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GOING ABROAD

Examining the International Footprint of Canada's Financial Services Sector.

TFSA | TORONTO FINANCIAL SERVICES ALLIANCE

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Going Abroad: Examining the International Footprint of Canada's Financial Services Sector

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Preface

This report examines the trends in Canadian international trade and investment in financial services. As well, the report discusses how Canadian financial institutions operate internationally, their key challenges, and their success factors. Finally, the report draws information from four interviews to get more expansive feedback/practical advice on what individual businesses should do when entering a new market.

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CONTENTS

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About the Toronto Financial Services Alliance

The Toronto Financial Services Alliance (TFSA) is a unique, public-private partnership dedicated to growing Toronto region's financial services cluster and building it as a global financial services centre. Established in 2001, TFSA is a collaboration involving three levels of government, the financial services industry, and academia.

EXECUTIVE SUMMARY

Going Abroad: Examining the International Footprint of Canada's Financial Services Sector

At a Glance

- Trade in financial services continues to expand. Since 2000, global exports have tripled, while Canadian exports have nearly quadrupled in U.S. dollar terms.
- Financial services other than banking and insurance have experienced the strongest growth and now account for half of Canada's financial services exports versus 31 per cent in 2000.
- The U.S. remains the largest market for exports of financial services, accounting for 50 per cent of the total.
- Despite the rise in exports, foreign affiliates are still the principal avenue by which Canadian financial institutions provide their services to overseas customers. This is why Canada's financial services outward foreign direct investment has more than tripled since 1999.
- The building blocks of successful foreign market entry include understanding/respecting local culture, finding a strong/reputable local partner, and having management expertise with local experience.

This report examines the trends in Canadian international trade and investment in financial services. As well, the report discusses how Canadian financial institutions operate internationally, their key challenges, and their success factors.

Trade in most service sectors has historically been small. However, financial services such as insurance, banking, securities trading, and portfolio management are becoming increasingly tradable in the modern economy. The act of providing financial services to customers outside of an institution's home market is now well established and continuing to expand.

Several factors help to explain the growth in global financial services exports. First, technological advancements, the greater adoption of electronic data processing, and the new era of Internet-based banking services have increased the international presence of the financial services sector. Furthermore, growing international trade has increased the demand for credit to finance international business and investment activities. Additionally, a global liberalization of financial services trade has widened the choice of financial services, institutions, and instruments available to companies and consumers.

Cross-border trade and commercial presence are the two most common ways for financial institutions to conduct business in foreign markets.

International Trade in Financial Services Is Growing

Since 2000, global financial services exports have tripled, while Canadian financial services exports have nearly quadrupled in U.S. dollar terms. While Canadian banking and insurance exports have both grown strongly over this period, "other financial services" including items such as securities issuance and trading, and asset management have experienced the strongest growth and now represent half of Canada's financial services exports versus 31 per cent in 2000.

Canadian exports of financial services are diversified geographically, but the U.S. remains the largest market, accounting for 50 per cent of total exports. There is a strong link between the countries to which Canadian financial institutions export and the countries where the financial institutions have chosen to locate their foreign affiliates.

Global Trends in Financial Services Foreign Affiliates

The presence of banking foreign affiliates in various markets has grown over the past 15 years. Foreign banks are common in some European countries, but many emerging and developed economies have limited exposure to foreign investment in their domestic banking system.

In the insurance industry, foreign presence is generally lower than in banking and has declined in many of the OECD countries over the past 20 years. This outcome is likely due to the fact that, in most OECD countries, there is already a strong domestic insurance industry serving the local customer base. Thus, it is difficult for international insurers to compete against the major domestic companies that have established extensive networks of branches and sales representatives.

Emerging markets are therefore often the most attractive markets for international expansion. They frequently provide an interesting mix of strong demand growth, limited foreign penetration rates, underserviced markets, and less-well-established incumbents. However, there are generally significant barriers to expanding in these markets. Thus, if foreign financial institutions are to take advantage of the opportunities in these markets, they need to find ways to overcome these barriers.

Canadian Trends in Financial Services Foreign Affiliates

Canadian financial firms have a significant out-of-country presence as shown by strong foreign affiliate sales growth; such sales have more than doubled since 2000. In fact, the financial services sector's share of Canada's foreign affiliate sales has grown steadily, and the sector now accounts for one-fifth of the Canadian total. Establishing a local presence is the principal avenue for Canadian financial institutions to provide financial services to international customers. Foreign affiliate sales are, on average, nine times greater than the value of financial services exports.

Canadian financial institutions have been developing their commercial presence around the world by means of foreign direct investment (FDI) into the host countries. Canada's financial services outward FDI has also grown immensely in the last 15 years, more than tripling since 1999. The foreign holdings of Canadian financial institutions are diverse, with the U.S. accounting for the largest share of FDI (39 per cent), followed by "Other Americas" (29 per cent) and Europe (26 per cent).

The Experience of Toronto's Financial Institutions in Foreign Markets

The Conference Board of Canada (CBoC), in partnership with the Toronto Financial Services Alliance, designed and conducted a survey to examine the international operations of financial services firms based in Toronto in terms of their (1) foreign market entry strategies/approaches; (2) success factors for conducting business outside Canada; and (3) key challenges to doing business in foreign markets.

The three major market entry strategies/approaches used by Canadian financial institutions in foreign markets are making acquisitions, establishing subsidiaries, and setting up joint ventures or local partnerships.

Financial services account for one-fifth of Canada's foreign affiliate sales.

The survey identified three building blocks of successful foreign market entry: an understanding of and respect for the local culture, environment, client base, and market; the strength of a local partner and joint-venture brand; and management expertise with local experience.

The three most pronounced challenges to entering new markets are regulatory barriers, access to the right people and skill sets, and an understanding of the local market and competitive landscape.

To gain additional insights regarding this issue, a series of interviews was conducted with four financial institutions headquartered in Toronto. The interviews provided an overview of each institution's international operations, challenges, and routes to success.

All of the interviewees reported that foreign market entry decisions can be driven by many different motives, but a core set of motivators includes high growth potential internationally, competitive differentiation, and diversification of the customer base.

One of the most important decisions regarding companies' global expansion strategies is the choice of market entry mode. None of the interviewees suggested a preference for any particular market entry mode and firms have chosen a variety of modes, ranging from mergers and acquisitions, to joint ventures, to the establishment of subsidiaries through greenfield investments.

Interviewees acknowledged that there are obstacles associated with international expansion. Three common hurdles were identified.

1. Regulatory Barriers

Our interviews revealed several approaches to navigating these regulatory barriers. Understanding how the nuances of local regulations impact the business is an important first step. In addition, putting in place sound business practices that comply with local regulations will also help to ensure success in foreign markets. In markets where regulatory barriers are significant or poorly understood, acquisition may be a good entrance strategy.

2. Cultural Barriers

Our interviewees proposed three different techniques to transcend cultural barriers. First, developing a deep understanding of and respect for the cultural nuances in each chosen market is vital. A company must also adapt its business practices and products to the unique conditions of a particular market. Last but not least, seeking out competent local partners with the requisite local expertise is critical to closing the knowledge gap and overcoming cultural barriers.

3. Brand Development

Our interviewees mentioned that businesses can establish and build their brands in various ways in new markets, such as with advertising. However, companies also need to learn how to reach out to local customers with messages that are tailored and relevant to the local context. As well, ensuring products consistently live up to customers' expectations is another time-tested way to establish and build a brand in foreign markets.

CHAPTER 1

Introduction

Chapter Summary

- Trade in financial services continues to expand. Since 2000, global exports have tripled, while Canadian exports have nearly quadrupled in U.S. dollar terms.
- Changing technology, the need to facilitate financial transactions linked to growing global trade, and liberalization of regulations on cross-border trade in financial services have also supported this growth.
- Canadian financial institutions have been a part of this expansion in financial services trade, with exports nearly quadrupling and foreign affiliate sales more than doubling since 2000.
- This report examines the trends in Canadian international trade and investment in financial services and discusses how Canadian institutions go overseas, their key challenges, and their success factors.

Trade in most services sectors has historically been small. However, financial services such as insurance, banking, securities trading, and portfolio management are increasingly becoming tradable in the modern economy. The act of providing financial services to customers outside of an institution's home market is now well established and continuing to expand. Since 2000, global financial services exports have tripled.

Several factors help to explain this growth in global financial services exports. First, technological advancements, the greater adoption of electronic data processing, and the new era of Internet-based banking services have increased the international presence of the financial services sector. Furthermore, growing international trade has increased the demand for credit to finance international business and investment activities. As well, global liberalization of regulations for financial services trade has widened the choice of financial services, institutions, and instruments that are available to companies and consumers. This last factor is particularly important, since there is a strong link between where financial institutions trade and where their foreign affiliates are located. This is because financial institutions will often trade directly with their affiliates, and having a local presence can frequently help to facilitate trade in a foreign country. This is especially true for services.

Canadian financial institutions are part of the trend of growing international trade and investment in financial services. Canadian exports of financial services have nearly quadrupled since 2000, and foreign affiliate sales have more than doubled. Given the success that Canadian firms have achieved in foreign markets, the main objective of this report is to shed light on the key factors and decisions made by Canadian financial institutions, that led to their successful forays into foreign markets.

We begin by examining the trends and changes in Canadian financial services trade and investment. This discussion encompasses both Canadian financial services exports and Canadian financial services sales through foreign affiliates.

We rely heavily on data provided by Statistics Canada to empirically evaluate Canadian financial services exports and foreign affiliate sales over the past 15 years. This data analysis is used to help develop a picture of the international footprint of the Canadian financial services industry. We also draw on available data from other international organizations such as the World Bank and the Organisation for Economic Co-operation and Development (OECD) to examine trends and changes in financial services trade on a global scale. These other sources enable us to compare Canada with the rest of the world in terms of trade in financial services.

The second part of the report discusses the results of a survey that The Conference Board of Canada conducted as part of this research. The survey asks financial services firms based in Toronto about their experiences when venturing abroad. In particular, the survey seeks to gain additional insights about (1) foreign market entry strategies/approaches; (2) success factors for conducting business outside Canada; and (3) key challenges of doing business in foreign markets.

As surveys do not allow for further probing of responses (i.e., respondents may want to qualify their answers), CBoC conducted a series of interviews with four financial institutions headquartered in Toronto to get more expansive feedback/practical advice on what individual businesses should do when entering a new market. The interviews gave an overview of the institutions' international operations, challenges, and routes to success.

We also provide profiles of the international operations of three of the four firms we interviewed in order to (1) provide a detailed description of the international operations of each firm; (2) analyze the entry mode chosen by each firm when entering foreign markets; and (3) identify the success factors behind each firm's international expansion strategies. Through these profiles, we hope to provide some useful insights for other companies that may wish to diversify internationally.

CHAPTER 2

Trade in Financial Services

Chapter Summary

- Cross-border trade and commercial presence are the two most common ways for financial institutions to undertake trade.
- Global trade in financial services exports has tripled over the past decade, while Canadian financial services exports nearly quadrupled over the same period.
- Canadian financial institutions have expanded their commercial presence around the world, which is reflected in the increasing volume of foreign affiliate sales.
- Foreign affiliates are the principal avenue by which Canadian financial institutions provide financial services to overseas customers. Foreign affiliate sales have been consistently nine times greater than the size of exports.
- Although the U.S. remains the primary target market for Canadian financial institutions, they have also invested broadly across a range of regions.

