ansoff (1965) built on the work of Chandler (1962) by developing a strategy grid that compared market penetration strategies, product development strategies, market development strategies, horizontal and vertical integration, and diversification strategies. He also developed the gap analysis in which a company must understand the gap between where it is currently and where it would like to be.

Mintzberg (1988) built on the work of the 1950s and 1960s and examined the strategic process and concluded it was much more fluid and unpredictable in the 1980s. Pearce (2000) defines strategic management as ‘the set of decisions and actions that result in the formulation and implementation of plans designed to achieve a company’s objectives’. Pearce (2000) believes that strategic management comprises the following critical tasks:

- Formulate the company’s mission, including broad statements about its purpose, philosophy and goals;
- Conduct an analysis that reflects the company’s internal conditions and capabilities;
- Assess the company’s external environment, including both competitive and general contextual factors;
- Analyse the company’s options by matching its resources with the external environment;
- Identify the most desirable options by evaluating each option in light of the company’s mission;
• Select a set of long-term objectives and grand strategies that will achieve the most desirable options [outcomes];

• Develop annual objectives and short-term strategies that are compatible with the selected set of long-term objectives and grand strategies;

• Implement the strategic choices by means of budgeted resource allocations in which the matching of tasks, people, structure, technologies and reward systems is emphasised; and

• Evaluate the success of the strategic process as an input for future decision making.

Pearce (2000) sees these tasks as indicating that strategic management involves the planning, directing, organising and controlling of a company’s strategy-related decisions and actions. Pearce (2000) also sees strategy as a company’s game plan, although he did not see such game plan as precisely detailing all future developments (of people, finance and materials) but providing a framework for managerial decisions. Pearce (2000) states that a strategy reflects a company’s awareness of how, when and where it should compete; against whom it should compete; and for what purposes it should compete. A framework based on the strategic decisions of when, where, what, how and who was a central theme for this thesis.

These strategic management concepts and theoretical foundations should be considered by a bank or financial services entity considering international expansion to ensure that such expansion is positioned within a broader strategic framework designed to ensure that the organisation achieves its strategic goals.
APPENDIX 6

A FURTHER FIELD OF STUDY – STRATEGIC DECISION-MAKING PROCESS

The views of a number of the interviewees in the case analysis in this thesis emphasised the need for a disciplined strategic decision making process. Such a process in a company in the banking and financial services industry may bring together multi-disciplinary functions and teams such as strategic planning, financial budgeting and marketing.

Pearce (2000) provides additional guidance on the distinctions between strategy formulation and strategy implementation which may be relevant to a company in the banking and financial services industry. Pearce (2000) sees strategy formulation as being comprised of -

- Defining the Company’s Mission and Social Responsibilities;
- The External Environment;
- The Global Environment: Strategic Considerations for Multinational Firms;
- Environmental Forecasting;
- Internal Analysis;
- Formulating Long-Term Objectives and Grand Strategies;
- Strategic Analysis and Choice in Single or Dominant Product Businesses: Building Sustainable Competitive Advantage; and
- Strategic Analysis and Choice in the Multi-business Company: Rationalising Diversification and Building Shareholder Value.

Pearce (2000) sees strategy implementation as being comprised of -

- Implementing Strategy through Short-Term Objectives, Functional Tactics, Reward Systems and Employee Empowerment;
- Implementing Strategy through Restructuring and Reengineering the Company’s Structure, Leadership and Culture; and

- Strategic Control and Continuous Improvement.

Pearce (2000) also sees the short-term objectives and action plans guiding implementation by converting long-term objectives into short-term actions and targets. Functional tactics translate the business strategy into activities that build advantage. Policies empower operating personnel by defining guidelines for making decisions, and reward systems encourage effective results.

