

Internationalization of Bank Enterprises in New Markets:
The Case of Penetration and Expansion into Two Eastern European
Countries

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Abstract: Regarding internationalization of bank services, aspects like entry mode choices or trends and obstacles and issues like the choice of foreign market entry have been the concern of researchers. But still, we observe a number of important gaps in the literature on how the banking firms penetrate and expand in new markets. In line with the demand from the latter studies, this paper aims to examine how banks penetrate and expand in foreign markets, and further how different banks act differently in the international market.

We study how two EU banks (from the same home country) penetrate and expand into new emerging markets in Eastern European countries. The study relies on internationalization process and business network theories and presents a theoretical framework for internationalization of the firms. Following the constructs of business commitment and knowledge the analysis manifests how two firms in different stages of internationalization face opportunities and problems. The study further reveals the impact of the political actors in internationalization process and manifest how political knowledge and commitments are interrelated to the business knowledge and commitment. The outcome elaborates new discussions on how to include the political relationship into the internationalization process model. After a short discussion of studies on internationalization of bank services, the paper introduces an analytical view for presentation and analysis of our two case studies.

1. Introduction

The interest of researchers in the study of the internationalization of service business firms has shown a remarkable rise in recent times (Blomstermo *et al.*, 2006; Svensson, 2004; Anderssen, 2002). This development has become intensified because of the high increase in investment in emerging markets. The recent globalization of services is exemplified by the fact that only in 1994 the first large multilateral agreement on global trade in services was signed by 100 nations (Clark and Rajaratnam, 1999). Yet, given that more than 50% of global exchange happens in services (Knight, 1999) and over 70% of the population in OECD countries is in the service sector (Edvardsson and Modell, 1996), the literature has not been on a par with the volume and importance of the global service industry. This shortcoming is

much more intense when considering research on new emerging markets. Though, there is a serious need for the study of service firms' internationalization in new emerging markets.

In the field of service marketing, studies have appeared on the hotel industry (Gannon and Johnson, 1996), the financial industry (Grosse, 1997), retailing (Anderssen, 2002; Burt *et al.*, 2003) and on service firms' entry and expansion (Blomstermo *et al.*, 2006). Researchers in the field of banking have put their attention on aspects like market conditions for the banks within EU (Vesala, 1995), competition in the bank services (Coccorese, 1999; Hondroyiannis *et al.*, 1999) and contestability in Eastern European banking (Yildirim and Philippatos, 2007). Regarding internationalization of bank services, aspects like entry mode choices (Alvarez-Gil, *et al.*, 2003) or trends and obstacles (Samiee, 2007) and issues like the choice of foreign market entry (Blomstermo *et al.*, 2006) have been the concern of researchers. But still, as Blomstermo *et al.*, (2006) declare "..., we observe a number of important gaps in the literature"; further research on this topic is needed. Thus, research in penetration and internationalization of banking services can increase our understanding (See also Svensson (2004)). In line with the demand from the latter studies, this paper aims to examine how banks penetrate and expand in foreign markets, and further how different banks act differently in the international market.

We study how two EU banks (from the same home country) penetrate and expand into new emerging markets in Eastern European countries. The study presents a theoretical framework for the analysis of these two banks' behaviour in three Eastern European countries. We employ a network perspective to describe and analyse the entry and expansion process of the two banks. After a short discussion of studies on internationalization of bank services, the paper introduces an analytical view for presentation and analysis of our two case studies.

2. Internationalization and Service Banking Firms

When studies refer to 'the internationalization of banks' they are concerned with two related but different aspects of internationalization. The first aspect refers to the exchange in terms of import and export of banking services and transactions in foreign currency (Cardone-Riportella and Cazorla-Papis, 2001), alteration in the exchange of foreign currency, which raises questions like currency risk. The second aspect, however, is related to the strategy of banks when internationalising. Research related to this aspect is interested in factors that determine banks' entry and penetration into foreign countries, i.e., their physical expansion (see for example, Bouquet, Hebert and Delios, 2004; Blomstermo *et al.*, 2006), and the

motivation of such strategic choices (Cardone-Riportella and Cazorla-Papis, 2001). In recent years, research investigating why service companies penetrate into foreign markets and how and in which way they expand their activities has captured the attention of an increasing number of researchers (Cardone-Riportella and Cazorla-Papis, 2001; Blomstermo *et al.*, 2006).

The theoretical frameworks of these studies are mainly constructed on theories developed for industrial firms' behaviour (Capar & Kotabe, 2003, Blomstermo *et al.*, 2006; Svensson, 2004b). Unlike physical and tangible goods, however, services are defined as very often intangible and highly specific (e.g. the performance of specific legal services) and inseparable, i.e. production and consumption are completed at the same time, as when sharing and developing capabilities and experiences of client companies involving equipment, people or finance (Knight, 1999). This means that service firms cannot, like manufacturing firms, enter foreign markets through integration in local networks of suppliers and customers, making an efficient use of their world-wide resources. They mostly repeat the value chain in each country they enter (Moore and Birkinshaw, 1998), relying on wholly owned subsidiaries as the preferred entry mode (Bouquet, Hebert and Delios, 2004).

A crucial aspect differentiating internationalization of bank services from internationalization of other enterprises, like industrial products, concerns the nature of the product. Unlike many other products, a bank's products are characterized by low levels of standardization, high need for adaptations, high customer involvement in providing the service, and a need for a high volume of customers. Some services, like hotel or transportation services, are much more similar to industrial products in several of these aspects, and demand lower levels of interdependency between international customers and the company. However, in banking, most services are non-separable and intangible and their exchange requires personal adaptation and advice in face-to-face interaction (Ford, 1990, Bouquet *et al.*, 2004). This 'idiosyncrasy' is likely to affect the internationalization strategies of service companies (Erramilli and Rao, 1993; Bouquet *et al.*, 2004).

In the next section, we will propose an analytical model for studying banks' internationalization in new markets based on previous literature, most particularly the internationalization process model developed by Johanson and Vahlne (1977), which has also been used in earlier studies on the internationalization of service companies, including banks (Cardone-Riportella and Cazorla-Papis, 2001; Blomstermo *et al.*, 2006; Hadjikhani, 1996). Our study on banks' internationalization in the new markets in Eastern Europe, which opened up to investment in the 1990s, offers a unique opportunity to study internationalization

processes in a recent time frame. At the same time, this context allows us to gain insight into internationalization processes in turbulent and even risky market circumstances.

3. An Analytical View

One of the most cited models on the internationalization process of firms, by researchers of both industrial and service companies, is the Internationalization Process (IP) model developed by Johanson and Vahlne (1977, 1990). Following prior studies on internationalization of banks and service companies (Cardone-Riportella and Cazorla-Papis, 2001; Blomstermo *et al.*, 2006; Hadjikhani, 1996), we base our model on the IP model, particularly on the idea that firms reduce risks in new markets through building up their local presence gradually. According to the IP model, firms start to expand into markets with similar circumstances (culture, language, business climate, political system etc.) to those they know from their home market and only gradually learn to deal with more different and more complex market circumstances (Johanson and Vahlne, 1977). Firms are also found to start their expansion in each new market first through exporting irregularly, then through a local agent. Because the original IP model was based on observations of manufacturing firms, Cardone-Riportella and Cazorla-Papis (2001) propose the following gradual steps to be more relevant for banks' internationalization process: from export to contract alliances, then partial ownership in a foreign bank and finally a wholly owned banking subsidiary.