What Is Trade in Financial Services?

Trade in financial services is categorized by the approaches that financial institutions use to reach their customers. According to the General Agreement on Trade in Services (GATS),[1] financial services can be traded using four modes.

Mode 1: Cross-border trade—These are services offered by an individual or firm in one country to an individual or firm in another country.

Mode 2: Consumption abroad—An individual from one country travels to a foreign country and uses a service in that country.

Mode 3: Commercial presence—A firm based in one country establishes an affiliate in another country and offers services through the local affiliate.

Mode 4: Movement of natural persons—An individual service provider from one country travels to another country on a short-term basis to offer a service there as, for example, a consultant.

Because financial services are traded via different modes, their transactions are also recorded differently. Modes 1, 2, and 4 are linked to the trade of financial services across borders. Such transactions are recorded as imports (services delivered by non-residents to residents) or exports (services delivered by residents to non-residents).

In contrast, the delivery of services in Mode 3 is unlike the conventional concepts of imports or exports. As a result, transactions of foreign affiliates are not included in national trade data. In fact, only a few countries—such as the U.S. and Canada—have separate foreign affiliate trade statistics (FATS), which include foreign affiliate revenues and employment. As a result, foreign direct investment (FDI) is often used as a proxy to measure Mode 3 trade.

1 The General Agreement on Trade in Services (GATS) is a treaty of the World Trade Organization. It provides a framework of rules governing services trade and establishes a mechanism for countries to make commitments to liberalize trade in services. It also provides a mechanism for resolving disputes between countries.

This report will focus on Mode 1 (cross-border trade) and Mode 3 (commercial presence), which are most relevant for financial services trade. Mode 2 is more related to tourism services, while Mode 4 is most important to professional services.[2]

Mode 1: Cross-Border Trade in Financial Services

Cross-border trade in financial services occurs when businesses in one country sell financial services to customers in another country with people, information, or money crossing national boundaries in the process. In most cases, financial services cross-border trade is difficult to observe directly. This report will use some of the more readily available statistics to measure the value of global financial services trade transactions.

Over the past decade, global exports of financial services[3] have grown tremendously. For example, in 2012, world exports of financial services totalled US$412.6 billion, up from US$125.3 billion in 2000. Thus, the value of financial services exports has more than tripled during this time period. (See Chart 1.)

Several factors help to explain this growth in global financial services exports. First, technological advancements, the greater adoption of electronic data processing, and the new era of Internet-based banking services have increased the geographic footprint of the financial services sector. Second, a global liberalization of financial services trade has widened the choice of financial services, institutions, and instruments that are available to companies and consumers.[4] For example, the GATS, which emerged from the Uruguay Round in 1995, represents

2 Foreign Affairs, Trade, and Development Canada, *Services Trade*.

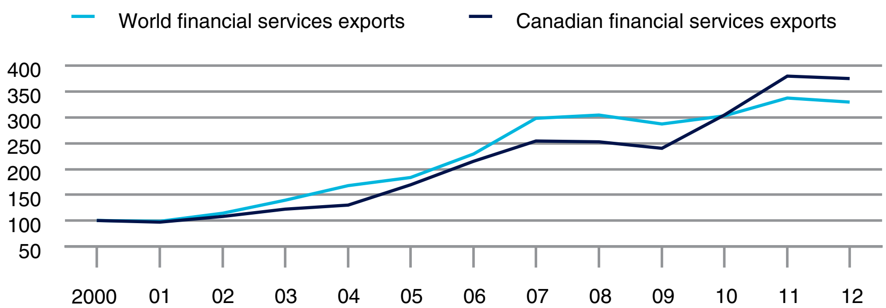
3 The World Trade Organization collects export data on financial and insurance services transactions separately. For the purpose of this report, we group these two transactions together and refer to the combined transactions as financial services. This approach is taken because the traditional definition of financial services includes both of these components.

4 Kono and others, "Opening Markets in Financial Services and the Role of the GATS."

Chart 1

Canadian Exports of Financial Services Have Grown in Parallel With the Increasing Trend in Global Exports of Financial Services

(US$ value of exports index, 2000 = 100)



Note: The significant appreciation of the Canadian dollar from 2002 to 2007 inflates the nominal value of financial services exports.
Sources: World Trade Organization; Statistics Canada, CANSIM table 376-0033; The Conference Board of Canada.

the first multilateral effort to establish rules governing financial services trade and to provide a framework on improved market access for foreign services and service suppliers.

Third and last, growing international trade has increased the demand for credit to finance international business and investment activities. An example of the growing international nature of financial services is apparent when we look at cross-border capital flows between banks (i.e., interbank lending). According to the Bank for International Settlements (BIS), the flow[5] of cross-border bank lending has expanded significantly in the past 15 years. For example, the global outflow of cross-border bank lending totalled US$18.8 trillion in the second quarter of 2014, compared with US$7.1 trillion in the first quarter of 2000.

5 From the Bank for International Settlements (BIS) database, we make use of the Locational Statistics by Nationality of Ownership of Reporting Banks (IBLN, Table 8). The amount of outstanding "Claims on banks" represents the total claims of domestic banks on foreign banks; thus, it is used to show the outflow of bank-to-bank lending.

Canadian exports of financial services have also grown considerably over this period, rising from US$2.4 billion to US$9.5 billion between 2000 and 2013, nearly quadrupling over this period and increasing at an even stronger pace than the global average in recent years. While banking and insurance exports have both grown substantially over this period, "other financial services"—including items such as securities issuance and trading, and asset management—have experienced the strongest growth and now account for half of Canada's financial services exports versus 31 per cent in 2000.

The U.S. market remains the largest market for Canada's exports of financial services, accounting for 50 per cent of the total, and this share has remained little changed over time. There are a variety of reasons for the strong growth in financial services exports to the U.S., including the need to facilitate the large volume of trade transactions between the two countries and the use of Canadian equity, debt, and derivative markets by U.S.-based businesses. Moreover, Canadian financial institutions have "followed" clients from Canada into the U.S. market to provide financing and other financial products as their customers engaged in a growing volume of international investment activities.

As well, Canadian financial institutions have a significant presence in the U.S. and there is a strong link between trade in financial services and the location of foreign affiliates of domestic institutions. In fact, one-fifth of Canadian financial services exports are directly to the foreign affiliates of Canadian institutions.[6] And even when these institutions are not trading directly with their affiliates, a local presence can often help to facilitate trade in foreign countries. With this in mind, it is useful to explore the commercial presence of Canada's financial institutions in foreign markets.

6 Statistics Canada, CANSIM table 376-0033.

Mode 3: Financial Services Trade via Commercial Presence

Commercial presence refers to the situation where a financial institution located in one country establishes an affiliate to offer financial services in another country. A financial institution's decision to enter a new market via commercial presence could be triggered by many reasons. For example, customers are more inclined to use a company's services if there is a convenient and accessible interface such as a branch or office outlet nearby. Differences in regulatory regimes and tax systems may also make setting up a local presence the best option for a company. In addition, the fiduciary nature of certain financial services such as deposit-taking and life insurance policies often require services supplied through local establishments.[7]

Global Trends in Banking

Since transactions data on global financial services trade via commercial presence are extremely limited, we can use other indicators as proxies. In the case of banking, two indicators are used to shed some light on the foreign presence of banks in particular countries: the share of branches established by foreign banks in a country, and the share of bank assets held by foreign banks in a country.

Between 1995 and 2009, foreign banks increased their commercial presence worldwide with respect to the share of branches with foreign ownership. (See Chart 2.) And this increase has been universal, across different types of countries including those in the OECD, other high-income countries, emerging markets, and developing economies.[8] The increase in the commercial presence of foreign banks is correlated

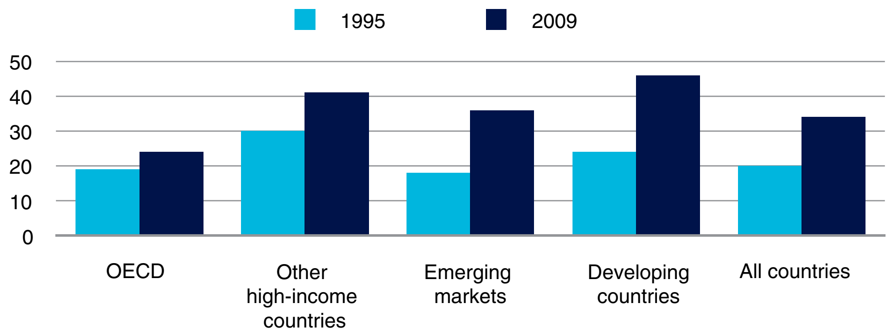
7 OECD, "Cross-Border Trade in Financial Services.

8 The first group, OECD, includes all core OECD countries. The second group, other high-income countries includes all countries classified as high-income by the World Bank in 2000, but not belonging to the OECD. The third group, emerging markets, includes all countries that are included in the Standard and Poor's Emerging Markets and Frontier Markets indexes and that were not high-income countries in 2000. The last group, developing countries, include all other countries. In total, 129 countries were included in the calculation.

Chart 2

Commercial Presence of Foreign Banks Increased Substantially Worldwide

(share of foreign banks' branches in total number of branches, by host country, income group, per cent)



Source: International Monetary Fund (IMF).

with economic reforms that have included the opening up of international financial services trade in Eastern Europe and greater market access to Asian countries.[9]

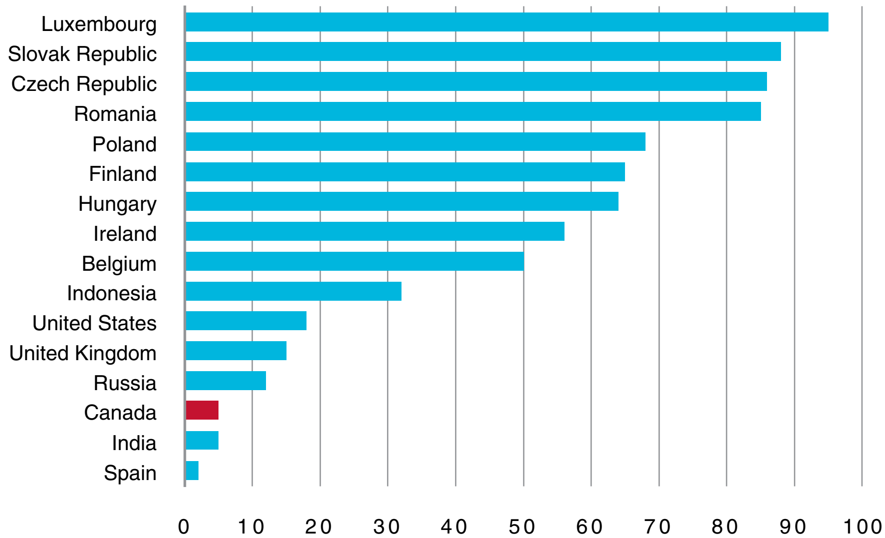
While the banking industry has become more open to foreign competition, potential opportunities for further growth still exist since there is wide variation in the foreign share of banking assets across countries. (See Chart 3.) For example, foreign banks are common in some countries, such as Luxembourg and the Slovak Republic. Conversely, many emerging and developed economies have limited exposure to foreign investment in their domestic banking system. In the case of India and China, for example, foreign ownership of banking assets is 5 per cent and 1 per cent respectively. The presence of foreign banks in countries such as Spain, the United Kingdom, and Canada is also limited.

