FINANCIAL ISSUES IN EMERGING ECONOMIES

RESEARCH IN FINANCE

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RESEARCH IN FINANCE VOLUME 36

FINANCIAL ISSUES IN EMERGING ECONOMIES: SPECIAL ISSUE INCLUDING SELECTED PAPERS FROM II INTERNATIONAL CONFERENCE ON ECONOMICS AND FINANCE, 2019, BENGALURU, INDIA

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emerald PUBLISHING

United Kingdom – North America – Japan
India – Malaysia – China

Emerald Publishing Limited
Howard House, Wagon Lane, Bingley BD16 1WA, UK

First edition 2021

British Library Cataloguing in Publication Data
A catalogue record for this book is available from the British Library

ISBN: 978-1-83867-960-6 (Print)
ISBN: 978-1-83867-959-0 (Online)
ISBN: 978-1-83867-961-3 (Epub)

ISSN: 0196-3821 (Series)

ISOQAR
REGISTERED
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INTRODUCTION

This volume is a special issue focusing on emerging economies with five of the eleven chapters selected from the International Conference on Economics and Finance hosted by Narsee Monjee Institute of Management Studies and Indian Econometric Society in Bengaluru, India in December 2019. The first chapter in the volume looks at the firm-level determinants of bank internationalization. Based on a comparative empirical study of Nigeria and India, it finds that capital adequacy ratios and bank size are the key drivers of a bank's decision to internationalize. The second chapter, also on banking, examines the impact of investment in technology on private and public sector banks in India. Based on the empirical analysis, the study finds that there is a mixed effect on revenue increases, cost-savings and employee productivity enhancement, due to investment in technology. The authors recommend an optimal technology-related strategy: planned technology reserves, customer awareness campaigns and a focus on employee–customer motivation.

Switching to macrofinance, the next two chapters focus on the impact of US monetary policy on emerging economies. Chapter 3 examines the impact of US quantitative easing on the weighted average call rate in India and finds evidence that the Indian money market is indeed susceptible to US monetary policy. Chapter 4 looks at three US monetary policy episodes: QE-I, the subsequent tapering and the balance sheet normalization. News of the first two episodes in the United States impact the volatility in bond and currency markets in Brazil, India, Russia, South Africa and Turkey, while the balance sheet normalization does not.

The next four chapters focus on a standalone set of topics. Using data on listed firms in Egypt, Chapter 5 proposes a financial distress prediction model that includes not just accounting ratios but also market-based ratios and macroeconomic ratios. The next study, Chapter 6, examines how the profitability of public–private partnerships in infrastructure projects in India could be restored – based on their empirical analysis, the authors recommend management control systems to mitigate the profitability risks. Chapter 7 presents an analysis of the best predictors of the performance of American Depository Receipts (ADRs). Using ADRs listed on the New York Stock Exchange since the 1990s, the study finds that whether the ADR is from a developed or emerging economy matters and that ADRs from the 2000s outperformed those from the 1990s. The following study, Chapter 8, investigates the most appropriate insurance model for emerging economies with a sizeable low-income population being voluntarily uninsured. Based on a qualitative fuzzy analytic hierarchy process (F-AHP), the chapter concludes that social insurance would work the best and recommends government intervention in the insurance market in emerging economies.

The final three chapters of this volume relate to corporate governance in emerging economies. Chapter 9 examines the role of board subcommittees. The empirical analysis of large, publicly traded firms in India, concludes that the presence of a nomination and remuneration subcommittee enhances firm performance. This finding provides support for the 2013 Indian Companies Act that revised Clause 49 of the Securities and Exchange Board of India requiring certain Board Subcommittees. The next study, Chapter 10, investigates the role of finance message board discussions on Indian firms. The authors conclude that larger, younger firms in non-manufacturing sectors tend to get discussed more and the discussion topics tend to be around their financial statements and performance. The final study in the volume, Chapter 11, examines the impact of ownership structure and board characteristics on firm value for Chinese and Indian firms. The empirical results find some interesting differences between China and India: for instance, board independence has a positive impact on firm value in India but has a negative impact in China.

