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Abstract: Currently, foreign banks own the banks that hold about 80 percent of the assets in Mexican banks. The paper argues that this is the third instance in which foreign-owned banks have initially comprised a large part of the Mexican banking system, and that in the first two cases (1865-1910 and 1920-1935), the degree of foreign ownership will recede. The argument is that reform and competition among the banks will cause the conditions that attracted the foreign banks to erode and the domestic banks to be able to grow more rapidly. Therefore, in subsequent decades many foreigner owners are likely to sell their subsidiaries to local banks and investors. Thus over time the ratio of assets in foreign-owned banks to total banking system assets should decline, even in the absence of government policies that aim for that result.

1.0 Introduction

Currently, foreign banks own the banks that hold about 80 percent of the assets in Mexican banks; in 2001 the share was 80 per cent, and at the end of 2005 78 per cent (Table 1). This foreign domination of the banking system is not unusual in small or medium-sized countries such as the Pacific island states, or Bulgaria, Hungary, and New Zealand. Although foreign banks have a smaller role in Argentina, when the percentage of foreign ownership started to climb past 40 percent, people started to talk of *extranjerización,* and some locally-owned banks featured their local ownership in their advertisements. However, I will argue, drawing on history and a qualitative model, that the foreign domination is a temporary, albeit long-lived, self-correcting phenomenon.

The metaphor of ecological succession provides the basis for our argument that the financial system will eventually return to predominantly domestic control (Koford and Tschoegl 2005; Tschoegl 2005). Ecological succession is a dynamic model that posits that when the first plants arrive in disturbed or clear soil they create opportunities for successor species by stabilizing the soil and changing light conditions. The successor species in turn provide opportunities for yet other species. The mix of plant and animal species continues to evolve until the system reaches the final steady state of a climax forest. Of course, when fire, flood or landslide clears a patch in the forest, the process starts again in that patch. During the process, should not mistake a temporary phase for the ultimate steady state.

This model implies that eventually most foreign banks will no longer find retail banking in Mexico interesting. As they compete with each other by introducing new products, by squeezing intermediation margins, etc., they remove the conditions that drew them. Some foreign banks will stay, particularly the efficient ones, but many will reassess their Mexican operations. The banks will be making a normal return on capital there, but they will want to redeploy their capital to areas where they can earn above normal returns. Those banks are going to sell out to local domestic banks, and to local entrepreneurs who will take over the banks. The banks the foreigners owned won't disappear; their ownership and control will simply revert to domestic hands.

Like all biological analogies and metaphors, ecological succession has its limitations. Still, we believe that the analogy can facilitate understanding of the trajectory of foreign ownership of banks in Mexico.

2.0 The situation in Mexico

From 1934 until the mid-1990s, Citibank was the only foreign bank with a branch in Mexico, save for the Deutsch-Südamerikanische Bank, which the Mexican government closed in 1943 when Mexico declared war on Germany (Marichal and Riguzzi 2006). Earlier, various other foreign banks had entered Mexico by establishing branches in Mexico City, but over time all had either left or reduced the scale of their efforts (see below). Successive Mexican governments proceeded to permit Citibank to remain although they prohibited foreign banks from establishing any new branches or subsidiaries, or acquiring Mexican banks. Some foreign banks did establish representative offices that could neither take deposits nor make loans.

In 1982, the Mexican government nationalized the 68 domestic banks and subsequently consolidated them into 18. Liberalization began soon after, with the government selling about 30 per cent of the shares of 13 of the 18 banks through public offerings (Lopez-de-Silanes and Zamarripa 1995). In 1989, the new Salinas administration introduced a series of deregulation measures.