9 Claessens and van Horen, "Foreign Banks."

Chart 3

Rates of Foreign Market Penetration Vary Widely

(share of foreign-owned assets in total banking assets by selected countries, 2009, per cent)



Source: IMF.

One of the key restraints around the degree of foreign ownership in banking assets is how open those countries are to foreign investment. According to the OECD Services Trade Restrictiveness Index (STRI),[10] developed countries are generally more open to trade. (See Chart 4.) In contrast, emerging markets—such as Indonesia and India—have stricter regulations toward foreign investment in their banking systems.

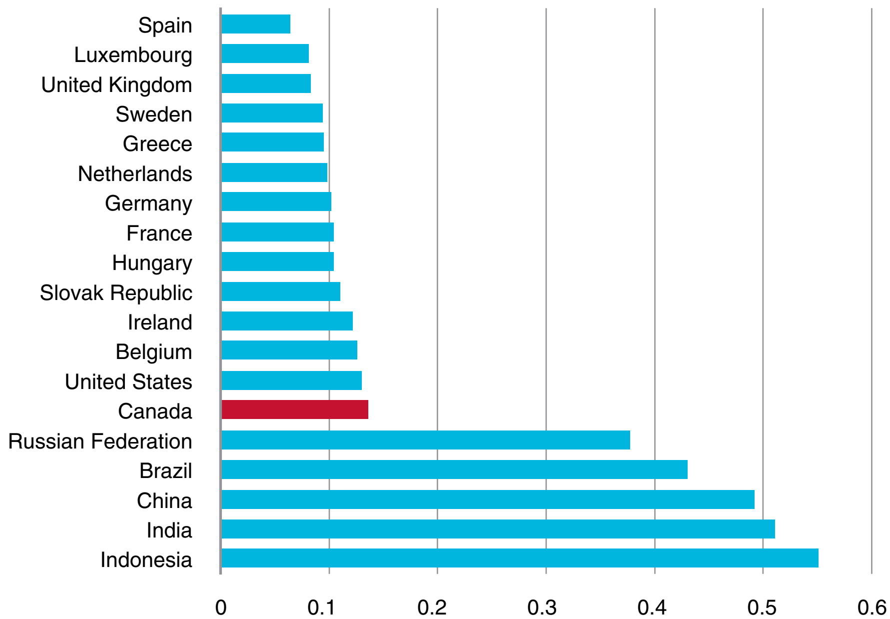
Although regulatory barriers in emerging markets may generally be higher, there are also significant opportunities in these countries. (See Chart 5.) For example, there are often 30 bank branches or more per

10 The Services Trade Restrictiveness Index (STRI) for commercial banking compares trade restrictiveness across 34 OECD countries and 6 major emerging economies (Brazil, China, India, Indonesia, Russia, and South Africa). STRI takes values between 0 and 1, with 1 being the most restrictive. The calculation is based on a regulatory database that contains comparable, standardized information on trade and investment relevant policies in force in each country. The results are mainly driven by two policy areas: restrictions on foreign entry and barriers to competition.

Chart 4

U.S. and Many European Countries Have Fewer Regulatory Restrictions on Foreign Investments in Commercial Banking

(Services Trade Restrictiveness Index, ranging from 0 to 1, select countries, 2014)



Source: Organisation for Economic Co-operation and Development (OECD).

100,000 people in developed countries, but this figure may be 10 or less in many emerging markets. This means that the banking industry in many of these countries is still developing, creating considerable growth opportunities for any institutions able to access these markets. Therefore, although regulatory barriers may be higher, the rewards of successfully navigating them are also high.

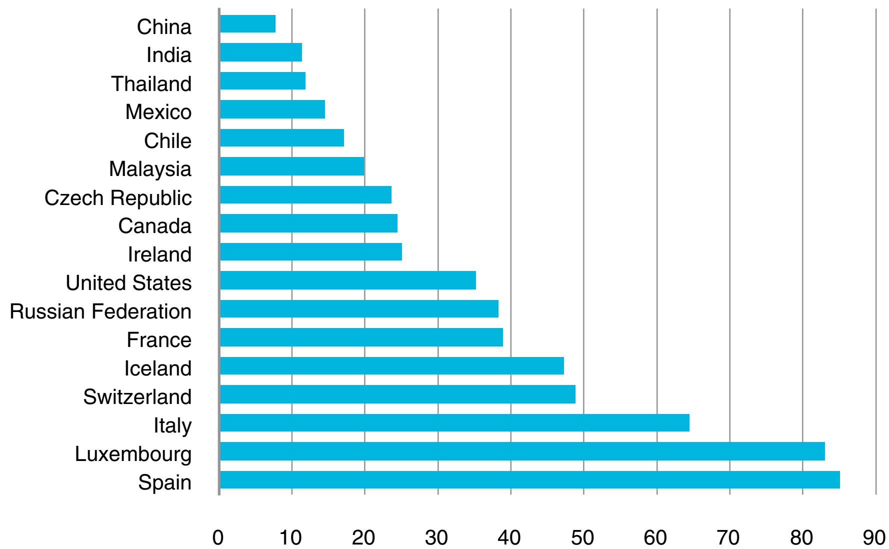
Global Trends in Insurance

Foreign penetration rates for insurance are often even lower than they are for banking. For instance, foreign life insurers generally have a very limited commercial presence in OECD countries. (See Chart 6.) There are only two countries, the United Kingdom and the Czech Republic, where market penetration by foreign suppliers exceeds 10 per cent.

Chart 5

Emerging Markets Are Underserved by Banking Services

(commercial bank branches per 100,000 adults, 2012)



Source: The World Bank.

Thus, domestic companies dominate life insurance in most industrialized countries. However, the commercial presence of foreign firms is typically higher in the non-life insurance (includes property, casualty, and health insurance) market. For example, foreign-owned firms provide close to 50 per cent of non-life insurance in Norway and the market share of foreign firms exceeds 10 per cent in many other countries.

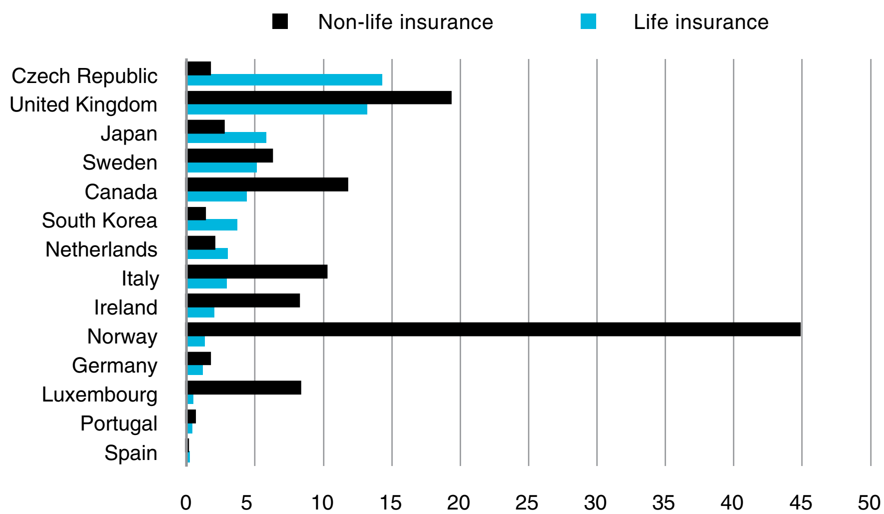
The commercial presence of foreign insurance companies is not only generally lower than that of banking, but it has declined in many of the OECD countries over the past 20 years. (See Chart 7.) In fact, in only a few selected countries (e.g., Switzerland, Japan, Germany, and the Czech Republic) have foreign insurance suppliers managed to increase their market share.

This outcome is likely because, in most OECD countries, there was already a strong domestic insurance industry serving the local customer base. Thus, it is difficult for international insurers to compete against the

Chart 6

Foreign Market Share in Life and Non-life Insurance Services, Select OECD Countries

(share of foreign-controlled undertakings* in net written premiums,** per cent, 2008)



*foreign-controlled undertaking companies: those domestic companies controlled by foreign interests, such "control" being defined according to national laws
**net written premiums: total retention in the reporting country and calculated as gross premiums minus premiums ceded
Source: OECD.

major domestic companies that have established extensive networks of branches and sales representatives. Furthermore, a slowdown in GDP growth in many OECD countries and the ongoing financial uncertainty in Europe have resulted in less disposable income and reduced sales of insurance products, dampening the incentives to enter these markets.

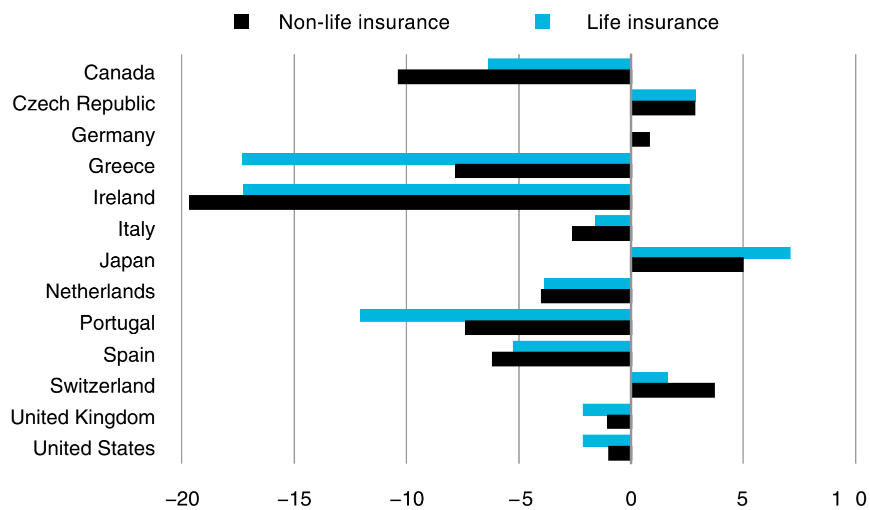
Thus, as with banking, emerging economies are likely to be more attractive markets for multinational financial institutions looking to expand their international presence. This is apparent when we look at indicators such as insurance density[11] by country. (See Chart 8.) For example,

11 Insurance density is calculated by annual premium payments, in U.S. dollars, divided by the total population. It shows the level of insurance consumption in a country and is often used as an indicator for potential growth within the insurance sectors. However, insurance density does not adjust for the income level of the economy. People in higher-income countries will spend more on insurance as they have more assets to protect.