Rita Biswas
Series Editor

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Volume Editor

CHAPTER 1

AN EMPIRICAL ANALYSIS OF THE DETERMINANTS OF BANK INTERNATIONALIZATION: THE CASE OF INDIA AND NIGERIA

Steve Onyeiwu and Sulagna Das

ABSTRACT

There has been an increase in the number of multinational banks (MNBs) in India and Nigeria. While the literature is replete with analysis of multinational banking in developed countries, not much is known about the drivers of multinational banking in developing countries. This chapter uses the linear probability estimation technique and a sample of 57 Indian and Nigerian banks to investigate firm-level determinants of bank internationalization, as well as inter-bank variations in the number of foreign branches/subsidiaries. The empirical results suggest that the decision by banks from India and Nigeria to internationalize is influenced by firm-level characteristics such as after-tax profit, capital adequacy ratio (CAR), total assets (TA or bank size), volume of customer deposits (CD) and the number of domestic branches. A bank's decision to establish a given number of foreign branches and subsidiaries depends on variables such as CAR, CD and TA. Based on the empirical results, the chapter proposes some hypotheses about bank internationalization in developing countries.

Keywords: Multinational banking; bank regulation; financial repression; financial sector reform; capital adequacy ratio; offshore banking; international banking

JEL classifications: B17; B26; E44; F23; G21

Financial Issues in Emerging Economies: Special Issue Including Selected Papers from II International Conference on Economics and Finance, 2019, Bengaluru, India
Research in Finance, Volume 36, 1–18

ISSN: 0196-3821/doi:10.1108/S0196-382120200000036001

1. INTRODUCTION

There has been a spike in the number of multinational banks (MNBs) in developing countries. It was assumed in the past that the general direction of multinational banking was from developed to developing countries (Cho, 1985, p. 6). Multinational banking was viewed from the perspectives of international trade theory, whereby developed countries had a comparative advantage in financial services, which can then be exported to developing countries (Odle, 1981, p. 23). But current patterns of multinational banking have shown that, rather than being passive recipients of banking services from developed countries, banks from less developed countries are increasingly becoming major players in the global banking industry. About 14 of the top 50 global banks in 2019 were from China.[1] Likewise, Chinese, Indian, Brazilian and Qatari banks were among the top 120 banks in the world in 2018.[2] This would be unimaginable 50 years ago. Although not ranked among the top global banks, several banks from developing countries now have offshore subsidiaries and representative offices in many countries.

Because most studies on multinational banking have focused on banks from developed countries, it is unclear what is driving the new trend toward multinational banking among developing-country banks. Perhaps, murkier is the question of whether theories of multinational banking in developed countries also apply to MNBs in developing countries. A major goal of this chapter is to use the case of India and Nigeria to provide insights into the drivers and determinants of multinational banking in developing countries. Motivated by the resource-based view (RBV) of the firm, we investigate bank characteristics that may explain the trend toward internationalization among developing-country banks.[3] The chapter is divided into eight sections. Following the introduction in Section 1, Section 2 discusses the emergence of MNBs in India and Nigeria, while Section 3 reviews some of the literature on bank internationalization. Section 4 explores firm-level determinants of bank internationalization and Section 5 presents the empirical model. Section 6 focuses on a discussion of the empirical results, followed by a robustness check in Section 7. Section 8 summarizes the major conclusions from the chapter.

2. EMERGENCE OF MNBs IN INDIA AND NIGERIA

Multinational banking has been defined in various ways. According to Cho (1985, p. 2), an MNB is a

> bank with physical presence outside its home county through a branch, an agency, a wholly owned or a majority owned subsidiary, or a bank formed by a merger of two or more banks based in different countries.

Robinson (1972), however, perceives an MNB as a bank with one or more branches that has established institutional presence on foreign soil. Likewise, Brimmer and Dahl (1975) regard an MNB as a bank with three or more branches operating on foreign soil.

Regardless of how it is defined, multinational banking is a recent phenomenon in India and Nigeria. Prior to the 1990s, most banks in these countries focused entirely on the domestic market.[4] During this era, many banks were either wholly owned by the government, or a majority of their shares were controlled by the government. As Tables 1 and 2 show, there were 278 and 47 banks in India and Nigeria, respectively, in 1989. The number of banks in Nigeria rose to about 105 by 1990 (Soyibo & Adekanye, 1992, p. 17).