The liberalization culminated in 1991 and 1992 with the government privatizing the banks in a series of auctions (Christopherson and Hovey 1996). At the time, existing Mexican law prohibited foreign firms from participating in the auctions. The privatized banks sold at a premium to the price of banks in other financial markets, and most of the owners came from what Minushkin (2002) calls the *bolseros*, the investment banking and stockbroking community, rather than the traditional *banquero* elite. This had two causes. First, Lopez-Portillo's wish to punish those who had caused (or not helped) the crisis withstood both the De la Madrid and Salinas governments. With few exceptions, the former owners of banks had no significant stakes in the financial groups post-1992. Second, the privatization law called for the creation of financial groups with at least three subsidiaries, a bank, a stockbrokerage, and a third such as a fund management company. This left the *bolseros* as the logical source of acquirers. A period of “hyper competition” apparently followed as the owners of the newly privatized banks sacrificed profitability to gain market share and position (Gruben and McComb 2003). Unfortunately, the *bolseros* skills were mainly in money market trading due to the huge growth of government domestic borrowing, and not in banking.

In June 1992 the government authorized banks to issue shares up to 30 per cent of their capital that foreigners could own, though one owner could hold no more than 5 per cent, or 10 per cent with Ministry of Finance approval (Lopez-de-Silanes and Zamarripa 1995). In the NAFTA negotiations, Mexico was able to keep its banking sector highly protected from foreign entry (Minsuhkin 2002). Foreign banks could only operate as subsidiaries, not branches of the parent, and initially each foreign bank could account for no more than 1.5 per cent of the market, and foreign banks as a whole could not account for more than eight per cent of the market. The Treaty provided for the gradual elimination of the restrictions, but subsequent events hastened the process.

When the government privatized the banks, the legal and regulatory framework governing the banking sector did not keep pace, and oversight was inadequate (Unal and Navarro 1999). The government underestimated the necessary investment in regulators and their skills to oversee the return to competition in banking. Consequently, the hypercompetition left the banks vulnerable when the 1994 Peso Crisis devastated the economy, with the result that many banks ended up back in the government's hands. In February 1995, Mexico changed its financial services laws to allow foreign banks to buy majority stakes in Mexican counterparts in exchange for cleaning up their balance sheets. However, the law limited foreign shareholdings in the top three Mexican banks—Banamex, Bancomer and Serfin—to a maximum 20 per cent stake. The law authorized the Ministry of Finance and Public Credit to permit foreign financial institutions to acquire a controlling interest in those banks whose capital represented less than 6 per cent of the total net capital of the Mexican banking industry (Palomares 1999). Then in December 1998, Congress removed these restrictions as well, permitting foreigners to own 100 per cent of any Mexican bank, including these three largest banks. The need to recapitalize and rehabilitate the Mexican banking industry led to a spate of acquisitions, re-privatizations, and the liquidation of four banks (Bubel and Skelton 1998).

3.0 The evolution of the foreign banks' current presence

Half-a-dozen foreign banks—two from Spain, two from Canada, one from the UK, and one from the United States—have been the most important foreign acquirers of Mexican banks. Santander (formerly BSCH - Banco Santander Central Hispano), and BBVA (Banco Bilbao Vizcaya Argentaria) have invested throughout Latin America, and their presence in Mexico is part of this strategy (Guillén and Tschoegl 2000;). One attraction of Mexico for the Spanish banks is that it provides a back door to the United States where, Puerto Rico aside, until recently neither bank has had a major presence. (By contrast, Mexican banks, most notably Banamex, had developed a minor presence in the south-western United States.) Also Mexico was a major destination for Spanish direct investment in general, not just in financial services (Bátiz-Lazo *et al.*, forthcoming).

Banco Santander has had a window on Mexico since 1955 when it opened a representative office in Mexico City. In 1994, following the establishment of NAFTA, Santander was able to create Grupo Financiero Santander Mexico. This consisted of three subsidiaries, an investment banking operation with several offices, which Santander staffed with a small team of highly trained executives, a stockbrokerage, and a fund management company. In 1997 Santander bought Grupo Financiero InverMexico, combining it with its existing operations to form Grupo Financiero Santander Mexicano (Banco Mexicano). At the same time, Hongkong and Shanghai Banking Corporation (HSBC) of the UK acquired 20 per cent of Banco Serfin, Mexico's oldest and third largest bank (Table 1). (Serfin traces its history back through Banco de Londres y Mexico, founded in 1864; see below).