The rapid changes that firms experience in today's globalized market environment challenge the IP's view on the gradual building up of experiential knowledge and the need to reduce risks in new entries (Oviatt and McDougall, 1994). It is often too costly for firms to wait and gain experience before entering and expanding in foreign markets. In today's business world, firms successfully expand in foreign markets even without or with very little prior experience. One explanation for this behaviour is that firms can use other foreign investors' or local firms' market knowledge to penetrate and expand in the foreign market (e.g. Forsgren, 2002). Others point to the importance of connections in supporting market entry (Ellis, 1995) and a fast international expansion, sometimes even within a few years after foundation (Oviatt and McDougall, 1994). As a consequence of these new trends in globalization, the IP model gains explanatory value from adding network relationships to study the penetration and expansion of firms.

In this paper we base our analysis on the IP model but we integrate views on how firms' network positions influence their internationalization strategies, particularly with reference to

the study by Johanson and Mattsson, (1988). In the theoretical frame of this study, the internationalization process model becomes interrelated to the strategy of firms.

In order to understand the degree of internationalization, researchers like Johanson and Mattsson (1988) connect the differences in the firms' internationalization behaviour to the degree of internationalization of the market (see Figure 1 below). Following this path the theoretical view in this paper connects the behaviour of the firms to the behaviour of the market (the behaviour of other firms). The decision of a service firm to enter or/and expand in a foreign market is related to the behaviour of other firms. In terms of network, the firms' market development is connected to the firms' position. The position is determined by the firm's market assets for penetration and expansion. These assets differ between the firms because of their available resources and knowledge. At the same time, the position of other firms is also constructed on their markets assets, relying on their resources and knowledge. While penetration into a new market is the development of a new position in the market, expansion is the commitment of further resources for strengthening the market position. Because of the heterogeneity of these assets, firms act differently. Some firms enter earlier than others and face conditions which are different from those faced by firms which enter later.

		Degree of Internationalization of Market	
		Low	High
Degree of Internationalization of Firm	Low	(1) The Early Starter	(3) The Later Starter
	High	(2) The Lonely International	(4) The International Among Others

Figure 1: A two-dimensional typology of internationalization strategies of firms

The connection between the degree of firms' internationalization and the degree of internationalizations of other firms in the market can aid the understanding of why firms gain opportunities or problems when they enter or expand in foreign markets. The combination of the degree of firm's internationalization with the degree of internationalization of other firms, as illustrated in Figure 1, describes four different situations. Following the study of Johanson

and Mattsson (1988) which has already been examined by several researchers in recent years, the theoretical frame of this paper contains these four different conditions. These conditions consider the processes of bank penetration and expansion. These processes take on different patterns depending on the situation in which firms are positioned. Though, the process of internationalization for a banking enterprise depends on the degree of the firm's internationalization which can be low or high, and also the degree of internationalization of other firms in the market which can be low or high (see Johanson and Mattsson, 1998).

Figure 1 above explains not only the fact that firms in their internationalization process may have different positions because of their market commitment and knowledge, but also depicts that their position is directly related to the position of other firms in the market. Though, the position of the banking firms is related to the degree of the firm's own knowledge and commitment and also that of other firms. That is to say that the firm's position in the network is related to what they want to do and have already done and also to the activities of others in the network. In order to differentiate position and behaviour, a simple discussion is presented of the four situations, which follows the study of Johanson and Mattsson (1988) and other recent studies in this area of research. These four conditions are 1) The early starter, 2) The lonely international, 3) The later starter, 4) The international among others.

The Early Starter (1): In this situation, the firm and also its competitors have very little knowledge about the foreign market. As the level of uncertainty is high, the firm does not want to enter into the market or add commitments. In the IP model, the firm handles this uncertainty with penetration into neighbouring countries as it needs low knowledge and has low psychic distance, low levels of commitments and product adaptation. In terms of network, firms in this situation can manage the uncertainty also by cooperation with local firms having market knowledge. The banking enterprise, with lack of sufficient knowledge and the strategy of being close to the customers, may require co-opting or cooperative strategies with agents (Thompson, 1967). The strategy of using agents or other local capabilities, for example, is vital to come closer to the buyers and to extend the delivery capabilities.

For the starter firms, the decision for internationalization is taken by the firms themselves or by their counterparts. No matter which alternative, the counterpart in the local market increases the firm's capability in solving different known and unknown problems. In other words, the early starters' market position and development is related to the position of the counterpart in the local business network. In the case when the counterpart has a good

market position, like being strong in distribution or financial connection to others in the local market, the starter firms can gain opportunity in filling the market holes (Ghauri, Hadjikhani and Johanson, 2006). One crucial aspect in banking enterprises is the nature of services which are more or less standardized and the large numbers of customers.

The counterpart in the local country may demand an increase in investments or more engagement in a specific type of banking services which lay the ground for the next phases in the firm's market commitment, and which strengthen the position of the banking firm. On the other hand, the more or less standardized nature of banking services can generate obstacles. It makes competitors follow the starter and enter into the market. The main commitment of the early starter firms is to build and maintain relationships with strongly positioned market actors. Therefore, the subsequent action is to commit resources also for generation of relationship trust. It is their aim to avoid competition and have a dominant position in the market. As the process develops, the situation of the firm changes to condition 2; i.e., the firm becomes highly international.

The Lonely International (2): In situation 2, as Johanson and Mattsson (1988) explain, the firm is highly internationalized but its market environment is not. The firm has made a large market commitment in foreign countries and has extended its market activities but the competitors are far from this stage. In this situation, the firm has market knowledge and has experience of where and in what they have to invest. More important for international bank enterprises is the relationship experience with different market actors. In order to increase commitment, they have to handle more complex issues, like acting directly with the foreign market actors and understanding different local institutions and cultural differences. Since financial products, unlike industrial products, are specific, their position of being alone depends on how they can manage the financial network in the local market. This interdependency is accommodated with the advantage of being less dependent on altering the products. The strong position of the firm in the network is helped by the ability to refer to products which do not need a high level of adaptation. Positioning in the market relies on enterprise capacity and good market knowledge to integrate others into its network rapidly. Though, the timing of building and maintaining the relationship and network is vital in penetration and expansion.

One crucial aspect in this situation is the level of resource input to stay alone in the market. These resources are for making adjustments in both quality and quantity. Because of the nature of the product exchanged in the bank industry, adjustment speed is a vital issue.

The low level of product complexity can easily open the doors for competitors and push the firm to situation 4. Naturally, the firm's resources are related to the size of the firm. Highly internationalised firms have access to resources and also capability for development of new services in several countries. Local partners may also see the enterprise's ties and relationships in other foreign countries as an opportunity to extend their own market activities. As the international banks can extend their operation in different countries, the customers or local partners in each market may speed up their own internationalization. Bank enterprises can sometimes function as a bridge to connect local customers or partners to other networks of relationships. These will consequently strengthen the ties between the local partners and extend the advantages of being alone in the market.