Chart 7

Commercial Presence of Foreign Insurance Companies Has Declined Over Time

(difference in market share of "branches/agencies of foreign undertaking" in total domestic business, selected countries, 1993–2011, per cent)



Source: OECD.

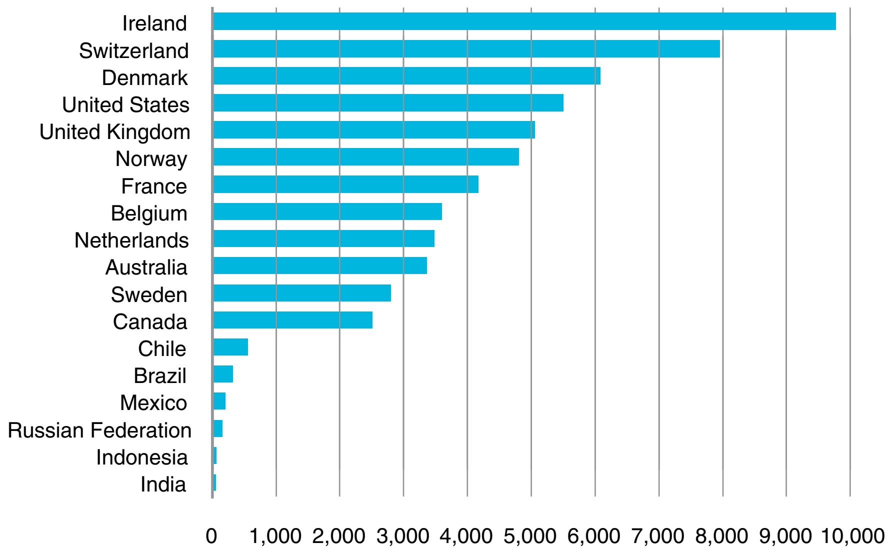
on a per capita basis, the average citizen of Ireland spent close to $10,000 on insurance in 2011, whereas a person in India would have spent $60. However, countries with a lower insurance density represent superior business opportunities because the insurance markets are underdeveloped.

However, barriers to insurance trade and investment are also higher in emerging economies compared with developed economies. According to the OECD's STRI index for insurance, even the most restrictive developed countries (such as Iceland, the U.S., and Norway) are less restrictive than many of the major emerging economies. (See Chart 9.) Thus, foreign firms need to find ways to overcome these barriers if they are to successfully take advantage of the opportunities that emerging economies represent.

Chart 8

Lower Insurance Density in Emerging Markets Represent Opportunities

(insurance premiums per capita for select countries, 2011, US$)



Source: OECD.

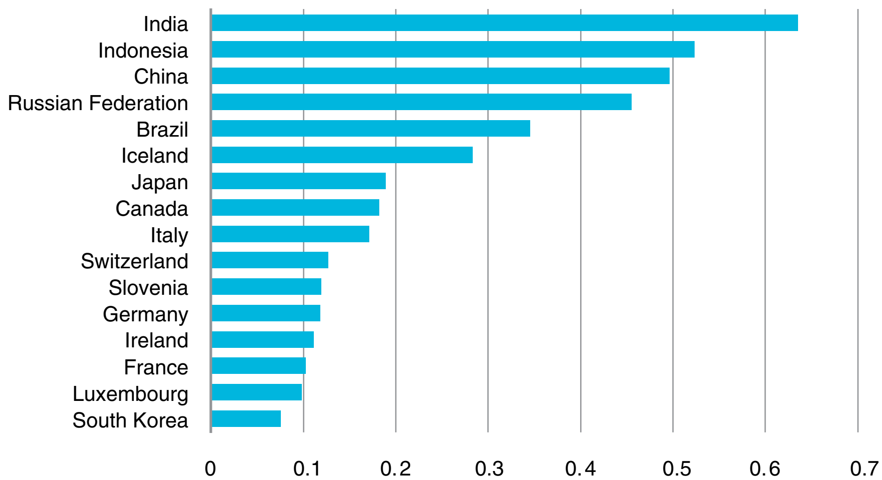
Canadian Trends

Although foreign financial firms have a limited presence in the Canadian market, Canadian financial firms have a significant out-of-country presence. We are able to assess this since Canada is one of the few countries in the world that provides detailed statistics on the commercial presence of Canadian companies abroad. The statistics are recorded as foreign affiliate sales, which directly show the sales value of the commercial presence of Canadian financial institutions in foreign markets. There are many benefits to doing business through foreign affiliates; for example, profits generated through sales by foreign affiliates directly benefit Canada by contributing to the gross national income. As well, Canadian firms can expand market share, provide better service for their foreign customers, and improve their competitiveness within global value chains.

Chart 9

Emerging Markets Have Higher Regulatory Restrictions on Foreign Investments in Insurance Industry

(Services Trade Restrictiveness Index, from 0 to 1, selected countries, 2014)



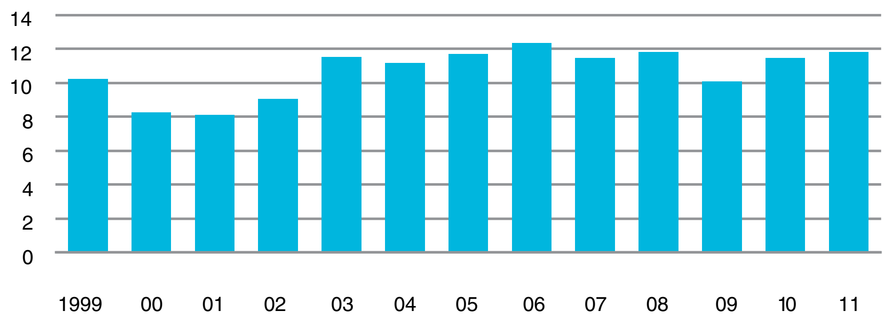
Source: OECD.

Foreign affiliates are the principal avenue for Canadian financial institutions to provide financial services to overseas customers; foreign affiliate sales are much larger than financial services exports. For example, financial services exports were equivalent to only 11 per cent of foreign affiliate sales on average from 1999 to 2012. (See Chart 10.) In other words, the value of services supplied by affiliates abroad of Canadian financial institutions has been, on average, nine times greater than the value of financial services exports.

Chart 10

Foreign Affiliate Sales Are the Principal Means of Providing Financial Services to Overseas Customers

(exports as a share of foreign affiliate sales, per cent)



Sources: Statistics Canada, CANSIM tables 376-0060 and 376-0108; The Conference Board of Canada.

Foreign affiliate sales in the financial services sector[12] have experienced robust growth over the past decade, with sales more than doubling from 1999 to 2012. (See Chart 11.) In comparison, foreign affiliate sales for all Canadian companies have risen by 60 per cent and for all service-oriented companies by 83 per cent over the same period. As a result, the financial services sector represents a steadily growing segment of Canada's foreign affiliate sales, rising from 12.6 per cent share in 1999 to 19.6 per cent by 2012.

The increasing volume of foreign affiliate sales attests to the fact that Canadian financial institutions have been developing their commercial presence around the world, and that presence has been growing by means of foreign direct investment (FDI) into the host countries. The IMF defines FDI as any direct investment into a business in a host country by an individual or company of a foreign country. FDI enables an investor to have a significant voice in the management of an enterprise operating

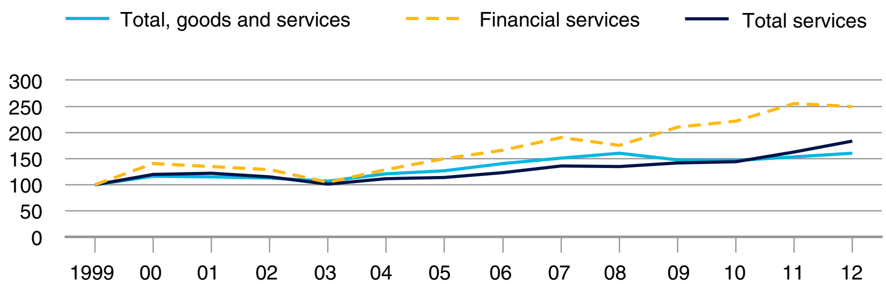
12 For our purposes, we combine the data for the financial services (NAICS 52) and holding companies (NAICS 55) sectors and refer to them as the financial services sector. We do this since financial institutions often use holding companies to set up and operate their foreign affiliates.

Canada's financial services outward FDI has grown immensely in the last 15 years, more than tripling since 1999. The expansion of FDI has enabled Canadian financial institutions to extend their international footprint.

Chart 11

Canadian Financial Services Sales Through Foreign Affiliates Have Outperformed Those of the Services Sector in General

(foreign affiliate sales index, 1999 = 100)



Sources: Statistics Canada, CANSIM table 376-0060; The Conference Board of Canada.

outside the investor's home country. The phrase "significant voice" usually means ownership of 10 per cent or more of the ordinary shares, voting power, or the equivalent.

Canada's financial services outward FDI has also grown immensely in the last 15 years, more than tripling since 1999. (See Chart 12.) The great expansion of FDI has enabled Canadian financial institutions such as banks, insurance companies, and pension funds to extend their international footprint. (See box "Canada's Pension Funds: Expanding on the World Stage.")

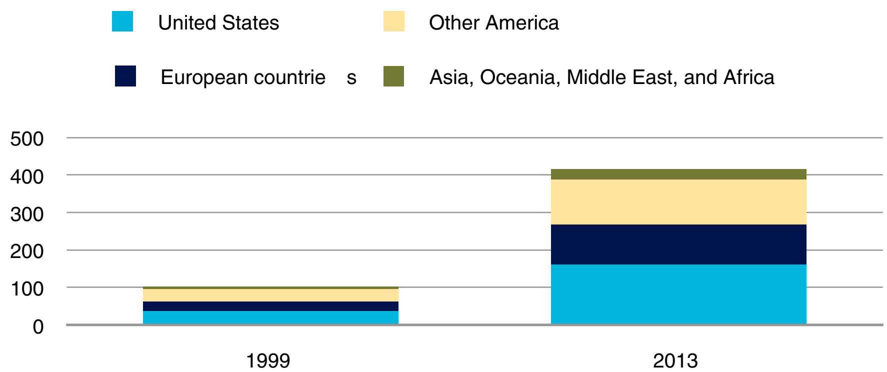
The U.S. remains the primary destination for Canadian financial services FDI, accounting for 39 per cent of the total outward stock of investments in 2013. This is followed by "Other Americas" (29 per cent) and Europe (26 per cent). These shares have remained largely static over the past 15 years. Thus, Canadian financial institutions have taken a broad approach to investing across a number of regions, instead of focusing on any particular area.

The motivations for Canadian financial institutions to invest abroad are many. For example, investing in new markets offers the potential to attract new customers for the institutions' services or products and to improve economies of scale and market power; plus, it may lead to

Chart 12

Canadian Financial Institutions Have Invested Heavily Abroad

(outward FDI stock for financial services, $ billions)



Sources: Statistics Canada, CANSIM table 376-0052; The Conference Board of Canada.

greater profits for shareholders. However, there are also extra costs associated with international expansion, such as greater transportation or overhead costs, costs associated with adapting products to different cultural and linguistic standards, and regulatory expenses. As such, the rest of the report will explore and try to understand the experiences of Canadian financial institutions' international operations.