However, Pearce’s (2000) differentiation between strategy formulation and strategy implementation in the manner outlined above is not a universally held view. Mintzberg et al. (2003) offer a different approach to the field of strategy. Mintzberg et al. (2003) state that, unlike most others, they do not devote attention to ‘implementation’ per se. Mintzberg et al. (2003) go on to say that the assumption in other literature is that strategy is formulated and then implemented with organisational structures, control systems, and the like following obediently behind strategy. Mintzberg et al. (2003) see their approach as following reality, with formulation and implementation being intertwined as complex interactive processes in which politics, values, organisational culture, and management style determine or constrain particular strategic decisions. Strategy, structure and systems mix together in complicated ways to influence outcomes. Mintzberg et al. (2003) accept that while strategy formulation and implementation may be separated in some situations – perhaps in crises, in some totally new ventures, and in organisations facing predictable futures – these events are far from typical. Mintzberg et al. (2003) state that they do not believe in building their literature around a conceptual distinction between strategy formulation and strategy implementation.
Wheelen & Hunger (2004) appear to support the approach by Pearce (2000) and offer the systemic strategic analysis approach presented in Figure A6.1. Although Mintzberg et al. (2003) may well be correct in pointing out the dynamic interplay between strategy formulation and strategy implementation, the approach by Wheelen & Hunger (2004) outlined a comprehensive set of key strategic analysis and decisions a company in the banking and financial services industry could use in developing its corporate strategy. Failure to critically examine any one of the steps outlined by Wheelen & Hunger (2004) could result in a strategic plan that is deficient in some form.
Figure A6.1 Strategic Decision Making Process

1(a) Evaluate Current Performance Results
1(b) Examine and Evaluate the Current:
   • Mission
   • Objectives
   • Strategies
   • Policies

2 Review Corporate Governance:
   • Board of Directors
   • Top Management

3(a) Scan and Access External Environment:
   • Societal
   • Task

3(b) Analyze External Factors:
   • Opportunities
   • Threats

4(a) Scan and Assess Internal Environment:
   • Structure
   • Culture
   • Resources

4(b) Analyze Internal Factors:
   • Strengths
   • Weaknesses

5(a) Select Strategic Factors (SWOT) in Light of Current Situation

Strategy Formulation: Steps 1–6
APPENDIX 4

A FURTHER FIELD OF STUDY - ORGANISATIONAL DEVELOPMENT

In the case analysis in this thesis, several of the interviewees emphasised the importance of a bank expanding internationally reviewing its readiness position; having a stable home base on which to build and being prepared to deploy adequate resources, capital and human, to give the international venture every chance of success. This raises the issues of what stage the bank may have reached in its organisational development and its corporate life cycle. This was a key conclusion in this thesis and the model in 5.3 includes these factors as important elements in the timing of enter decision to be taken when considering international expansion.

In the literature review, when to enter an international market focused predominately on the external factors. However, for an Australian bank or financial services company, with potentially limited human and financial resources, expanding internationally at the wrong timing could be the underpinning of future failure.

Greiner (1972 & 1998) does not focus on the development of a bank or financial services company. However, his views on organisational development may be relevant to a bank or financial services company expanding internationally. Greiner (1998) believes that the influence of history on an organisation is a powerful but often overlooked force. Managers, in their haste to build companies, frequently fail to ask such critical developmental questions as - Where has our organisation been? Where is it now? and - What do the answers to these questions mean for where it is going? Greiner (1998) believes, when confronted with problems, managers fix their gaze outward on the environment and toward the future, as if more precise market projections will provide the organisation with a new identity.
Greiner (1972 & 1999) looks at organisation growth and strategic change, and developed a theory based on an understanding of what he describes as the five phases of business growth. Greiner's (1972 & 1999) theory offers some practical advice as to how companies can take steps to anticipate future crises and turn them into opportunities for future growth.