Only a couple or so of the banks in India and Nigeria competed internationally prior to the 1990s. Banks were not internationally competitive because the banking sector was characterized by gross inefficiency, corruption and lack of innovation. Board members and key officers of the banks were political appointees, and major decisions by the banks were made on the basis of political considerations, rather than efficiency. In Nigeria, the banking industry was heavily regulated by the government, including the setting of interest rates. Interest rates were usually set well below the equilibrium interest rate, leading to negative real rates of interest – a phenomenon referred to as “financial repression” (McKinnon, 1973; Shaw, 1973). Nigerian banks were also required by the government to maintain rural branches, even when it was inefficient and unprofitable to do so. Some were required by the government to employ a certain number of workers.

Several indicators of performance show that banks in India were characterized by inefficiency prior to the 1990s. For instance, many Indian banks accumulated large stocks of non-performing assets (see, for instance, Business Standard,

Table 1. Number of Banks and Branches in India Prior to 1990s.

Year	Scheduled Commercial Banks[a]	Number of Branches	Non-scheduled Commercial Banks	Number of Branches	Total Number of Commercial Banks	Total Number of Bank Branches
1985	264	47,804	4	4,833	268	52,638
1986	272	49,868	4	4,561	276	54,429
1987	275	50,704	4	4,446	279	55,150
1988	274	52,192	4	4,458	278	56,650
1989	274	54,448	4	4,545	278	58,993
Growth %	3.78	13.89		(−)5.95	3.73	12.07

[a]A scheduled bank in India is a bank listed in the Second Schedule of the Reserve Bank of India Act, 1934. These banks are required to maintain a minimum paid-up capital of about 500,000 Rupees (or \$8,000 @ \$1 = 66 Rupee as of September 2014), as well as a 5% cash reserve ratio. Licensed banks that don’t meet these requirements are referred to as non-scheduled banks. Because of the very low paid-up capital requirement, only a few very small banks fall under the latter category.

Source: Rbi.org (Computed from the sources available).

Table 2. Number of Banks and Bank Branches in Nigeria, 1988–1989.

End of Year	Number of Commercial Banks	Number of Branches	Number of Merchant Banks	Number of Branches	Total Number of Commercial and Merchant Banks	Total Number of Branches and Offices
1988	40	1,655	24	46	64	1,701
1989	47	1,844	34	60	81	1,904
Growth %	17.5	10.8	41.7	30.4	26.6	11.3

Source: Soyibo and Adekanye (1992, p. 5).

January 12, 2015).[5] As a result, these banks suffered severe liquidity problems, which made it difficult for them to meet investors' demand for capital to finance-short and long-term investment projects. Lacking incentives for efficiency, and protected from foreign competition, banks in India and Nigeria failed to achieve international competitiveness. But the tide began to turn toward internationalization in the 1990s. As Tables 3–5 show, many Indian and Nigerian banks now operate in foreign markets.

As of September 2019, Indian MNBs had about 125 branches and subsidiaries in several countries across all the regions of the world. Table 3 shows some of the foreign locations of a selected number of Indian public-sector banks, while Table 4 shows that Indian MNBs have established global value chains that focus on specific services to complement or support the activities of the banks' branches and subsidiaries. In 2019, Indian public-sector banks had 25 subsidiaries in the following countries:

Gaborone, Kenya, Georgetown Guyana (South America), New Zealand (Auckland), Uganda, United Kingdom, Tanzania, Trinidad & Tobago, Salaam, Indonesia, Bhutan (Thimpu), Kathmandu (Nepal), Los Angeles, Artesia, San Jose (Silicon Valley), Toronto Vancouver, Mississauga and Mauritius and Port Louis. They also had 25 representative offices in United Kingdom, United Arab Emirates, Indonesia, Hong Kong, China, Dhaka, Iran, Philippines (Manila), Turkey (Istanbul), United States (Washington), Sau Paulo (Brazil), Paris, Tehran, Bangladesh and Myanmar. Additionally, they entered into joint ventures with banks in the following countries Bhutan, Moscow, Russia, Nepal, Malaysia (Kuala Lumpur), Zambia, Kazakhstan, and Nigeria (Lagos).