The Later Starter (3): Situation 3 refers to a condition where the market is very internationalised but the firm itself is not. In other words, different bank enterprises are internationalized and have established business networks in foreign countries, but the focal firm starts to internationalise. Internationalization of firms delivering similar service products and competition are high. Late starter firms can be pulled along by their partners or even can mimic their behaviour. Firms may observe how other banks have penetrated and expanded their behaviour in foreign countries and decide to act like them. They may even resort to other networks and use them as bridges to penetrate into the highly internationalized market.

One determinant factor in the decision for the late starter is their assets. Shortcomings in knowledge and resources to commit in uncertain markets are decisive. The decision to penetrate and expand requires the firm to undertake risk and commit resource to build new 'second hand' relationships. Local enterprises with high assets and market capability are already busy with relationships with early starters or with banks which are alone. As the market is already occupied by competitors with a tightly structured network, the market share of the later starter can not be high. Integration of other networks with high costs is, for example, a means to gain access to the tight relationship and create a profitable position.

The later starters' knowledge on current market condition may force them to diversify the products and avoid the competition with strong ties in the market. The dilemma, however, lies in the nature of the banking enterprises' products. Low level of complexity and adaptations contains two characteristics of later starters. On one hand, the nature of bank services, compared to industrial products, makes it difficult to avoid competition with other networks, specifically with local enterprises and those alone in the markets. On the other hand, the nature of products, unlike industrial products, can give opportunity for development

of diversified products and relationships different from the early starters. Specialization of bank services can aid the later starter in their establishment. International banks offering standardized service products contain high risks. Later starters may, in conditions of crisis, take the risk to stay in the market and take opportunities from early and lonely starters who leave the market. The later starter can, for example, change their situation (from situation 3 to situation 1) and become an early starter when all competitors have left the local business relationship. Firms can take over the competitors' relationships (Hadjikhani, 1996).

Later starters have a disadvantage in terms of the shortcomings in knowledge. Further, it is difficult for these banks to build a position in highly structured international networks. Highly tight structures can make the business less profitable for the later comers. The competitors can use all legal and market means to prevent later starters gaining a position in the market. The competitive tools of late comers include high level of investment for adaptation and changing the service nature. A very tight structure forces firms into the development of specialized products to avoid high levels of competition.

International among others (4): The situation arises when both the firm and the market are highly internationalized. A globalized and highly internationalized bank can easily move from one country to another. The changes in the firm are marginal as the firm has the experiential knowledge and also the assets to enter into new markets. Further, a standardized bank service can probably help such a movement. The main and fundamental obstruction, similar to condition 3, is the level of risk taking as the products have financial natures.

A firm can use its knowledge and position in one market to gain a position in another. In this vein, the bridging requires a kind of international coordination and that makes the parts interdependent. The knowledge and experience from other markets can speed up the agency phase and deliver further market commitment. International bank enterprises, because of the nature of their products, can increase their commitments internationally more easily than is possible for industrial firms. Diffusion of new and specific service and coordination between different international units happens at a higher speed. Internationalization in banking enterprises, on the other hand, consists of other aspects that can hinder this speed. Aspects like political or economic risks or crises, for example, can rapidly affect the financial assets of the firm. On the other hand, the banks can spread their risk in different countries with different conditions. Unlike the other 3 situations, firms can even out the risks in one market with progress in another.

In this situation, bank enterprises similar to any other businesses, are predominantly confronted with high levels of competition. In order to strengthen their market position, issues like size of the firms and specificity in the service products are vital. However, major position changes are reached by joint actions with others, acquisition and mergers.

4. Method

In order to understand the questions of how bank enterprises internationalize and how different bank enterprises enter and expand in foreign countries, a theoretical frame was presented. This view is constructed on the business network and connects the internalization processes (Johanson and Vahlne, 1999), with the degree of the firm's and the market's internationalization (see for example, Johanson and Mattsson, 1988). The detailed theoretical view will be used in the coming sections to describe and analyse the two empirical case studies.

We have selected two banks from the same EU market¹ that are both confronted with a saturated home market and that have started to internationalise more extensively during the 1990s. Both banks have started activities in Eastern Europe as part of this increased internationalization strategy, yet they have done so in different time periods. The first bank, we call it 'Penta', started to invest in Eastern Europe shortly after these markets opened up for foreign investment. The other bank, 'Kappa', started its activities in the second half of the 1990s.

We have collected our data through interviews with managers of the banks and also studying publicly-available resources such as annual reports, press releases and articles published by third parties in printed or electronic form. For the interviews, we selected managers from the banks' headquarter offices in the domestic markets, as well as (former) General and Marketing managers in several of the Eastern European offices of Penta and Kappa. The semi-structured interviews were based on a few main topics of interest, largely following the historical development of the banks' overall or local market entry strategy in Eastern Europe. For each case, more than 10 interviews were conducted. They lasted between 60 and 90 minutes and were all taped and fully transcribed before being written into concise case histories. We analysed the cases first separately, after which we compared the resulting

¹ The banks did not want to disclose their names, and we have therefore guaranteed their anonymity by using fictitious names in presenting them. We also provide a minimum level of information that might help to disclose the identity of the banks, such as exact years and countries of entry, levels of market share and the domestic market.

patterns in a cross-case analysis. Below, we will first present the case material and then continue to provide our analysis.

5. Two banks' internationalization strategies in Eastern Europe.

Penta Bank (The Case 1)

Penta's roots go back to 18th century insurance cooperatives protecting people from certain communities or professions against bad fortune. The first international activities of Penta date back to 18th and 19th century insurance initiatives. Penta Bank has two main divisions, banking and insurance, which historically developed separately, each growing through mergers and acquisitions until they merged in the 1990s and founded the bank in its present form. The insurance division made its first foreign acquisition as early as 1977, whereas the banking division started its international expansion in the 1990s, after the large merger. Penta's first foreign steps were in European markets and the United States, but currently it is also present in South America and Asia.

The Exploration Stage (The First Phase)

As soon as the Berlin Wall was taken down and along with it the communist regimes in the former Comecon markets, a top manager with experiences in emerging markets elsewhere in the world coined the idea, and heavily sponsored it, to 'jump on the opportunities' in these new ("virgin white") markets. At home, the Penta Bank was confronted with a saturated market, which urged management to look across national borders for expansion. According to Western standards, the Eastern European countries lacked a sound financial industry, so there seemed to be ample opportunities to be part of developing one. Further, the observation that many foreign companies, among which were the bank's clients, were investigating opportunities to invest in Eastern Europe and could use the support of a Western bank in doing so, increased the attraction of the expansion idea. The bank therefore decided to take their chances and become one of the first investors in Eastern Europe. By 1991, both the banking and the insurance divisions had opened representative offices in Czechoslovakia (soon two separate markets, thus two offices), Hungary and Poland, and would soon enter more markets in the region (including Romania, Bulgaria, Russia and Ukraine).

All markets were entered with a Greenfield strategy: renting an office in the local capital and simply starting activities. In the beginning, the wholesale office in Poland for example was nothing more than two people operating from their hotel room, but gradually it grew larger. After office space, the first managers needed to organize a banking license for the

respective markets. Such a license would allow the bank to undertake all banking activities locally, though preferably under the responsibility of its own headquarters (so not under the stricter control of the local National Banks), and with access to the company's funds².