Canada's Pension Funds: Expanding on the World Stage

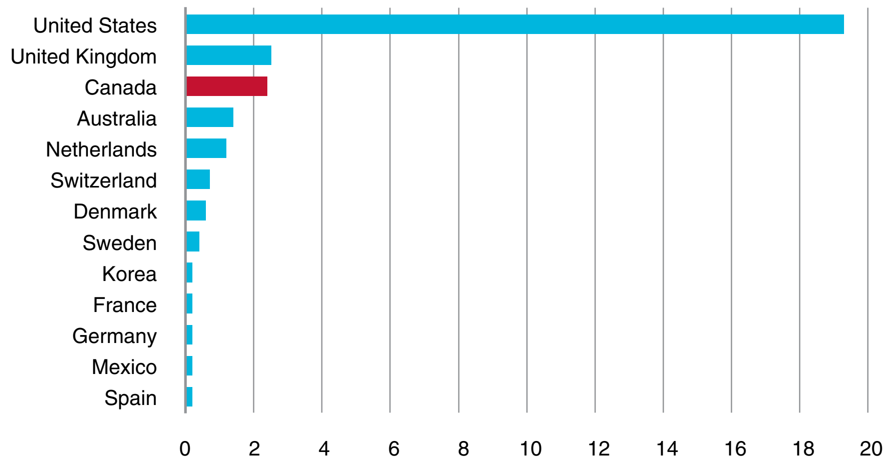
The pool of pension assets in Canada is most impressive. In fact, with total pension assets of over US$2 trillion, Canada was ranked number three in the world in 2012 in terms of pension assets. (See Chart 13.) The large pool of pension assets translates into Canada's having some of the largest pension funds managed in the world. In 2013, the two largest Canadian funds—the Canada Pension Plan Investment Board (7th) and the Ontario Teachers' Pension Plan (17th)—were both ranked among the top 50 pension funds in the world in terms of assets under management.[13] And the Ontario Municipal Employees Retirement System (OMERS) was ranked as 51st.

13 Towers Watson, *Pension & Investments*.

Chart 13

Canadian Pension Funds Held the World's Third Largest Pool of Assets

(US$ trillions, 2012)



Source: OECD.

Canada's pension funds continue to expand their international presence. Foreign investments accounted for more than 30 per cent of the total portfolio in 2013, up from 17 per cent in 1999.[14] For example, the Canada Pension Plan Investment Board held 63.3 per cent of its assets outside of Canada, in 39 different countries.[15] The Ontario Teachers' Pension Plan had direct investments in 50 countries worldwide, with close to 50 per cent of its assets invested outside of Canada.[16] OMERS also had significant international holdings, with 53 per cent of assets invested abroad.[17] Additionally, the Healthcare of Ontario Pension Fund also possessed significant foreign holdings: 43 per cent of its portfolio in 2013.[18]

14 Statistics Canada, CANSIM table 280-0003.

15 Canada Pension Plan Investment Board, *Annual Report 2013*.

16 Ontario Teachers' Pension Plan, *Today for Tomorrow.*

17 Ontario Municipal Employees Retirement System, *Going the Distance*.

18 Healthcare of Ontario Pension Plan, *Fully Committed.*

Portfolio diversification by geography helps to explain the investment strategy of large Canadian pension funds. The strategy diversifies risk exposure beyond the relatively small Canadian economy. As well, greater global diversification allows income from foreign investments to flow back into Canada to support future pension payments.

Canadian pension funds have participated in some very large transactions in recent years that have helped to drive up their foreign holdings. These deals included investments in one of the largest electricity transmission and distribution companies in the U.S., several airports in the United Kingdom, three Chilean water utilities, and one of the largest and most profitable insurance providers in South Korea.[19] These types of investments are not generally a traditional form of commercial presence for the financial services sector. This is because these assets are not necessarily providing financial services in the destination market (e.g., an airport owned by a pension fund sells air transportation services, not asset management services). However, these types of holdings have increased the visibility of Canadian pension funds in those foreign markets. For example, four Canadian pension funds were among the top 20 global commercial real estate investors. As well, four Canadian pension funds were among the top 20 global investors in infrastructure assets.[20]

19 Ontario Teachers' Pension Plan, "Canada's Top Ten Pension Funds Help Drive National Prosperity."

20 Ibid.

CHAPTER 3

The Experience of Toronto's Financial Institutions in Foreign Markets

Chapter Summary

- More than half of surveyed firms are active in 11 or more countries, with more than 40 per cent of surveyed firms garnering more than one-quarter of their revenues from outside Canada.
- Markets in North America, Asia, Europe, and Latin America are the areas primarily targeted for foreign growth over the next two to three years.
- The survey results show asset management as the most popular way to boost overseas growth over the next two to three years.
- Acquisitions, establishing a subsidiary, and joint ventures/local partnerships are all key market entry strategies when going overseas.
- Three building blocks of a successful foreign market entry are understanding/respecting local culture, finding a strong/reputable local partner, and having management expertise with local experience.

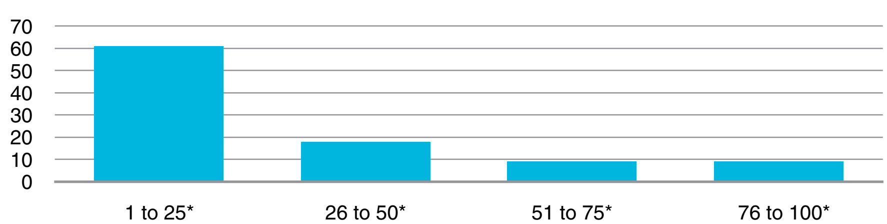
Given the growing international presence of Canadian financial services institutions, it is important to recognize the challenges and key success factors of those institutions when they conduct business in foreign markets. To do this, The Conference Board of Canada, in partnership with the Toronto Financial Services Alliance, designed and conducted a survey to examine the international operations of financial services firms based in Toronto in terms of (1) their market entry strategies/approaches; (2) the factors that are considered when entering a new market; and (3) the key challenges of conducting business outside Canada.

A total of 47 responses from 40 different institutions were received. The survey participants represent a cross-section of Toronto's financial services sector, with three industries—banking, insurance, and securities—accounting for the majority (82 per cent) of respondents. The surveyed firms all have international operations and close to 40 per cent of respondents indicate that they currently derive one-quarter or more of their revenues from overseas. (See Chart 14.)

Chart 14

Many Financial Institutions in Toronto Derive a Major Share of Their Revenues From International Operations

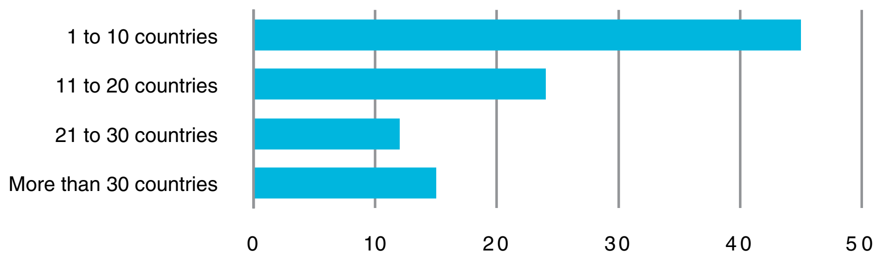
(n = 32; share of responses, per cent)



*per centage from international operations
Source: The Conference Board of Canada.

As well, all the respondents operate on a worldwide basis with more than half active in 11 or more countries. (See Chart 15.) These firms can therefore provide useful information about their experiences in conducting business in foreign markets.

Chart 15
Most Respondents Operate in at Least 11 Countries
(n = 32; share of responses, per cent)



Source: The Conference Board of Canada.

The survey asked respondents about the locations of their operations, with countries grouped into six regions: North America, Asia, Europe, Latin America and the Caribbean, Oceania, and Africa.[1] The respondents currently operate in only four of the six regions. North America remains the centre of business, with more than half of the surveyed firms conducting a majority of their business in the region. (See Chart 16.) One-quarter of institutions do business primarily within Asia. Less than 10 per cent of respondents operate mainly in Europe or in Latin America and the Caribbean. These four regions are also the primary targeted growth markets for respondents over the next two to three years. Asia in particular is of note, with nearly 60 per cent of respondents indicating that it is a target growth market.

1 North America includes Bermuda, the United States of America, Greenland, Saint-Pierre and Miquelon. Asia includes Eastern, South Central, South Eastern, and Western Asia. Europe includes Eastern, Northern, Southern, and Western Europe. Latin America and the Caribbean includes the Caribbean, Central America, and South America. Africa includes Eastern, Middle, Northern, Western, and Southern Africa. Oceania includes Australia, New Zealand, Melanesia, Micronesia, and Polynesia.

Chart 16

Toronto-Based Financial Institutions Would Like to Expand Their Business in All Regions

(n = 31; share of responses, per cent)

Source: The Conference Board of Canada.

At present, none of the surveyed financial institutions conducts business primarily in Africa or Oceania. However, a handful of respondents have targeted these regions for near-term growth. The smaller size of many markets in these areas may be one factor limiting the interest of Canadian financial institutions. Regulatory or geopolitical risk factors may also be a concern in some markets.

Besides identifying targeted international growth targets in the near term, it is also important to learn about specific products or services that Canadian financial institutions would like to grow. "Asset management" stood out as the most popular way to expand overseas, with 55 per cent of respondents aiming to grow their business in this area over the next two to three years. (See Chart 17.) Expectations for strong growth in asset management revenues and profitability beyond those experienced in the banking and insurance segments are two likely factors.[2] According to McKinsey, global assets under management reached a record high in 2012. While assets under management in North America are significantly

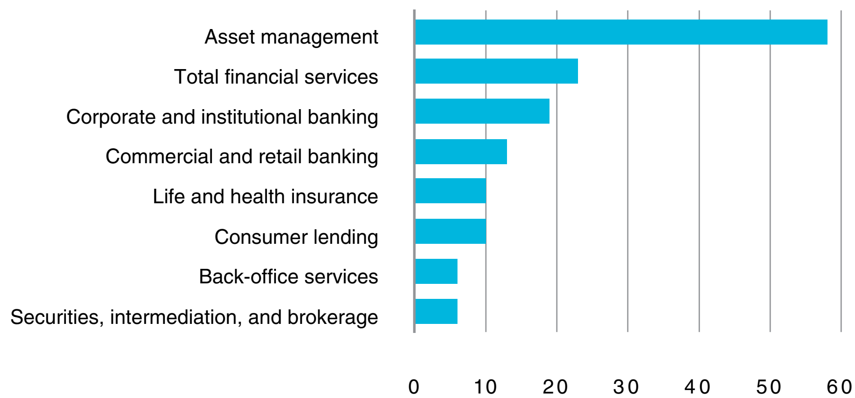
2 Baghai and others, "Searching for Profitable Growth in Asset Management."

greater in absolute terms because of this market's dominant position, asset management in emerging markets is growing faster than in developed markets and is slowly increasing its global share.[3]

Chart 17

Majority of Surveyed Respondents Aim to Grow Asset Management Services in the Next Two to Three Years

(n = 31; share of survey responses, per cent)



Source: The Conference Board of Canada.