Out of the 22 commercial banks in Nigeria, 8 (about one-third) are MNBs, whereas there was only one prior to the 2000s. As of 2019, Nigerian MNBs had about 95 foreign branches in mainly African countries[6] (see Table 5). A comparison of Tables 3–5 shows that Nigerian MNBs are less global than their Indian counterparts. Indian banks operate in more regions and countries than Nigerian MNBs. The two oldest banks in Nigeria, First Bank of Nigeria and the United Bank for Africa (UBA), have the highest numbers of foreign subsidiaries. In Section 4 of this chapter, it shall be investigated whether the age of a bank is an important determinant of the scope of internationalization. Nigerian banks, however, are major players in Africa. According to *Business Insider*, Zenith Bank and Ecobank were ranked among the top 15 banks in Africa in 2019.[7] Zenith Bank and Guaranty Trust Bank were the most profitable MNBs in Nigeria in 2019, while Ecobank and Access Bank had the largest assets (Table 5).

We next discuss some of the reasons why Indian MNBs have been more "global" than Nigerian MNBs. First, being relatively new in the industry, Nigerian MNBs may not have developed sufficient capabilities to compete effectively in non-African countries. Focusing initially on an "African brand" may be a deliberate strategy for learning how to compete globally. Another reason why Nigerian banks have adopted an "Afrocentric" strategy may be because African economies are "under-banked." Thus, the scope for foreign investment in the banking sector of African countries is very large. On average, foreign banks make up about 58% of banks in African countries, compared with an average of just 14% in South

Table 3. Some Foreign Branches of Selected Indian Public-sector Banks[a] as on September 30, 2019.

Name of the Country	Allahabad Bank	Bank of Baroda	Bank of India	Canara Bank	Indian Bank	Indian Overseas Bank	Punjab National Bank	State Bank of India	Syndicate Bank	UCO Bank	Union Bank of India	Total
Australia	–	1	–	–	–	–	–	1	–	–	1	3
Bahrain	–	–	–	–	–	–	–	2	–	–	–	2
Bangladesh	–	–	–	–	–	–	–	3	–	–	–	3
Belgium	–	1	1	–	–	–	–	1	–	–	–	3
Cambodia	–	–	1	–	–	–	–	–	–	–	–	1
Cayman Islands	–	–	1	–	–	–	–	–	–	–	–	1
China	–	1	1	1	–	–	–	2	–	–	–	5
France	–	–	1	–	–	–	–	–	–	–	–	1
Fiji Islands	–	9	–	–	–	–	–	–	–	–	–	9
Germany	–	–	–	–	–	–	–	1	–	–	–	1
Hong Kong	1	1	2	1	–	1	2	1	–	1	1	11
Israel	–	–	–	–	–	–	–	1	–	–	–	1
Japan	–	–	2	–	–	–	–	2	–	–	–	4
Kenya	–	–	5	–	–	–	–	–	–	–	–	5
Maldives Islands	–	–	–	–	–	–	–	4	–	–	–	4
Mauritius	–	9	–	–	–	–	–	–	–	–	–	9
Myanmar	–	–	–	–	–	–	–	1	–	–	–	1
Seychelles	–	1	–	–	–	–	–	–	–	–	–	1
Singapore	–	1	1	–	1	1	–	6	–	1	–	11
Sri Lanka	–	–	–	–	3	1	–	4	–	–	–	8
South Africa	–	2	1	1	–	–	–	1	–	–	–	5
South Korea	2	–	–	–	–	1	–	1	–	–	–	2
Sultanate of Oman	–	3	–	–	–	–	–	1	–	–	–	4
Thailand	–	–	–	–	–	1	–	–	–	–	–	1
United Arab Emirates	–	7	1	1	–	–	1	1	–	–	1	12
United Kingdom	–	1	5	1	–	–	–	1	1	–	–	9
United States	–	1	2	1	–	–	–	3	–	–	–	7
Vietnam	–	–	1	–	–	–	–	–	–	–	–	1
Total	1	38	25	6	4	5	3	37	1	2	3	125

[a]For a comprehensive list of foreign branches and subsidiaries of Indian Banks, see *https://rbidocs.rbi.org.in/rdocs/Content/pdfs/71206.pdf*.