In July 1999, IPAB (Instituto par la Protección al Ahorro Bancario), the newly-created bank deposit guarantee institute, took charge of the banking rescue FOBAPROA (Fondo Bancario de Protección al Ahorro) had begun and took over Serfin. Shareholders had refused to recapitalize the bank, which had some $6.2 billion in bad loans. In May 2000, Santander bid $1.56 billion at auction to acquire Serfin, beating HSBC's bid. HSBC sold its shares to Santander, which then created Banco Santander Serfin.

In 2003, Santander sold 25 percent of Santander Serfin to Bank of America for $1.6bn, an amount a little above what Santander had paid to acquire the whole bank, for a capital gain of about $700mn. Bank of America was willing to pay dearly because it wanted to compete with Citigroup, which owns Mexico's largest bank (Banamex; see below), for fees on the estimated $10bn in remittances that Mexicans in the United States send to their families each year. Santander gained access to Bank of America's approximately 16 million Mexican and Mexican-American clients (45 percent of the total Hispanic population in the US.

Starting in 1991, then Banco Bilbao Vizcaya (BBV) acquired a 2% stake in Banco Mercantil Probursa, which it quickly raised to 10%, at Probursa's invitation and initiative.[1] Probursa was a stockbroker and when it acquired Banco Mercantil it wanted access to expertise to help it grow in retail banking. In 1993 BBV raised its stake to 30%. BBV was interested in increasing its stake but Probursa's management was unwilling. Still, Probursa ran into difficulties and in 1995, BBV was the first foreign bank to take a majority stake in a Mexican financial group when it raised its ownership to 70%.

Then in 1996, BBV bought Banca Cremi and Banco Oriente from the government for about $22.5 million. (In 1991 Spain's Banco Espanol de Credito (Banesto) had acquired 10% of Oriente.) In 2000, now BBVA bought Banco de Comercio (Bancomer; est. 1932), the second largest Mexican bank, and merged it with BBV Probursa, injecting $2.4 billion in new capital to strengthen the combined bank. The acquisition temporarily made BBVA-Bancomer Mexico's largest financial group. In 2004, BBVA acquired the 40.6 percent of BBVA Bancomer that it did not already own, paying €3.3bn. Then it bought Hipotecaria Nacional (Hipnal) for $375mn. Hipnal is Mexico's largest private mortgage banking institution, with a $2.2bn loan portfolio and about 90,000 clients. BBVA's strategy for taping the US Hispanic market has been to acquire retail banks in Texas and California, and to create a money remittance company.

Bank of Montreal and Scotiabank (Bank of Nova Scotia) also entered, though only Scotiabank remains. Bank of Montreal established a representative office in Mexico in 1960 and started working with Bancomer in 1989. In 1995, Bank of Montreal acquired 20 per cent of Bancomer but then chose not to increase its stake. In 2001, it agreed to sell its shares in to Spain's BBVA.

[1] Bernardo Bátiz-Lazo's pointed this out to me, based on his interviews at Probursa.

In 1993, Scotiabank acquired 8.5 per cent of Grupo Financiero Inverlat (GFI), the seventh largest bank in Mexico, but FOBAPROA suspended the bank two years later. In 1996, FOBAPROA, GFI and Scotiabank agreed that Scotiabank would acquire 10 per cent of GFI's shares and purchase subordinated convertible bonds; Scotiabank also agreed to manage GFI. The bonds carried an option permitting Scotiabank to convert them into GFI common stock, an option that Scotiabank exercised in 2000, shares, thereby increasing its stake to 55 per cent, and giving it control of Inverlat. Three years later it paid about US$323mn for almost all of the shares remaining in the government's custody, bringing its ownership up to 91 per cent. (IPAB retained 9 per cent of the shares while it determined to whom they belonged.) In 2004, Scotiabank paid about US$53mn for an additional 6.3 per cent and announced its willingness to purchase the remaining 2.7 per cent at the same price per share.