Foreign Market Entry Strategies/Approaches

Because companies have different objectives when entering a new market, the choice of market entry mode often differs from firm to firm. There are many different types of entry modes into new markets, such as licensing, strategic alliances, joint ventures, and subsidiaries. According to the survey, three major market entry strategies/approaches are used by Canadian financial institutions in foreign markets:

- making acquisitions
- establishing subsidiaries
- setting up joint ventures or local partnerships

3 Shub and others, "Global Asset Management 2013.

Acquisitions involve the direct ownership of firms in the target country. This allows the foreign investor to have direct control of operations and to gain complete access to the assets and/or knowledge of the acquired firm(s). This approach is typically taken if it aligns with a company's long-term strategy to strengthen its presence abroad, as it requires a high level of resources and strong commitment. This is also the preferred approach in countries where legal impediments preclude the direct establishment of branches or offices of the foreign company.[4]

A subsidiary is a partially owned company with a parent company holding more than 10 per cent of the subsidiary's stock. This approach is often chosen if the host country has a weak economy or a risky business environment.[5] This is also the preferred approach if a financial institution has a line of retail businesses, such as deposit-taking. Thus, the financial institution may benefit from having a local management team that will be directly accountable for the performance of the subsidiary.[6] As well, the subsidiary structure may place fewer liabilities on the parent company in the event of distress (or failure).[7]

Joint ventures occur when two or more firms join together to create a new business entity that is legally separate and distinct from its parent companies. Moreover, a separate management team is created to carry out the tasks specific to the joint venture. There are many reasons why firms set up joint ventures, such as gaining access to the technology, distribution channels, or management skills of the other firms involved while simultaneously sharing risk. Joint ventures often facilitate market entry for foreign firms that believe they may not fully understand the market conditions in the host country. For example, one study[8] on

4 Dahl, "International Operations of U.S. Banks"

5 Feinberg and Gupta, *MNC Subsidiaries and Country Risk*.

6 Fiechter and others, "Subsidiaries or Branches."

7 Cerutti and others, "How Banks Go Abroad."

8 Kogut and Singh, "The Effect of National Culture on the Choice of Entry Mode."

market entry modes used by foreign firms entering the U.S. found that the greater the cultural distance between the home and host countries, the greater the probability that joint ventures would be employed.

Joint ventures have become increasingly popular in recent years. They allow companies to share the risks and resources required to enter a new market. As well, partnering with a local firm can reduce transaction costs associated with acquiring resources and carrying out business in a foreign country.[9] It also increases access to expertise and contacts in the local market. Finally, joint ventures are often used as a way of meeting government regulatory requirements.

In summary, the three different entry modes have distinct characteristics such as their upfront investment requirement, political risk exposure, market penetration, and return on investment.[10] (See Table 1.)

Table 1
Comparing Three Different Market Entry Modes

	Acquisition	Subsidiary	Joint venture
Upfront investment	High	High	Medium
Speed of entry	Quick	Slow	Quick
Market penetration	High	Medium	Medium/high
Political risk exposure	High	High	Medium
Return on investment	High/medium	High/medium	High/medium

Source: Lasserre, *Global Strategic Management.*

Our survey shows that market entry strategies and approaches used by Canadian financial institutions are not limited to any of these entry methods. No single method stands out as being employed more often than the others, and some respondents use all three methods. The survey results do not suggest a preference for any particular market

9 Bhaumik and Gelb, "Determinants of MNC's Mode of Entry Into an Emerging Market."

10 Lasserre, *Global Strategic Management.*

The survey results do not suggest a preference for any particular market entry mode. Instead, local market risks and regulatory requirements are the most likely factors in determining the preferred mode of entry for that market.

entry mode. Instead, local market risks and regulatory requirements are the most likely factors in determining the preferred mode of entry for that market.

Keys to Success

Success in a foreign market takes more than just choosing an entry strategy. In fact, it demands a broader approach. The survey identified three building blocks of successful foreign market entry:

- understanding and respecting the local culture, environment, client base, and market;
- finding a strong local partner and joint-venture brand;
- having management expertise with local experience.

Understanding the local culture is a complex yet essential criterion. This is because culture encompasses many different elements, from language, customs, and religion to values, aesthetics, and attitudes. Each element affects consumption behaviour and the purchasing pattern of individuals. Thus, it has direct implications on how the services or products should be launched and marketed to local customers.

The strength of a local partner and the reputation of the joint-venture brand are viewed by survey respondents as significant factors for success. This is not surprising, given that many Canadian financial institutions undertake joint ventures/partnerships with local companies. While the strength of a local partnership is important when forming a successful joint venture, more is needed to succeed. Clear objectives related to the partnership, trust between the partners, and a good cultural fit between the partners are also important to success.[11] (See Chart 18.)

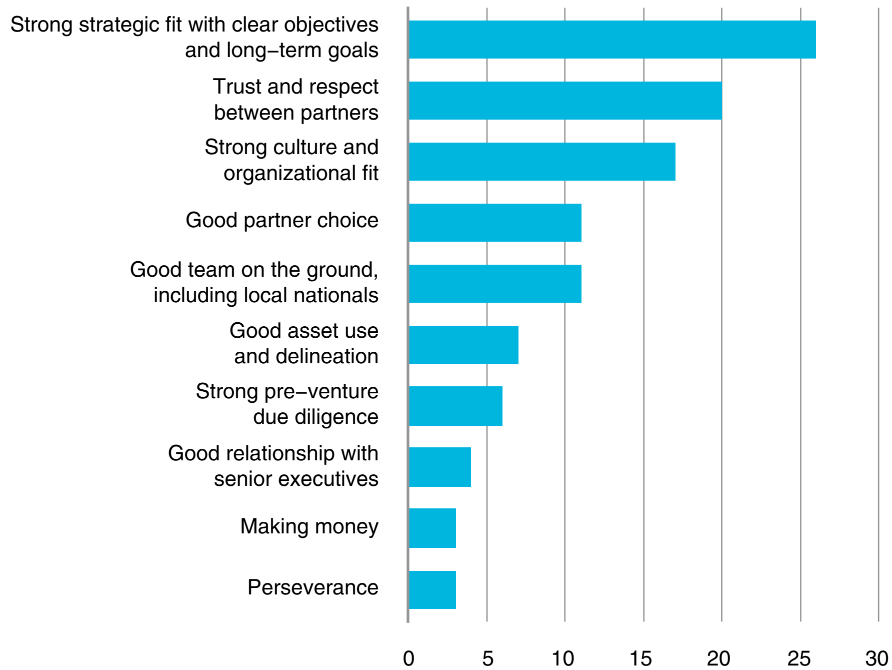
Commencing business operations in a new market can involve significant risks. Therefore, it is essential to have a strong management team with the right skills. Experience among Canadian managers with developing

11 Hubbard, *Conquering Global Markets.*

Chart 18

Importance of Criteria for a Successful Joint Venture

(share of respondents, per cent)



Source: Hubbard, *Conquering Global Markets*.

and implementing business strategies is important. Equally important is having people with local expertise, who understand the intricacies of the market, as part of the management team. Localized experience helps to mitigate potential learning mistakes that are often made by inexperienced managers in new markets. According to the Globalization Index Survey 2009, organizations that operate in more than 10 countries are more likely to have a higher proportion of senior management who are nationals of another country.[12]

12 Ernest & Young, "20 Issues for Businesses Expanding Internationally."

Getting the right people in the right location can provide a vital competitive advantage. The quickest method of acquiring the right people is through “buying” them—for example, by forming a partnership with local firms or by hiring directly from the local experienced workforce. Otherwise, developing the experience takes a significant amount of time through learning-by-doing as well as “growing pains.” This could at times mean the difference between success and failure when expanding into a new market.

Key Challenges

Survey respondents cited many different challenges to entering new markets; however, three challenges were identified as the most pronounced:

- regulatory barriers
- access to the right people and skill sets
- understanding the local market and competitive landscape

Regulatory barriers were identified by respondents as one of the key challenges of conducting business outside Canada. Although regulatory restrictions vary by country, limitations are often placed on, for example, the degree of foreign ownership, the format of foreign financial institutions’ establishment in the local market (e.g., branch) directly, and the range of services offered by foreign financial institutions. This can be partially attributed to the fact that the financial services sector is often regarded as a sector of national importance and a tool to foster domestic economic development. Therefore, national governments tend to favour firms owned and controlled by domestic interests. Furthermore, several countries have suffered serious banking crises following deregulation and liberalization of their banking sectors.[13]

13 Cornelius, “Trade in Financial Services, Capital Flows, and the Value-at-Risk of Countries.”

Apart from regulatory barriers, access to the right people and skill sets is considered the second greatest challenge faced by Canadian financial institutions when they look to hire talent with appropriate qualifications to help carry out their international operations. This result echoes Manpower Group's annual global talent shortage report, which lists that "accounting and finance staff" was one of the top five most difficult jobs in 2013 for global employers to fill due to the lack of available talent.[14]

Another challenge respondents frequently raised is developing a deep understanding of the local market and competitive landscape. This is due sometimes to complications associated with the source, quality, and comparability of available information with respect to the foreign market. It may also be due to variations in business practices from country to country that may confuse or send distorted signals to companies unfamiliar with the formal and informal business or regulatory procedures of foreign countries.

In summary, going abroad offers both opportunities and challenges for Canadian financial institutions. In the next chapter, we share specific experiences of four Canadian financial firms about overcoming the challenges and operating successfully internationally.

14 ManpowerGroup, "2013 Talent Shortage Survey Research Results."

CHAPTER 4

Foreign Market Entry: Canadian Financial Institutions Examples

Chapter Summary

- Core motivations behind global expansion plans include higher growth potential in foreign markets, competitive differentiation, and diversifying the customer base.

- The market entry mode of firms depends on factors such as the degree of understanding of the local market, regulatory barriers, and the opportunities that exist in the market.

- The interviews confirmed three common hurdles to global expansion: regulatory barriers, cultural barriers, and successfully developing the company brand.

The previous chapter provided some broad insights regarding the size of the international presence of Toronto's financial institutions, as well as which markets they are targeting, different success factors, and key challenges. However, surveys provide only limited practical advice about what individual businesses should do when entering foreign markets. To gain some additional insights, we conducted a series of interviews with four financial institutions headquartered in Toronto. (The interview guide that was used can be found in Appendix A.)

The interviews provided an overview of the institutions' international operations, challenges, and routes to success. The small number of interviews does not allow us to draw definitive conclusions; nonetheless, we are able to identify common themes and opinions.

Motives Behind Global Expansion

Interviewees reported that foreign market entry decisions can be driven by many different motives. For example, some decisions are related to the economic characteristics of the foreign business environment, such as gross national income per capita. Others are related to a company's business strategies in terms of geographic or product diversification. As well, a company may want to enter a market to obtain the "first-mover" advantage. All interviewed companies expressed a core set of motivators behind their global expansion plans.