Table 4. Global Value Chains of Some Indian Banks as on September 30, 2019.

Name of the Country	State Bank of India	Bank of Baroda	Indian Overseas Bank	Total
Australia	SO – 1			1
Bahrain	RC – 1	–	–	1
Bangladesh	IVCs – 12; EC – 1	–	–	13
Singapore	RC – 1	–	RC – 1	2
South Africa	MO – 2 SO – 4	–	–	6
Sri Lanka	EC – 2	–	EC – 1	3
United Arab Emirates	RHO – 1	EBSUs – 9	–	10
United Kingdom	EC – 1	–	–	1
Total	26	9	2	37

Notes: EBSU, electronic banking service unit; EC, extension counter; IVC, Indian visa centers; MO, marketing office; SO, suboffice; RC, remittance center; and RHO, regional head office.

Source: https://rbidocs.rbi.org.in/.

Asian countries (Claessens & van Horen, 2012, p. 32). But foreign-owned banks are not major players in Nigeria. About 94% of banking assets in Nigeria are privately owned by local investors, representing the world's second largest domestic ownership of banks (Nachum & Ogbechie, 2019, p. 231). The presence of foreign banks in Nigeria has been further diluted with the exit of HSBC and UBS from the country in 2018. The exit has been attributed to a decline in investor confidence, following the 2016 recession in the country.[8] But Nachum and Ogbechie (2019) disagree, arguing instead that the market structure of the Nigerian banking industry and a conducive policy environment have enabled Nigerian banks to develop the capability for outcompeting foreign banks. There are currently 22 commercial banks in Nigeria, out of which three are foreign owned (Citibank, StanbicIBTC and Standard Commercial Bank).[9]

As the banking market in African countries becomes saturated, Nigerian MNBs will be forced to adopt a more global strategy like their Indian counterparts. Regional integration also appears to be driving the investment of Nigerian banks in Africa. As a member of various regional blocs, more especially the ECOWAS and the New Partnership for African Development, Nigerian MNBs find it easier to operate in regional markets.

In the case of Indian MNBs, the nature of the Indian economy may have boosted their more extensive internationalization. The Indian economy is more export-oriented than the Nigerian economy. In 2018, India's volume of trade as a percentage of GDP was 43%, while that of Nigeria was 33% (World Development Indicators Database). As a trade-intensive economy, Indian firms need more global banking services than Nigerian banks. Also, as the world's sixth largest economy in 2019 (it was the third in 2016),[10] its banks are bound to play larger roles in the global economy than Nigerian banks. As well, India has more outward foreign direct investment (FDI) than Nigeria, and Indian banks may simply be following their corporate clients abroad. In 2018, Nigeria's outward FDI was about \$1.4 billion,[11] whereas India's was \$11 billion.[12]

Table 5. Foreign Locations of Nigerian MNBs, 2019.

Name	Year Established	Ownership	Assets in 2019 (Billion $)	After-tax Profit in 2019 (Billion $)	Africa	Asia	Latin America	Middle East	Europe	North America	Subtotal
Access Bank	1989	Private	18.0	0.3	6	0	0	0	1	0	7[a]
Diamond Bank (2014)	1991 (acquired by Access Bank in 2019)[b]	Private	4.7	0.02	3	0	0	0	1	0	4
Ecobank Nigeria[c]	1986	Private	24.0	0.3	33		0	0		0	33[d]
First City Monument Bank	2004	Private	4.4	0.05	1	0	0	0	1	0	2
First Bank of Nigeria	1894	Private	17.2	0.2	7	1	0	1	2	0	11
Guaranty Trust Bank	1990	Private	10.1	0.6	8	0	0	0	1	0	9
Skye Bank (became Polaris Bank in 2018)[e]	2006	Private	3.1	0.08 (before tax)	6	0	0	0	0	0	6
UBA	1949	Private	16.5	0.3	18	0	0	0	2	1	21
Zenith Bank	1990	Private	16.4	0.6	4	1	0	0	1	0	6
Total			109.7	2.3	83	2	0	1	8	1	95
Average			13.7	0.31	10	0.	0	0	1.2	1	10

Source: Compiled from web sites of various banks. The financial data were originally expressed in the Nigerian Naira, but we converted to US$ using the 2019 exchange rate of $1 = 360 Naira.