Penetration Stage (The Second Phase)

To get such a license, the bank hired local persons with strong connections to the local financial-institutional network. In the Czech wholesale office, the first local man was hired because he had the right contacts at the Central Bank, and the license (and many other things) was organized swiftly. The fact that good connections with the Central Bank were important is demonstrated in the experience of a new expatriate manager. He had a meeting with the director of the Central Bank, who told him: "I know you have your headquarters in [the home country], but in this country I am your boss". In Poland, the bank has benefited from the authorities' inexperience: it received an office license shortly after requesting one. According to the new Polish Banking Act from 1989, foreign banks received a license if they fulfilled two requirements: to bring in a minimum starting capital of 5 million ECU, and to have at least one Polish citizen on the Managing Board. Foreign banks were exempted from paying corporation tax for three years and could fully repatriate their profits. Penta's actions had been well-timed: between the end of 1992 and the middle of 1994, no new licenses were given at all. And after 1994, licenses came with an extra 'cost': banks were required to provide services for the Polish government³ or support a local bank threatened by bankruptcy.

When the authorities further realized that the license they gave allowed the bank to withdraw from control by the National Bank, they decided to give banks which invested later only permission for a subsidiary (a freestanding local entity, which was therefore subject to local regulations and control). Penta's easily achieved license for a branch office in Poland was obviously the result of its early entry. The bank's first mover advantages in this and other markets further resulted in honorary jobs carried out by members of the local Management Boards, like chair of the home country Chamber of Commerce in one market and chair of the Union of Insurance Companies in another, all illustrating the well-embedded connections with the local governments. From the beginning of their presence in Eastern Europe, managers from both the banking and the insurance divisions have also had an active advice function to

² The insurance division also followed a Greenfield strategy, but in contrast to the wholesale office, it established local subsidiaries that *are* susceptible to local regulations and control. The wholesale offices in Hungary and Russia are subsidiaries as well, because local law required that.

³ Dresdner Bank for instance, had put much effort into negotiations on Poland's external debt reconciliation and was 'rewarded' for that service with a license (Konopielko, 1999).***not in refs

the respective governments, who consulted them for their expertise on financial institutions, like fiscal systems and laws. The bank has also undertaken joint lobbies, in cooperation with competing banks, in order to influence governmental decisions about financial institutions and regulations. Further, aware of the importance of market growth and local employment for the respective governments, the bank designed strategies that would be favourable to local development. Also in other ways Penta shows its commitment: “whenever the local government organizes something, [Penta] is often one of the first to join”.

In terms of products, all offices started simply. The insurance division started with one basic product, a life insurance, much simpler than the extensive portfolio available to consumers in the domestic market. For the distribution, local intermediaries were hired who worked on commission. Since the bank was the first to offer such products, their intermediaries could sell to everyone, starting with their circles of family and friends, and sales therefore boomed. For the banking offices, the strategy was first directed at serving large multinational companies, not only existing clients with whom they had long lasting relationships (these relationships go back 35 years on average), but also new clients - large multinationals that were attracted to the bank’s early and extended network of offices in the Eastern European region. Without this early network position, the bank would not have been able to attract such large clients, particularly the American multinational corporations that it has served since then.

As a second step, the bank made a choice between either offering more sophisticated product packages on the market, or extending to other client groups, like local companies. Which choice was made and when was dependent on the developments in the local market (e.g. the level of competition, saturation, institutional development, economic development, assessed level of risk). When the market situation allowed it, Penta offered up its full product range as developed for Western markets. In doing so, the bank’s managers were often confronted with the limitations set by local regulations and officials who would say: “Sure you can do this [introduce a certain product], but there is a penalty to it”. If the choice was to start serving local companies, a higher level of investment was required, because the bank felt that staff had to be present throughout the country for such localized service, implying the need to build up a network of offices. In Poland, for instance, the bank was confronted with a decreasing growth of returns and opportunities to expand in the segment of large multinationals stalled, partly due to the fact that competitors also focusing on these clients had entered the market now. Figure 2 is a simple illustration of Penta’s relationships at this stage.

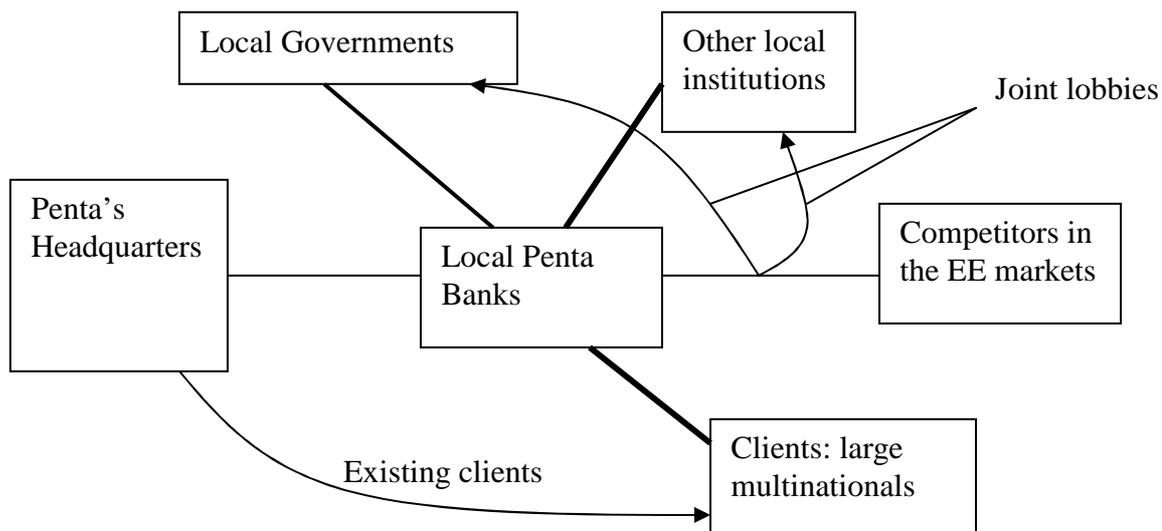


Figure 2: *Penta's Relationships in the Penetration Stage*

Expansion Stage (The Third Phase)

To cope with these problems, Penta decided to expand in Poland through serving local clients and acquired a significant stake in a local, formerly state owned bank, with around 300 offices. Gradually, the bank extended its shares in this bank and later merged its Greenfield office with this local bank. The accounts inherited through the acquisition were not in growth industries (under the planned economic system, banks were appointed to serve certain industries) and a refocus on industries with more financial opportunities was needed. In a third stage of expansion, the Polish office, now merged with the acquisition, started to develop retail products for private customers. This development, to also focus on private households, happened not earlier than ten years after the first entry, because only then the bank judged local welfare to have increased to such levels as to justify the large commitment needed for retail banking. By 2004, Penta's Polish bank was one of the country's largest and possessed a market share of around 6%.

The insurance offices have also flourished for a long time on the original Greenfield formula, with a single basic product. After a few years however, also in this branch competition from foreign and local competitors had increased to such a level that Penta needed to reconsider its strategy. In this part of the bank, this resulted mostly in extending the product offerings, adding for instance more complicated and commitment-demanding products such as pensions programs. Which new products were offered depended on the level of development of the market (and the welfare of its inhabitants) and on local rules and regulations. For instance in one country, Penta would be allowed to sell certain products through existing intermediaries, but in other countries regulations and laws demanded more

complex organizational constructions. In those countries, the solution for the distribution of such products was found in the support of Penta's local banking office.