Higher Growth Potential Internationally

Nearly all the interviewees stated that a key attraction of international markets is the higher growth potential, particularly in emerging markets. The Canadian financial market is mature, both in terms of accessibility and product offerings. For example, according to the Canadian Bankers

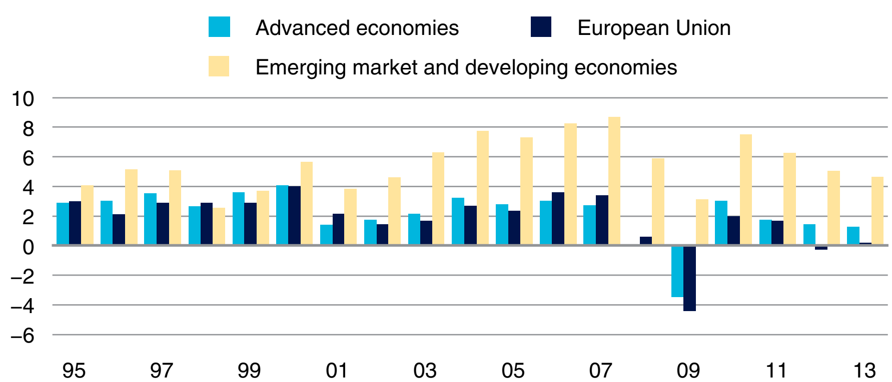
Association, there are more than 100 personal and business account packages on the market and 96 per cent of Canadians hold an account with a financial institution.[1] Moreover, Canadian firms are increasingly being challenged at home by foreign financial institutions, as information and communication technologies have broken down some of the barriers that previously protected domestic institutions from external competition.

Other factors such as the size of the population, the degree of local purchasing power, and economic growth determine the market potential for businesses seeking to expand internationally. The local competitive landscape and regulatory environment are also key considerations. Many emerging markets meet some or all of these objectives. For example, GDP growth in developing countries has consistently outpaced that in developed economies since 1995. (See Chart 19.)

Chart 19

GDP Growth of Developing Economies Has Outpaced That of Developed Economies Since 1995

(gross domestic product, constant prices; annual percentage change)



Source: World Economic Outlook Database, IMF, April 2014.

1 Canadian Bankers Association, "Competition in the Financial Services Sector."

Canadian financial institutions can adapt the expertise they have gained at home to create a competitive advantage elsewhere.

The "usual suspects," such as Mexico, India, China, and Brazil, are part of this story. However, many other countries can offer the right mix of growth characteristics and a degree of openness to foreign financial institutions. For example, in Asia, this would include countries such as Indonesia, Malaysia, and Vietnam.

Creating a Competitive Advantage

Due to the maturity of Canada's financial sector and its high degree of concentration in many segments, domestic growth opportunities are limited. As well, the convergence among major players in terms of the types of products and services they offer means that financial institutions struggle to differentiate themselves from their competitors in the Canadian market. This is less true in many other countries where the financial products that are available may be less developed. As such, the ability of Canadian financial institutions to offer an array of products can be a competitive advantage in those markets. In short, Canadian financial institutions can adapt the expertise they have gained at home to create a competitive advantage elsewhere.

Diversification of Customer Base

Interviewees also mentioned that an additional objective when expanding into foreign markets is diversification of their customer base, which ultimately acts as a form of risk mitigation. For example, negative credit and liquidity shocks from individual customers would have a smaller impact on the overall firm due to the increased risk-pooling of the customer base. As well, geographic dispersion of the customer base may reduce risk exposure in a particular market because any adverse economic development unique to one market area may not affect an institution in other markets.[2]

2 Emmons and others, "Scale Economies and Geographic Diversification as Forces Driving Community Bank Mergers.

Market Entry Modes for Global Expansion

One of the most important decisions regarding companies' global expansion strategies is the choice of market entry mode, as this affects how the company operates in the selected market. None of the interviewees preferred any one particular market entry mode. Instead, the interview results showed that firms have chosen a variety of market entry modes, ranging from mergers and acquisitions, to joint ventures, to the establishment of subsidiaries through greenfield investments.

The market entry mode differs depending on a number of factors such as existing relationships with local counterparts, a company's risk strategy, and the regulatory environment of the target market. The fact that the four firms interviewed operate in different business sectors means that they have different customer needs and product offerings, which have also led to different market entry strategies.

Obstacles to Global Expansion

Interviewees acknowledged that there are obstacles associated with international expansion. Understandably, each financial institution faces its own specific barriers, but three common hurdles were identified.

Regulatory Barriers

Interviews with executives pinpointed two major reasons why foreign market regulations can hinder international expansion plans. First, businesses are required to comply with local regulations and laws that are often different from Canadian regulations. Understanding these regulations and changing the product or service offerings to comply can be time-consuming and expensive, potentially limiting the success of the foreign venture. For example, in China, joint ventures are required if the sales operations are located within the country, and the foreign partner must fund at least 25 per cent of the total project costs,[3]

3 Wikipedia, "Joint Venture."

whereas Canada does not have this funding requirement for foreign investors. In a recent survey of 250 global companies from six different sectors, including financial services,[4] more than half of respondents estimated regulation compliance costs to be 5 per cent or more of their annual turnover.[5]

"Red tape" was identified as the other major regulatory hurdle for business development in foreign markets. For example, local regulations may prohibit issuing certain financial product licences or permits to foreign financial institutions. As such, this may limit their ability to offer the full range of products that they would have otherwise developed in the local market.

These two reasons align with the findings of a survey of global financial services institutions published by Deloitte in 2013.[6] In the survey, financial institutions around the world shared their rationales as to why compliance with new regulations can be an obstacle to growth. (See Chart 20.) The costs associated with regulation and compliance is the number one reason, with more than 80 per cent of respondents indicating that the cost of new regulations is impeding growth.

Our interviews revealed several approaches to navigating these regulatory barriers. Understanding how the nuances of local regulations impact the business is an important first step. In addition, putting in place sound business practices such as a financial reporting system that complies with local regulations will also help to ensure success in foreign markets. In markets where regulatory barriers are significant or poorly understood, acquisition may be a good entrance strategy. This will allow the acquiring company to learn from experience of the local firm.

4 Berwin Leighton Paisner LLP, "The Speed of Business."

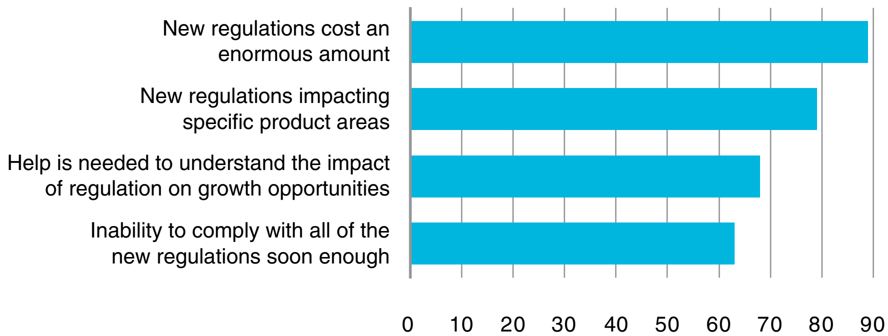
5 In business, *turnover* or *revenue* refers to income that a company receives from its normal business activities, usually from the sale of goods and services to customers.

6 Deloitte, "Elements for Successful Growth in Financial Services."

Chart 20

Main Reasons Why Compliance With New Regulations Is an Obstacle to Growth

(share of responses, per cent)



Source: Annual Survey of Global Financial Institutions, Deloitte, 2013.

Cultural Barriers

Besides the regulatory barriers, interviewees identified cultural barriers as an issue that may hamper the success of an international operation. Since culture combines many different elements that together create a unique way of living, our interviewees talked specifically about two elements: customs/traditions and languages. In their view, without a clear understanding of the local customs/traditions, a company's management team may have issues closing local contracts or agreements. That could mean reduced business opportunities and increased risk of financial loss. For example, business meetings for foreign companies wanting to operate in the Middle East should always include a local intermediary. Gifting is an important trust-building exercise in the Middle East and Asia, but it must always be given at the end of meetings. Conversely, in Latin America, gifting is usually done at the start of business meetings.

Furthermore, language differences can create communication barriers between the management team and its local representatives who interact with government, regulators, and customers. At a minimum, misunderstanding and inefficient communications make it difficult to build trust and slow the process of a business establishing itself. More importantly, language barriers can make it difficult for the company to transfer its company's competencies and skills to foreign markets.

Our interviewees proposed three different techniques to transcend cultural barriers. First, developing a deep understanding of, and respect for, cultural nuances in each chosen market is vital. And a company must adapt to the unique conditions of a particular market by, for example, making appropriate product adjustments to suit local customs. Last but not least, seeking out competent local partners with the requisite local expertise is critical to closing the knowledge gap and overcoming the cultural barriers.

Brand Development

Another potential stumbling block to operating successfully abroad is the time and cost associated with establishing and building a brand in the local market. If existing competitors already have well-established brands, this may require new entrants to invest heavily in both money and time to introduce their new brands. And this is no easy task. Internal conflicts can arise if the management team does not fully understand that building a brand requires a long-term commitment with possibly only a long-term payoff. In some cases, the foreign market can be hard to break into because local brands often evoke national pride.

Our interviewees mentioned that businesses can attempt to build up the brand of their company and products in various ways such as with advertising and word-of-mouth. However, advertising alone is not sufficient to ensure awareness. Companies need to learn how to reach out to local customers with messages that are tailored and relevant to the local context. Sometimes, finding a local partner that matches the company's profile can be a good place to start. This may mean acquiring a local established brand and then potentially rebranding, rather than building an unfamiliar brand in a market from the ground up. As well, ensuring products consistently live up to customers' expectations is another time-tested way to help establish and build a brand in foreign markets.

Company Profiles

We have prepared profiles about the international operations of three of the four firms we interviewed. These profiles have three objectives: (1) to provide a detailed description of the international operations of each firm; (2) to analyze the entry mode chosen by each firm when entering foreign markets; and (3) to identify the success factors behind each firm's international expansion strategies. Through these profiles, we hope to provide some useful insights for other companies that may wish to diversify internationally.

Information and data collection instruments used included annual reports, official firm websites, and various news articles about the internationalization of the firms.

Scotiabank

Scotiabank is Canada's most international bank and a leading financial services provider in more than 55 countries spanning three key regions: Latin America (focusing on the Pacific Alliance, i.e., Mexico, Peru, Chile, and Colombia); the Caribbean and Central America, and parts of Asia. Through a team of more than 86,000 employees—50,000 of whom are located outside Canada—Scotiabank and its affiliates offer a range of products and services, including personal and commercial banking, wealth management, and corporate and investment banking, to more than 21 million customers.

The bank serves its international customers through two business lines, International Banking and Global Banking and Markets. The International Banking business line offers a full range of personal and commercial financial services as well as wealth management and insurance in Latin America, the Caribbean and Central America, and Asia. The Global Banking and Markets business line offers corporate lending, equity and debt underwriting, mergers and acquisition services, capital market products and services, and global transaction banking services.