Citibank had the longest presence in Mexico of any foreign bank but was slow to build up its operations. In 1997 Citibank acquired Banca Confia and bid unsuccessfully for Banco Serfin. Finally in 2001, Citibank paid US$12.5bn for Grupo Financiero Banacci, which included Banco Nacional de Mexico (Banamex). Before BBVA acquired Bancomer, Banamex was Mexico's largest bank. Citibank consolidated Banca Confia and Citibank of Mexico into Banamex, returning Banamex to the top position.

In 1992, Banco Central Hispano (BCH) and its affiliate Banco Comercial Portugues (BCP) each acquired 8 per cent of Banco Internacional (Bital) in Mexico (Guillén and Tschoegl 2000). In 2002, after it had merged with BCH, Santander bought BCP's eight per cent share in Bital and built up its shareholding to 26 per cent of the capital and 31 per cent of the voting capital. Shortly before Santander had started buying up its stake, Bital had acquired Banco del Atlantico from the government. As part of the deal, Bital agreed to increase its capitalization. Ultimately, this necessity forced it to find a buyer that would increase its capitalization.

In August 2002, HSBC wholly acquired Bital from the Berrondo family (who owned 54 per cent), Santander, and other shareholders. This made HSBC the last foreign bank to takeover a major Mexican bank. As part of its agreement with the government, HSBC added another US$800 million into Bital to increase its capital. Bital has the largest network of ATMs and branches of any Mexican bank, though in branches alone it lags the two largest banks. It is very much a retail bank and lacks a large wholesale business. When it acquired Bital, HSBC had already built up a major presence in the US and Canada (Tschoegl 2004b), and was building a major presence elsewhere in Latin America, especially in Brazil, as part of its strategy to be “The world’s local bank”.

Of the six largest banks, the only one that is not foreign-owned is Banorte, which is the 5th largest bank in Mexico. Banorte traces its origins to the founding in 1899 of Banco Mercantil de Monterrey and to the 1947 founding of Banco regional del Norte. The two banks merged in 1986 to form Banco Mercantil del Norte. In late 2001, Banorte spent US$125mn to acquire Bancrecer, which IPAB had taken over in 1999. Bancrecer had itself taken over another bank, Banoro, in 1997.

3.0 Statistical Analysis

One simple technique for analyzing the strategies and efficiency of banks is to perform a linear regression of total assets on the number of employees and the number of branches (Choi and Tschoegl 1984). In the regression for the data for the six largest banks from 2001, the coefficient for the number of was negative, suggesting that branch expansion either under government ownership or in the subsequent hypercompetition had led banks into locations where they could gather fewer assets, either because of the number of people there or their wealth (Table 2a). The residuals from the regression show that Bital had the smallest amount of assets, relative to the number of its branches and employees; Santander-Serfin had the highest (Table 2b). (Bital was known for opening mini-branches in supermarkets and the like.)

The same regression, using data from 2005, still shows Bital with the smallest amount of assets relative to the number of its branches and employees, and Santander-Serfin with the highest (Table 2b). Now, the coefficient for branches is positive (Table 2a), suggesting that the decrease in branches at the four largest—foreign-owned—banks (Tabe 1), was due to the closure of marginal branches. However, this rationalization by the large foreign banks has provided an opportunity for smaller banks, which as a class have greatly increased the number of their branches (Table 1).

Still, Schulz (2005) shows that FDI has had a positive but only limited effect on the development of the banking sector. What the foreign banks accomplished was to recapitalize the banking sector. However, he argues that the low level of competitive intensity so far has limited the transfer of skills, technology, or management know-how. Haber and Musacchio (2005) found that relative to domestic banks, foreign banks granted less credit, screened loans more intensively, and charged lower interest rate spreads. They attribute this to risk aversion engendered by a Mexican environment that provides weak enforcement for contract rights. Interestingly, they also found that the foreign banks were less profitable than the domestic banks, once they excluded the foreign banks' income from fees for services.