In the experience of the insurance division, Hungary is the frontrunner in terms of business environment: "in Hungary one could sense a feeling for business, which was far from present in other countries". The Hungarian office has therefore often been the one to introduce a certain practice or product first (examples are the way to set up the distribution channel, mortgage products and insurance products linked to the Euro), which is then rolled out in other markets as well. Also in other ways the older offices support new activities, like in case of the recent (after 2000) expansion into retail banking aimed at private households in several markets. Whereas these activities are started up from the banking channel in Poland as described above, using the acquired extensive network of offices, in other markets it is the local insurance office that supports the establishment of new Greenfields for retail banking, because these often have more extensive networks than the local banks have in this market segment.

The Eastern European offices of Penta are well connected to each other. Despite the large differences related to differences in local laws and regulations, overall the strategies (products, client groups, Greenfield strategy, and distribution system) are the same. Offices that were started later have learned from the first movers: the Romanian insurance office reached break-even in three years instead of the seven years needed in Hungary, because it could build on the systems and experiences developed there. The company as a whole has also learned from the experiences of the Eastern European offices: Western European units have copied Human Resource practices developed in Czechia *****should this be Czechoslovakia or the Czech Republic?** and Hungary. The highly competitive situation for quality personnel forced these offices to develop sophisticated practices for recruitment and selection as well as training programs for the sales force. Less well-developed are the connections between the two divisions, banking and insurance. This lack of connection unfortunately translates into missing business opportunities: insurance managers would like to use banking offices' business networks for selling insurance or pension packages, but so far this "corporate gateway" has not been exploited to the full. In conclusion, all managers of the bank emphasize the great success of the bank's first mover entry into the region. The bank continuously investigates options for further expansion, into new product and client segments as well as new countries. A simple illustration of the relationships is exhibited in Figure 3 below.

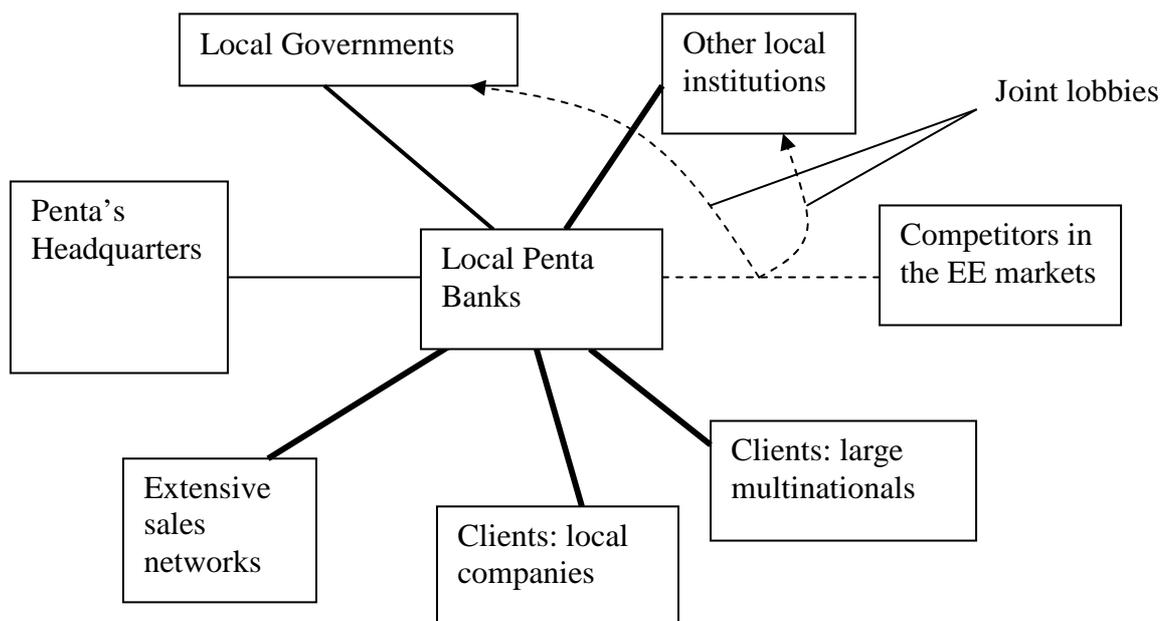


Figure 3: *Penta's Relationships in the Expansion Stage*

Kappa Bank (The Case 2)

Kappa Bank has its roots in agricultural banking cooperatives dating back to the end of the nineteenth century. Its focus has long been on the domestic market, but in the 1970s it carefully started to explore opportunities abroad, with joint ventures with another EU bank and with an American bank. In the 1980s, Kappa made its first acquisition in a neighbouring country, but underestimated the complexity of making a foreign acquisition and failed. Headquarter managers state that the company lacked strategic focus at the time as well. Since the 1980s, however, Kappa carefully internationalized taking small investment steps, from using a local agent, to setting up small activities under its own ownership and then acquiring a local bank if the opportunity existed. From the 1990s onwards, this expansion accelerated and Kappa Bank currently has successful establishments on five continents.

Kappa has decided to build on its roots and focuses on the agricultural and related industries, a strategic choice that determines Kappa's markets of interest, clients served and products offered. Although retail banking is the main activity of Kappa in its domestic market, retail activities abroad have always been supportive of wholesale. Only recently, after successful experience in two foreign markets, headquarters decided that retail should become more important in the future also in foreign subsidiaries, bringing in up to 40% of the profits.

Exploring opportunities (The First Phase)

The opening up of Eastern Europe coincided with Kappa's accelerated internationalization throughout the 1990s. Several countries in this region had extensive agricultural sectors so Kappa carefully started to study the opportunities in these markets. The bank specifically investigated markets with options for large and growing sales volumes, paying particular attention to markets that their large international clients entered. Other important factors to study for each new market were the relevant local parties (companies, institutions) from the bank's perspective, the legal and fiscal climate, and the political stability. In order to collect this information, managers talked to colleagues in other banks, lawyers, fiscal and other experts and the Central Bank both domestically and locally and started discussing the opportunities for Kappa in the respective markets. Around 1997, Kappa entered four selected Eastern European markets with a representative office⁴: Hungary, Poland, Russia and Ukraine. Headquarters optimistically expected to be able to open more new subsidiaries in the years following.

The bank expected to have an advantage over local players because they could offer higher standards on all aspects of banking activities: higher service levels, better products and services, better process control and more advanced systems for relationship management. Another competitive advantage, particularly in comparison to foreign competitors, would be Kappa's niche strategy, to mainly focus on the agricultural sector and related industries, and the bank's long held expertise in this sector. Despite these competitive advantages, Kappa did not expect fast and large profits. Kappa preferred to start carefully and to learn through direct experience about the Eastern European markets and their opportunities in the agricultural sector, as was its proven strategy in other foreign markets. That is why the bank started with Greenfield offices, which take much more time to become profitable than acquiring a local bank at once. The bank had patience however: "sure, the growth years [of the transition economies, halfway through the 1990s] offered many opportunities, but in order to survive in emerging markets on a long term, one needs to have patience", one manager remarked.