Scotiabank's international businesses have experienced strong growth over the past 10 years. In 2003, earnings generated outside Canada represented 36 per cent of the bank's net income. By 2013, 47 per cent of earnings were generated through this business segment.

The bank has used a variety of market entry strategies for different geographic locations. For retail and commercial banking, the bank has tended to make an initial investment, often with a local partner, choosing markets in which it is comfortable operating that have higher growth potential, the right economic indicators, and stable economic fundamentals. Once the market opportunities are understood, Scotiabank then builds incrementally; examples of this include Peru and Chile. Alternatively, strategy can be driven by customer needs. The presence of the Global Banking and Markets business line in Asia is an example of this, where customer needs continue to drive the strategy in that region.

Manulife Financial

Since welcoming its first customers more than 125 years ago, Manulife has grown into a leading Canada-based financial services group with principal operations in Canada, the United States, and Asia.

Manulife's history began in 1887 under Sir John A. Macdonald, Canada's first prime minister and Manulife's first president. Today, the firm serves one in five Canadians, offering a diverse range of life insurance, estate planning, health, pension, investment, and banking solutions through a diversified multi-channel distribution network. The Canadian market contributed approximately 33 per cent of the company's business in 2013.

However, it is the U.S. market that accounted for the largest share of Manulife's earnings (45 per cent) in 2013. Manulife has operated in the United States since 1903. Nevertheless, it greatly expanded its U.S. operations when it merged with the U.S.-based John Hancock Financial Services in 2004. That merger made Manulife, at the time, the largest life insurer in Canada, the second largest in North America, and the fifth largest in the world. Manulife's U.S. insurance division operates under the John Hancock brand and provides a full range of life and long-term-care insurance products and services. John Hancock also offers a broad range of personal and family-oriented wealth management products and services focused on individuals and the business market.

Manulife has also operated in Asia since 1897. As a pan-Asian financial services company, it has insurance and asset management operations in 12 territories, namely Hong Kong, the Philippines, Singapore, Indonesia, Taiwan, China, Japan, Vietnam, Malaysia, Thailand, Cambodia, and Macau. In 2013, Asia contributed 28 per cent of the company's earnings.

Manulife's international expansion strategy in Asia uses multiple market entry modes. These range from establishing joint ventures, to acquisitions, to establishing greenfield licences. For example, in 1996, Manulife—together with China-based Sinochem Finance Co., Ltd.—created Manulife-Sinochem Life Insurance Co. Ltd (MSL). This was the first-ever Chinese-foreign joint-venture life insurance company established. It was also the first foreign-invested joint-venture life insurance company to be granted a branch licence by the China Insurance Regulatory Commission. Today, MSL has 51 city licences, the highest number of city licences for a foreign joint-venture life insurance company.

Examples of acquisitions include Manulife's purchase of Daihyaku Mutual, one of the largest insurers in Japan in 2001. Also, Manulife decided to set up a wholly foreign-owned life insurance subsidiary when it entered Cambodia in 2012.

Thus, Manulife has used all three market entry strategies to build its high-growth Asia business. These market entry strategies were developed based on a number of factors such as market size, regulatory environment, competitive landscape, and industry structure. Most of all, the success of Manulife's international operations has been due to its long-term commitment to and recognition of business opportunities outside Canada. Manulife works to build strong relationships between local partners and governments and to build a brand that consumers know and trust. Differentiating between markets and taking the time to understand differences between countries have also been fundamental to its success.

TMX Group

TMX Group Limited (TMX Group) is an integrated, multi-asset class exchange group whose businesses operate cash and derivative markets and clearinghouses for multiple asset classes, including equities, fixed income, and energy. TMX Group businesses also provide clearing facilities, depository services, data products, and other services to the global financial community. International business contributed roughly 30 per cent of TMX Group's total revenue in 2013.

This case study will focus on TMX Group's equities exchanges, the Toronto Stock Exchange (TSX) and the TSX Venture Exchange (TSXV). Taken together, TSX and TSXV's international footprint is captured by allowing offshore investors to participate in Canada's equities markets and by providing platforms for companies worldwide to access North American growth capital. Key markets include the United States, Australia, New Zealand, China, the United Kingdom, Africa, and Central and South America. The exchanges are home to more than 3,500 listed companies across a broad range of sectors, including mining, oil and gas, technology, life sciences, and financial services, to name a few.

TMX Group's equities markets enable retail and institutional investors from around the world to trade Canadian-listed securities and access investment opportunities. Every day, it is estimated that 40 per cent of trading activity on TSX and TSXV originates from international brokers outside of Canada, such as UBS, Morgan Stanley, and Barclays Capital. Domestic banks such as the Bank of Montreal, which operates in China, and Scotiabank, with its extensive Latin American network, also facilitate trading by offshore investors.

Moreover, TSX and TSXV have strong ties with Latin American countries. For example, several Latin American companies are listed on TSX and TSXV, and over 500 companies listed on the exchanges have operations in Latin America, primarily mining and oil and gas companies. Thus, a key part of TMX Group's international revenues is derived from the internationalization of its services. Latin American ties were made stronger in March 2014 when TSXV entered into an agreement with the Santiago Stock Exchange (BCS) in Chile that will eventually lead to the creation of a new venture exchange division of the BCS, called the "Santiago Stock Exchange, Venture." Once implemented, the agreement will leverage the experience of TSXV as a global specialist in facilitating capital formation for early-stage growth companies.

TSX and TSXV also take a targeted approach in their marketing strategy, for example, by directly promoting their profiles through local seminars and information sessions around the world. They also conduct regular road shows and investor days across the U.S., China, and major Latin America cities.

In looking at TMX Group's business operations more broadly, opening international offices is another important component of the group's international business strategy. TMX Group is headquartered in Toronto and operates offices across Canada (Montreal, Calgary, and Vancouver) and in key U.S. markets (New York, Houston, Boston, and Chicago), as well as in London, Beijing, and Sydney. Earlier this year, TMX Group announced plans to open a new office in Singapore. Thus, its primary market entry strategy is to directly establish offices in foreign markets. TMX Group believes that strategically establishing offices in certain international cities provides an important local presence, as well as efficient services to local clients. Ultimately, the aim is to bring in more overseas listings into Canada's capital markets.

CHAPTER 5
Conclusion

Chapter Summary

- Financial services are becoming increasingly tradable; since 2000, global financial services exports have tripled, while Canadian financial services exports have nearly quadrupled over the same period.
- Establishing foreign affiliates is the primary means for Canadian financial institutions to operate overseas; foreign affiliate sales in the financial services sector have more than doubled since 2000.
- There are ample opportunities for additional growth, particularly in emerging markets. Growing business and consumer demand for financial services plus a limited degree of available services make these markets desirable.
- However, barriers to trade and investment tend to be higher in many emerging economies compared with developed economies.
- Other challenges when conducting business in foreign markets include accessing the right people, gaining a thorough understanding of the local market, and successfully developing the company brand.
- Three keys to overcoming the obstacles include understanding and respecting local culture, finding a strong/reputable local partner, and having management expertise with local experience.

Financial services are becoming increasingly tradable; since 2000, global financial services exports have tripled. Canadian financial institutions are part of this trend. Canadian exports of financial services have nearly quadrupled over this period, and foreign affiliate sales have more than doubled. All three segments of financial services exports (banking, insurance, and other financial services) have experienced robust growth in Canada, with "other financial services" in particular experiencing the strongest growth.

Several factors help to explain this growth in global financial services exports. First, technological advancements, the greater adoption of electronic data processing, and the new era of Internet-based banking services have increased the geographic footprint of the financial services sector. What is more, there are ample opportunities for financial services trade and investment to grow even further. Foreign penetration rates in many countries are low and emerging markets are of particular interest. Their strong economic growth is creating demand for new financial services among businesses and consumers, and these markets are often underserviced with less-well-established incumbents.

Canadian financial institutions have recognized this growth potential and are increasingly targeting their international expansion strategies toward emerging economies. This is reflected in our survey results, where nearly 60 per cent of respondents indicated that Asia is a top target growth market over the next two to three years.

However, operating in foreign markets does not come without challenges. Barriers to trade and investment tend to be higher in many emerging economies compared with developed economies. This aligns with our survey and interview results, which both identified regulatory barriers as the number one challenge when conducting business in foreign markets. Another challenge commonly raised was developing a thorough understanding of the local market, including its customs and business practices. Finally, other challenges include finding and retaining the right people and skill sets and developing the firm's brand from scratch in a foreign market.

Overcoming these challenges is the key to successfully expanding internationally. Part of this is choosing the right mode of entry into a market, the choice based on the regulatory and competitive environment and a firm's familiarity with the market. As well, understanding and respecting local culture, finding a strong/reputable local partner, and having management expertise with local experience are all important.

In addition, our interviewees gave some more detailed and practical advice on steps that businesses could take to overcome challenges to success in foreign markets. In order to navigate through regulatory barriers, understanding how the nuances of local regulations impact the business is an important first step. Putting in place sound business practices that comply with local regulations is also essential. In practice, this may mean that, when entering markets where regulatory barriers are significant or poorly understood, acquisition may be the best entrance strategy.

To transcend cultural barriers, companies should first develop a deep understanding of, and respect for, cultural nuances in each chosen market. Second, a company must adapt to the unique conditions of a particular market. Lastly, seeking out competent local partners with the requisite local expertise is critical to closing the knowledge gap and overcoming cultural barriers.

Finally, our interviewees mentioned that businesses can attempt to build up their brands in various ways, such as with advertising. However, companies need to learn how to reach out to local customers with messages that are tailored and relevant to the local context. As well, ensuring products consistently live up to customer expectations is another time-tested way to help establish and build a brand in foreign markets.

Canadian financial institutions have shown that they are capable of successfully expanding in multiple new markets. Given the mature nature of the domestic financial services sector in Canada, continued foreign expansion is likely the best way for the sector to grow further going forward. Challenges exist, but opportunities abound for those with the right vision and strategies to overcome them. Proper planning, in-depth market research, and patience are key tenets to success abroad.

APPENDIX A

Interview Guide Questions

1. How would you describe your business?
2. What are the main lines of business or sources of revenue?
   a. By products
   b. By geographic locations
3. Would the main sources of revenue change 5 to 10 years from now?
   a. By products
   b. By geographic locations
4. What are the main reasons behind your expansion into those markets?

   External forces:

   a. Market potential/large customer base
   b. Underdeveloped local financial services products
   c. First-mover advantage/filling resource gaps
   d. Facilitating Canadian businesses' financial needs overseas
   e. Limited domestic growth potential

   Internal forces:

   a. Financial possibilities
   b. Geographic/product diversification
   c. Reputation

5. Did/do you use different market entry strategies for different geographic locations?
6. What are the main reasons to use this specific market entry strategy for this location?
7. What were the key obstacles you encountered when entering this location? Or after entering this location?
   a. Regulatory barriers
   b. Access to right people
   c. Understanding local market
   d. Home-bias competition
8. How did you overcome those obstacles?
9. What were the main success factors?
   a. Understanding/respecting the local market
   b. Strength of local partner
   c. Uniqueness/quality of the financial services products
10. Is there anything else you would like to tell us related to your strategy for expansion of your foreign operations?

APPENDIX B

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