4.0 Ecological succession

The simple textbook story of ecological succession discusses how forests develop on previously uninhabited landforms. One example would be the development of forests in previous glacial regions in North America and Western Europe after the last Ice Age. The story begins with primary succession as pioneering species of small plants first colonize the available terrain. As these pioneering plants increase in size and influence, competition between them and the changes they cause in soil and light conditions facilitates secondary succession, the establishment and survival of succeeding organisms that are better adapted than the pioneering species to the emerging conditions. Eventually, a final self-maintaining community, such as a climax forest, emerges (Collier et al. 1973). As Bormann and Likens (1979) point out, secondary succession may also follow the abandonment of once cultivated land or disturbances such as fire, flood, landslides or tree-falls that have left some trace of earlier organic activity. In either case, succession culminates in a steady-state in which the forest is self-replicating.

Further research has specified the four mechanisms involved, more than one of which may be in operation at any particular time, with the relative importance of the mechanisms depending on the climate (Botkin 1993). In the competitive hierarchy mechanism, late succession species start to arrive as members of the early succession species reach the end of their life-cycle and die out; this mechanism delays, or at least does not facilitate succession.

With the tolerance mechanism, early succession species do not affect the rate of recruitment, growth or survival of later species. The early species simply arrive and grow more quickly. Later species can grow during the early succession phase but better tolerate the more limited resources that prevail when competition is well established.

In the facilitation mechanism, one species prepares the way for the second. An extreme case of facilitation would have the early species as a necessary condition for the survival of the later species. More usually, the presence of the early species leads to earlier arrival or greater success for later species.

Lastly, reverse interference is the direct opposite of the competitive hierarchy mechanism. Late succession species interfere with the continuation of early succession species instead of early succession species impeding late succession species.

“Weeds” are prominent among the pioneering species. Weeds are opportunistic plants that invade disturbed soil; typically they evolved to fill the minor role of secondary succession (Elton 1958). As succession proceeds, weeds lose ground but some remain in place here and there, ready for the next disaster. “Weeds” may include plants that appear in, via migration or transplantation, in a new environment that is far from their original one. The new arrivals thrive in the new environment because they have left their enemies behind and face no new ones.

The ecological succession model has two striking characteristics. First, the logic of the process means that species that are most prevalent in the early stages of the process become far less prevalent later. Until the system reaches its steady-state one what one sees at any moment in time is a poor indicator of what the system will look like in the future. Second, facilitation, whether augmented or not by reverse interference, means that the success of the pioneering species leads to their relegation to the margins. As the pioneers succeed, they change soil and light conditions in ways that permit other species to gain a foothold and in time to dominate.

An initial entry of foreign banks leads to the same pattern of succession. First foreign banks appear; one can think of this as the arrival of the first weeds. Second, competitive turmoil emerges, with some foreign banks closing down and others merging with each other or with domestically-owned banks. At the same time, new domestic competitors emerge. Lastly we get-state climax, with the bulk of the banking system is in domestic hands. The Mexican banking system is only at the beginning of the second stage. However, even without government intervention, it will eventually achieve this third, steady state with a foreign presence that is much reduced from its current situation in which foreign banks own over 80 per cent of the assets in banks.

5.0 Applying ecological succession to foreign banking

Foreign banks are among the weeds that first respond to the disturbed, hospitable soil that liberalization, crisis, or transition has created. The foreign banks that respond to these opportunities are often willing to enter retail banking as well as traditional international banking and can respond quickly because they are well-capitalized, efficient, and have surplus managerial resources (Kindleberger 1969 and Tschoegl 2004).

The ecological succession metaphor is a model of the evolution of a system after a disturbance; it is not a model for the role of foreign banks in mature, stable markets. Still, as Tschoegl (2002a&b and 2005) shows for Norway and a number of other countries, even in mature markets, the model has applicability in crises and their aftermath. Papp (2005) too has documented the increased presence of foreign banks after a financial crisis. Tschoegl (2001) provides a discussion of the role of foreign banks in a large, competitive market such as the U.S.; in essence, in mature markets foreign banks generally specialize in niches and engage in wholesale and corporate banking.)