Penetration Stage (The Second Phase)

The first aims of the local offices were to legalize banking activities and apply for a license from the local governments. Further, local people had to develop a portfolio of local clients in

⁴ Kappa prefers to start up activities as a branch because of the fiscal and legal advantages as compared to the more locally committed subsidiary, but this is not possible in most of the Eastern European markets. The bank has used different strategies in the different markets to deal with these restrictions. The respective solutions in Poland and Russia will be treated in this text.

each market besides its first international clients, because “one cannot maintain an office merely for giving loans to existing clients”. The bank’s headquarters felt this was particularly important because many of Kappa’s foreign competitors had also been attracted by the growing potential of the Eastern European markets. In order to reach the important local parties in each market, the activities were started up by an expatriate manager, who teamed up with one or more local people as soon as possible. One respondent explains: “It is important to know ‘the right people’ in Russia. We bought a network by hiring good local employees, who are known to understand ‘the Russian way of doing business’ and who had the required contacts in the local market”. Local employees therefore were hired to provide the bank with their useful connections in both local business and government institutions, supporting the bank’s legitimacy and business opportunities, but they were also valued for their knowledge about the local culture and business practices. The expatriate managers in the respective countries had to train local personnel and transfer their knowledge with regard to the bank’s products, how to service clients and risk and relationship management.

Kappa could not use its preferred entry strategy of a branch office everywhere. The Polish government for instance, after its open license policy up till 1992 and its license stop until the middle of 1994, had become wiser and demanded that Kappa established a local legal entity that would report to the Polish Central Bank. Government further appeared unwilling to provide a new banking license to Kappa but instead suggested the bank should buy one of its formerly state owned banks. The bank declined this offer because the state owned banks were judged to possess bad credit and to be badly managed⁵. It was clear, however, that in order to achieve a license, an acquisition should be the way, as “in that period [around 1996-1997] most foreign banks had to buy their license”. Kappa was able to acquire a 50% share in a young bank, set up by a former Polish Trade Minister in the early 1990s, with a focus on the agricultural sector. With this acquisition (the rest of the shares were acquired a few years later) the bank received its license, as well as an established pool of knowledgeable local employees. Furthermore, the “old boys’ network” of the local manager who headed the acquired bank has proven very valuable: “as an expatriate you will never build such useful local networks as important local persons have”. Although the acquired bank’s main activities were in the right sector, it had also developed other, widely diverse,

⁵ In 1996, 24 of the 81 commercial banks in Poland were owned by the state, whereas already almost half of the 57 privately owned banks were in foreign hands (Miani and Sagan, 2006) *****not in refs.** With the number of banks declining (to 57 in 2004) and the number of banks under foreign control increasing (to 41 in 2004, meaning 71%, Miani and Sagan, 2006) competition among foreign investors rose heavily, and with the most interesting acquisition targets, whether state owned or not, being bought first, late investors’ choices became less and less attractive.

activities. Kappa first needed to restructure this bank, including cutting clients and activities and laying off personnel as well. It therefore took a few years for Kappa's Polish office to show growth figures. In 2004 the Polish office employed 55 people and that number was growing, though its total market share in Poland lies below 1%. Kappa nevertheless emphasizes its success, pointing at higher market shares (some over 50%) in its industries of interest.

In Russia, Kappa has not yet succeeded in setting up a banking office, with the required license. Because of the very complex Russian legislation and the dominant role of government in business, Kappa decided to start with a financing company instead which they thought would be easier to organize than a banking office. The financing company, set up in 1997 by three people, indeed received a license as soon as 1998. Kappa applied for a banking license as well but by 2004 still did not have one. Starting late was difficult according to Kappa: a few years earlier it was possible to take larger steps and penetrate the market faster, but in the years around the rouble crisis (August 1998) one had to take more care. The bank nevertheless stayed in Russia, because of the market's enormous potential in the long term. Between 1998 and 2004, the Russian office grew from 20 to about 40 employees.

The first exploratory activities made Kappa decide to withdraw from both Hungary and Ukraine. Although Hungary was judged by headquarters to be the most advanced market, this also meant it had passed the first aggressive growth stage with decreasing business opportunities and margins as a result. Further, the volume in the focused sector appeared unsatisfactory in this market with only 10 million inhabitants. Ukraine looked much more interesting when it came to volume; Kappa entered this market with support of the European Bank for Reconstruction and Development (EBRD), however the high level of political risk made the bank reluctant to proceed.

In order to influence and support the development of a sound financial sector in the countries Kappa entered, the bank joined the lobbies of international players united in, for instance, the European Business Club, Bank Associations in the host countries and European Chambers of Commerce to advise local governments on legal and fiscal issues. These connections have also provided a source of information to help interpret information and legislation and to find one's way in the institutions one has to deal with.

Kappa's client base has from the beginning contained both international clients as well as local firms, also small and medium sized firms. The bank explicitly viewed local clients as an important target group: "we are here to reach Russian clients" as an interviewee from the Russian office stated. Yet, another manager of the bank stated that great care was taken in

dealing with local clients, especially in Russia with its bad reputation and mafia stories: “you don’t want to burn your fingers with the wrong counterparts”. In Poland the bank first focused on reaching farmers and small companies and extended to larger local corporations later. Today, these larger Polish companies have become international players themselves. To simplify the relationships discussed above, a simple illustration is exhibited in Figure 4.

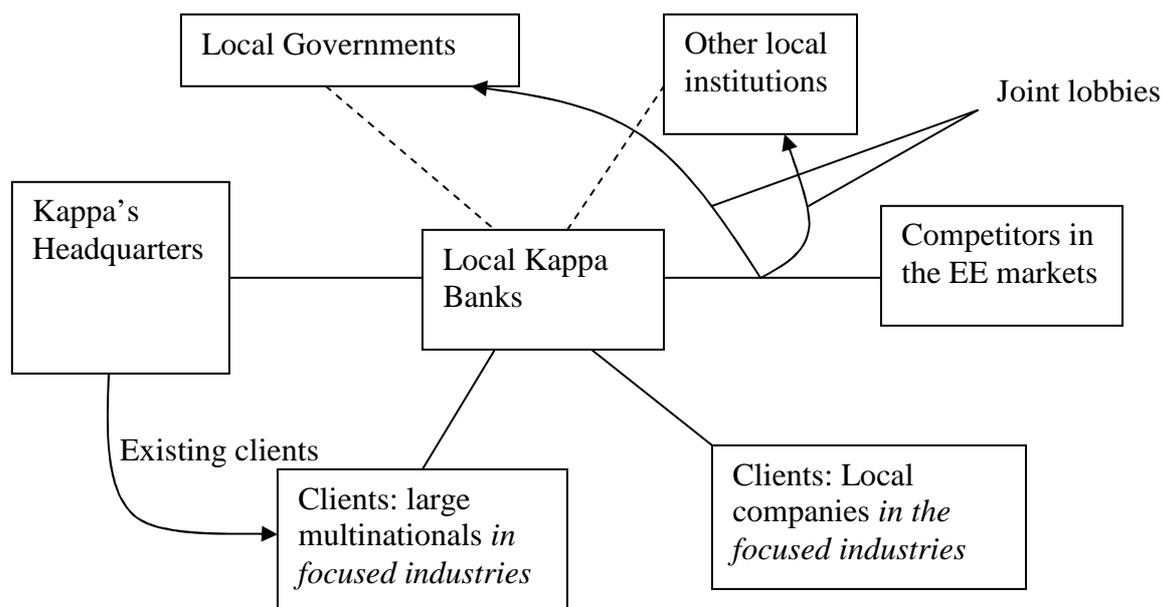


Figure 4: *Kappa's Relationships in the Penetration Stage*

Expansion Phase (The Third Phase)

The progress of the Eastern European markets and the increasing competition among foreign banks made all players more careful in exchanging information. The connections with other foreign banks became of less importance for the expansion of Kappa’s experiences. A manager of the Polish office, asked about its current connections with other banks commented: “it does not hurt us [to keep these connections] but they are not very important to us”. Also for the Russian office, the frequency and intensity of these contacts have been reduced since “there are not so many big issues anymore in Russia” as compared to the “serious problems that arose during the crisis” when joint lobbies and intensive contact with the Russian government institutions were extremely important.