Greiner (1999) believes that a company's problems and solutions tend to change markedly as the number of employees and sales volume increase. This is the position that an Australian bank or financial services company expanding internationally hopes to achieve. Thus, time is not the only determinant of structure as companies that do not grow can retain many of the same management issues and practices over lengthy periods. Most businesses however aspire to grow, and history has thrown up what Greiner (1999) observed as an interesting phenomenon. Most growing businesses expand for two years and either retreat or stagnate for one. Yet, those that survive a crisis and evolve at a critical stage, usually enjoy four to seven years of continuous growth (Greiner 1999).

The model in Figure A7.1 illustrates the five phases of business development as defined by the Greiner (1972 & 1999) growth model. At the end of each phase the crisis point is reached which will determine the future growth of the business. Greiner states that each crisis needs to be addressed in a specific way by management as failure to successfully overcome it could undermine its very existence as outlined in Table A71. Various parallels could be made between the comments of Greiner (1972 & 1999) and the history of banking and financial services in Australia, particularly over the last twenty years.
Taking each phase of development step-by-step, Greiner (1999) considers the dominant management problems that can arise together with the management style required to achieve continuously strong growth are as follows:

A. Birth

Greiner model

The founders are usually entrepreneurial and their physical energies are absorbed entirely in making and selling the new product or service. Communications with employees is frequent and informed. Long hours are rewarded by modest salaries but high promises for the future. Control of activities comes from immediate customer feedback and fast management reaction.
Crisis

The individualistic and creative activities of the founders are essential for the company to get off the ground. But therein lies the problem.

° New employees are not motivated by the intense dedication of the original founders
° The founders long for "the good old days" still trying to act as they did in the past
° Strong, new leadership skills are required.

B. Awakening

Greiner model

Those businesses that survive the first phase through good management will only embark on further sustained growth under able and directive leadership.

A functional structure is introduced to separate marketing from production. Strong accounting and control systems are introduced.

Crisis

Although the new directive techniques channel employee energy more efficiently into growth, they eventually become inappropriate for the more diverse, complex organisation -

° Staff become more knowledgeable about the markets and products than the management
° Consequently they feel torn between following procedures and taking their own initiatives
° The organisation flounders as it establishes centralised methods while lower staff grow disenchanted and leave.

C. Growing

Greiner model

The next phase of growth evolves from the successful application of a decentralised organisation structure. Profit centres and bonuses are used to stimulate motivation.
Communication from the top is infrequent and usually non-verbal. Senior management seriously consider growth by acquisition for the first time.

Crisis

° Top executives sense they are losing control with autonomous field managers running their own show

° Hence, top management (sometimes the original founders) attempt to return to centralised management

° Management buy-outs and buy-ins are considered.

D. Maturing

Greiner model

This phase is characterised by the use of formal systems for achieving greater coordination. Formal planning procedures are established. Numerous staff are hired and located at headquarters. Share options and employee incentive packages are used to stimulate dedication and motivation.

Crisis

° A red-tape crisis is created as a lack of confidence develops

° Procedures take precedence over problem solving and innovation is dampened

° The organisation has become too large and complex to be managed through formal programs and rigid systems.

E. Established

Greiner model

The last phase establishes strong interpersonal collaboration to overcome the red-tape crisis. A more flexible and behavioural approach to management is needed through teams.
Lessons from the Greiner (1999) model

Greiner (1999) sees companies as having a series of growth phases. He distinguishes the phases by their dominant themes: creativity, direction, delegation, coordination, and collaboration. Each phase begins with a period of evolution, steady growth and stability, and ends with a revolutionary period of organisational turmoil and change. Greiner (1999) believes that the critical task for management in each revolutionary period is to find a new set of organisational practices that will become the basis for managing the next period of evolutionary growth. Those new practices eventually outlast their usefulness and lead to another period of revolution. Managers therefore experience the irony of seeing a major solution in one period become a major problem in a later period.

Greiner (1999) believes that the value of his model is that it enables an organisation to extrapolate specific situations and circumstances to a general theory to see what comes next. This is relevant for an Australian company in the banking and financial services industry engaged in international expansion.
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