[a]Access Bank also has representative offices in China, United Arab Emirates, Lebanon and India.
[b]The acquisition has led to an increase in Access Bank's assets, from $11.5 billion in 2014 to $18 billion in 2019.
[c]Ecobank Nigeria is a key subsidiary of Ecobank Transnational Incorporated (ETI). Headquartered in Lome, Togo, ETI is a holding company established in 1984 by the Federation of West African Chambers of Commerce, with the support of the Economic Community of West African States (ECOWAS). Ecobank Nigeria is thus part of a network of subsidiary banks, affiliates and representative offices spread across Africa, Asia and Europe.
[d]Ecobank has representative offices in China, United Arab Emirates, Johannesburg and the United Kingdom.
[e]The Central Bank of Nigeria (CBN) revoked Skye Bank's license in 2018 for failing to meet "the regulator's key liquidity and capital adequacy ratios." *(https://www.bloomberg.com/news/articles/2018-09-22/polaris-to-takeover-assets-liabilities-of-skye-bank-nigeria)*. The bank was renamed Polaris Bank and handed over to the Asset Management Corporation of Nigeria, a quasi-government entity established in 2011 to purchase and manage troubled assets. Its overall goal is to help restore confidence and stability in Nigeria's banking system.

Although the size of the middle class has increased in both countries, estimated at over 20% of the population in both countries, India's middle class of 267 million individuals far exceed the 40 million Nigerian middle class. The demand by middle class households for sophisticated financial services usually induces a supply response, by way of the proliferation of MNBs and the depth/mix of financial services they provide.

Global competition, while creating opportunities for banks, comes with significant economic and political risks (Hill & Hult, 2019). The more globalized a bank is, the greater the risks. Indian banks, by virtue of their large-scale of global operations, have recently faced challenges with their global operations, prompting some to shut down some foreign branches and subsidiaries.[13] As of 2019, State Bank of India and Canara Bank closed nine branches in China, Sri Lanka, Oman, Saudi Arabia, France, Botswana, United Kingdom and Bahrain. Of the 159 foreign branches of Indian state-owned banks, about 40 were incurring losses due to bad loans, inadequate capitalization, declining market value, as well as high operation, infrastructure and personnel costs.[14] The Reserve Bank of India (RBI) is concerned about Indian MNBs and is closely monitoring their operations and performance, especially in the COVID-19 era when loan losses and bad debts are expected to increase phenomenally.[15]

But what is driving the internationalization of Indian and Nigerian banks? The next section reviews the literature to gain insight into the potential drivers of bank internationalization.

3. BRIEF LITERATURE REVIEW

The literature on bank internationalization has focused on two themes: the determinants of the choice of foreign locations and the organizational forms chosen by banks in their host countries. Consequently, scanty attention has been paid to bank characteristics that influence the decision to internationalize. The few studies that analyze the role of bank characteristics do so as control variables, rather than salient determinants of the decision to internationalize (see, for instance, Tsai, Chang, & Hsiao, 2011).

Studies on bank internationalization have focused on "pull factors," or factors in the host economy and the regulatory environment that influence the decision to invest abroad. As a result, not much is known about firm-level determinants of bank internationalization, and why banks that face similar exogenous environments make different decisions with regard to internationalization.

Clarke, Cull, Martinez Peria, and Sanchez (2003) argue that banks' primary motive for expanding abroad is to support the business activities of their domestic customers. This perspective is consistent with Buch's (2000) study, which shows that the foreign activities of German banks are positively correlated with the overseas activities of German firms. This "follow-thy-customer" model of international banking is also reflected in the pattern of internationalization by banks from developing countries, whereby they tend to locate in countries that receive large amounts of remittances from citizen's resident abroad. Locational