Kappa describes its expansion mainly as a process of adding clients and products. In each market, the bank started with general and simple banking products like paying systems, money transfers, currency exchanges or funding. Together with their (local) clients, Kappa developed and extended its product offerings in the Eastern European offices. The Polish

office for instance supported an international client that was confronted with local pressures to extend the terms of payment beyond the company's restrictions (from three to six months). The client's office could not cope with that demand and Kappa decided to take over the payment, and therefore also the risks of non-payment. This product was later offered to more clients and in more offices. In the case of Russia the office in principle supported clients with working capital, but in practice their activities were to finance trade: buying and selling goods. The background to these activities was of course to provide the clients with financial working capital, but for that the bank would have needed to apply for a banking license and to comply with the extensive legislative and reporting demands of the Russian Central bank. For trading money to goods no banking license was needed. An extra challenge for the Russian office was to manage the resulting supplies of goods; to store them, secure and insure them, etcetera.

With the development of the local economies and legal and fiscal institutions, Kappa extended its product offerings even more, to include for instance leasing products. In Russia for instance, an international client asked Kappa to participate in a leasing company to support its small local suppliers, increasing the product quality of Kappa's client. Leasing products have also been widely introduced in other countries. Kappa expects its product offerings to look more and more like its domestic portfolio with the development of the Eastern European markets, most notably the joining of the European Union of some of them. For further expansion, Kappa plans to focus on retail banking for private clients, yet still in the agricultural sector. Particularly the Polish office is starting up these activities. However, also in Russia Kappa explores opportunities for starting up retail activities. The bank further considers using its existing successful offices as 'hubs' for starting up activities in more markets in the region. Figure 5 provides a simple illustration of Kappa's relationship with actors in its environment.

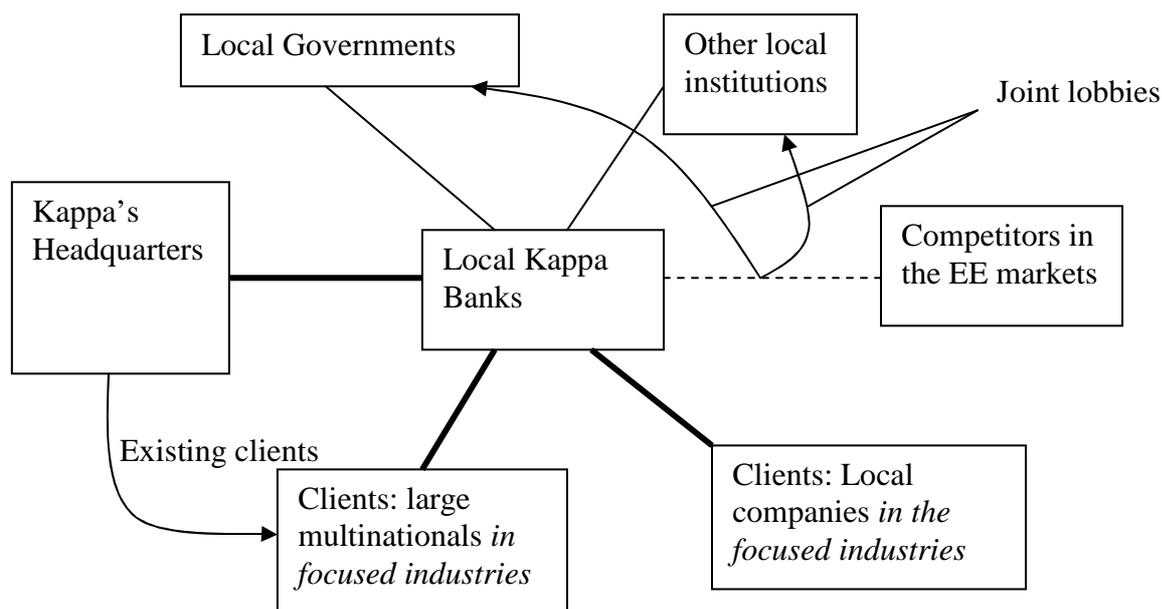


Figure 5: *Kappa's Relationships in Expansion Phase*

6. Analysis

Before presenting our analysis of our two case companies' positions in the Johanson and Mattsson model (1988), we will first analyse the degree of internationalization of the financial market in Eastern European markets and how it changed over time.

Shortly after the fall of the communist regimes and the opening up to foreign investment, the Eastern European markets lacked business networks in most if not all industries. Old networks fell apart because they were organized centrally and when that central organization of task divisions among countries disappeared, most industrial networks had to be built up again from scratch. The financial industry was so much underdeveloped in Eastern Europe, in comparison to most Western and Asian markets, that we can say that no institutional or business networks existed in the first stage of the transition to market economies. We therefore compare the situation in Eastern European markets in the first half of the 1990s to the situation of low degree of internationalization of the industry in the Johanson and Mattsson model (1988). In the second half of the 1990s, business and institutional networks start to emerge, also in the financial industry: laws and regulations are developing, foreign companies have entered the markets in large numbers and local businesses have progressed in reorganizing (for instance through privatization, exit of non-profitable firms and entry of entrepreneurial companies). In this stage and later, one can

compare the Eastern European markets to the situation of a high degree of internationalization in the industry (Johanson and Mattsson, 1988). The fast developments in Eastern Europe show that the degree of internationalization of a market and the development of network structures can go much faster in today's globalized world than was true at the time the model was published.

Considering the firms' degree of internationalization, our two case companies represent an Early Starter (Penta) and a Late Starter strategy (Kappa) respectively. Below we will explain the companies' positions in the model based on the case material described above. Penta started commitment for expansion in Eastern Europe shortly after the communist regimes fell, at a stage in which no business or institutional networks existed in these markets. Penta's entry strategy shows that it invested heavily in developing relationships with all sorts of government and other institutions, supporting the development of network structures in its industry. This is in accordance with the Early Starter pattern (Johanson and Mattsson, 1988). Because Penta lacks experiential knowledge of the Eastern European markets and cannot use existing network relational paths, it hires local people in order to develop such network relations. The Czech experiences show that hiring the right person with the right connections at the Central Bank smoothes the entry process and in Poland, the early investment in developing network connections results in Penta's strong position in several institutions. But Penta's early entry did not only result in beneficial network positions in the institutional network, Penta also achieved a strong position in the developing business networks in the markets it entered. The bank's managers relate for instance that their early positioning in the market resulted in attracting large clients like large multinational companies, whose 'own' banks were not present in the Eastern European markets yet.

Although Penta internationalised in other regions before entering Eastern Europe, it took a gradual, risk avoiding approach to entering these markets. It preferred to enter through a branch, i.e. avoiding the control of the local Central Bank and only established subsidiaries when forced by local government. In congruence to Johanson and Mattsson's (1988) Early Starter, Penta offered only simple and standard products in the new markets. It was only after they had acquired enough local market knowledge and after the market showed a certain level of development that Penta expanded its product offerings. Likewise, Penta extended its focus to other target groups, including groups that are more difficult to reach and that demand a higher level of local commitment, such as private households.

Johanson and Mattsson (1988) suggest that Early Starters search to solve their uncertainty and lack of market knowledge in foreign markets through co-operations with local

companies. In contrast, Penta has not established such co-operations in its first stage of penetration, but instead acquired local knowledge through hiring local managers in important positions. In a next stage, expansion was eventually furthered through acquiring a local bank, as in the Polish wholesale activity. This acquisition offered Penta the fine-grained network of offices that it needed to expand to customer groups like private households. Penta's Early Starter strategy has proven to bring the bank success because it has provided the bank with a powerful position in networks of customers and regulators. It has followed a gradual expansion pattern with extensive investments in building a network position, but like Johanson and Mattsson (1988) reasoned, this has given them a beneficial position in facing the competition of later entrants.

Our second case, Kappa, has been one of those later entrants. Kappa set its first steps in four Eastern European markets in 1997, when banks like Penta had already been present for a number of years, building their network of relationships with institutional counterparts and clients, just like the highly developed international context the Late Starter is confronted with according to Johanson and Mattsson's (1988) model. Kappa experiences this as a drawback right from the start, because it is much less successful in organizing banking licenses and even withdraws from two of the four markets it entered. In order to receive a banking license Kappa is required, against its preferred entry strategy, to make an acquisition in Poland; in Russia it still did not have a banking license after seven years in the country and had organized its activities in an alternative way, different than planned, in order to serve this market. In Hungary, its withdrawal is partly the result of the market already being taken by competitors and not allowing enough space for another player, not even in Kappa's niche industries. In Ukraine, it is the bank's uncertainty about the high level of political risks that stalls further expansion. In order to build network relations, Kappa joins the lobbies of united international banks and also, like Penta, hires local managers with extended networks. In order to build profitable banks in Eastern Europe, Kappa further cannot rely on its client network of foreign investors alone. In contrast to Penta, Kappa is forced to reach out to local companies, also small and medium sized companies, to start up their business.

In several ways Kappa's entry strategy is in accordance with the gradual approach predicted by the theories (Johanson and Vahlne, 1977; Johanson and Mattsson, 1988). Before entering Eastern Europe, Kappa collected extensive information about these markets from several directions, including competitors that already had entered them. Further, Kappa's preferred entry strategy is through a Greenfield office, i.e. an entry mode that demands less immediate investments than an acquisition. Like Penta, Kappa started with simple banking

products first, adding products and developing new ones in cooperation with clients over time. Kappa also gradually expanded its number of clients, but only recently has decided to aim for the more commitment-demanding private customers by offering retail banking products.

An important characteristic of Kappa's entry strategy is its focus on a particular niche, the agricultural and related sectors. It conceives of this knowledge advantage in this sector as an opportunity to compete with other foreign banks that invested in the region. Headquarters' research centre heavily supports its Eastern European affiliates in providing detailed background knowledge on developments in the focused niche. This, according to Johanson and Mattsson (1988) is a common strategy for Late Starters. Faced with existing tight network structures, Late Starters choose niche strategies and offer specialized products in order to compete with Early Starters. To aim at this specific market allowed Kappa to develop relationships in particular networks: the agricultural and related sectors. By doing so the bank could refrain from investing in developing relations in other market sectors.

Beside the heterogeneity in the commitment of these firms because of their degree of internationalization, we also found an interesting homogeneous behaviour toward actors that the study of Johanson and Mattsson (1988) and even other studies do not treat properly. This aspect considers the type of commitments. As the cases manifest, the firms' resource commitment and organization can be divided into two types. These two types are business commitments which were related to the business relationships and the other was the political commitments which considered the political actors and bureaucrats (see Hadjikhani and Ghauri, 2000***not in refs). As the cases and also the figures illustrate, there was a clear difference between these two types of the firms' commitments. Both firms, specifically in the penetration stage, faced with the problem of, for example, having to obtain a licence. Kappa's problem in gaining a licence was one of the reasons that the firm did not succeed in expansion in Russia. These two different commitments developed hand in hand but demonstrated different degrees of internationalization.

		Internationalization and Business Commitment	
		Low	High
Internationalization and Political Commitment	Low	1	2
	High	3	4

Table 1: Types and Degree of Commitments

As illustrated in Table 1, the two banks had two types of commitments which varied depending on the degree of internationalization. In the first stage of internationalization, for example, both firms were in cell 3 as the first commitment was to solve the political and bureaucratic problems. But, as the case of Kappa manifested, the firm in the expansion stage considered the business commitment to be high and the political commitment was less. If a firm like Kappa conducts a high investment in the political arena for penetration and is not able to move from cell 3 to cell 2, then the only option is exit. Although, beside the fact that firms conduct commitment towards two different political and business markets, the degree of commitments in these two types do not follow each other's development. While one is high in one stage the other can be low and vice versa. In severe conditions, like mergers and acquisitions, both types may stand in cell 4 as the firms require a high level of investment for the businesses and at the same time resolve the political and bureaucratic demands.

Conclusion

The study above contains facts about the behaviour of two banks when penetrating and establishing units in new emerging markets. Comparing the entry strategies of both banks leads to the conclusion that they both used a gradual approach in these new Eastern European countries. Their market entry choices are quite similar, for example in terms of entry mode preference and product offerings. However, the main difference between these banks' entry circumstances is the level of development of the Eastern European markets and the network structures in financial institutions and businesses. Early Starter Penta has benefited from being a first mover: it has a very strong position in the local business and institutional networks and their strong network relations have shown to support the success of the bank. Market shares of Penta's insurance offices reached to over 50% in the second half of the 1990s, and its Polish bank serves about 6% of the market. Kappa in contrast, has been much less successful in reaching its aims: it has been confronted with higher levels of competition from local business networks resulting in lower chances of starting with a portfolio of foreign investors. But it has also faced more barriers from the better-developed institutional networks in its markets of entry, which resulted in the need to drop the preferred entry strategy and adapt to circumstances. Its market shares in the banking sector generally are all below 1%; smaller than Penta's market shares. However, we can conclude that Kappa's niche strategy has helped them to meet the high level of competition: in their focus markets, market shares do reach higher levels, even up to 50%.

On the base of the facts we can easily make the conclusion that there is a difference in, for example, the firms' type of trust and commitment. This aspect which seldom captures the attention of the researchers in banking is related to issues like varieties in the commitment or trust types at different stages of internationalization. As manifested in the cases, we can conclude that there are clear cut differences between the two types of business and political commitment of the firms. Beside that, the degree of commitment in these two types can vary at different stages of internationalization. Such a conclusion opens new research arenas. A deeper understanding of the types of commitments at different stages of internationalization may provide a better understanding of why some firms do not succeed: not because of the degree of internationalization of the businesses, but because of the hindrances created by political actors.

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