One can think of the share of banking system assets in foreign banks relative to total banking system assets as the fast responding plants' proportion of the system's biomass. The ecological succession process involves both a numerator and a denominator effect, where the numerator consists of the market share of the foreign banks, and the denominator is the total banking system, foreign and domestic. The behavior of the foreign banks themselves has a large effect on the numerator. Over the long term, the response of the domestically owned banks will have a large effect on the denominator. Obviously, when a domestic bank buys a foreign bank, this reduces the numerator, while leaving the denominator unchanged.

Initially, as the foreign banks enter, especially when they acquire host country banks in privatizations, rescues, recapitalizations and rehabilitations, the numerator grows more rapidly than the denominator. The reason the foreign banks enter is the opportunities the situations present, now that the banks are free to enter. One source of opportunity can be the foreign banks' efficiency relative to that of the domestic banks. In the Czech Republic and Poland foreign-owned banks were more efficient than domestic-owned banks and this was not due to scale differences or the structure of activities (Weill 2003). Dopico and Wilcox (2002) found that foreign banks are more pervasive in countries where banking is more profitable, such as in a previously closed market, and where the banking sector is smaller relative to GDP, as in many developing countries such as Mexico (Lopez-de-Silanes and Zamarripa 1995). Conversely, in mature, competitive markets foreign banks tend to have a more limited presence. Similarly, Demirgüç-Kunt and Huizinga (1999) and Claessens *et al*. (2001) found that in industrial countries foreign banks tend to have lower margins and profits than domestic banks, but that the opposite holds in developing countries.

The markets that draw the foreign banks tend to be ones that are growing, underbanked or uncompetitive, but the point is that foreign banks' entry changes these markets. The literature on the effect of foreign banks on host country banking systems, suggests that the effect is precisely to undermine the conditions associated with the presence of foreign banks. For instance, Lensink and Hermes (2004) find that in developing countries, foreign entry is associated with shrinking margins, but this is not necessarily the case in developed countries. In the Philippines foreign competition compelled domestic banks to be more efficient, to focus operations, and to become less dependent on relationship-based banking practices (Unite and Sullivan 2002).

This means that over time, measured in decades, the foreign banks will find the conditions that drew them have eroded, and some will withdraw, selling their subsidiaries to locally-owned banks. The histories of particular banks or of banking systems in particular countries suggest four factors that operate to reduce the foreign presence. First, some foreign banks leave when they find they are not competitive. Second, some foreign banks they find themselves in difficulty at home and sell the foreign operation in order to raise funds. Third, others sell out to local investors and banks when host country markets are depressed and the foreign owners see little benefit from staying. Lastly, some simply sell out to local banks growing by acquisition.

For instance, of the eight subsidiaries that Japanese banks established in California between 1952 and 1978, three remain, the rest having disappeared through merger into the survivors or sale; assets in California subsidiaries of Japanese banks peaked in the early 1990s and has fallen since though the largest, Bank of Tokyo-Mitsubishi's Union Bank of California continues to grow (Tschoegl 2003a).

Similarly, in 2003 Banco Bilbao Vizcaya Argentaria sold its Brazilian operations to Bradesco. BBVA had bought Banco Excel-Economico in 1998 for 1 Real. BBVA sold because it realized that it would be too expensive to achieve a profitable scale. As part of the sale price BBVA took a small equity stake in Bradesco.

Also in 2003, Lloyds TSB sold its Brazilian operations to HSBC. HSBC had entered in 1997 and the purchase of Lloyds is its third in Brazil. Lloyds' association with Brazil dated back to ancestors of the Bank of London and South America (BOLSA), which in 1863 and 1864 were the first banks in Brazil (Joslin 1963). However, top management at Lloyds decided to focus on the UK and also sold National Bank of New Zealand (NBNZ), despite Lloyds having been associated with NZNB since the 1870s.

In the mid-1990s, foreign banks rushed to acquire banks in Argentina, to the point where the assets in foreign-owned banks reached some 50 per cent of banking system assets. However, as the Argentina's economic situation worsened, many turned over their banks to the government-sponsored rescues, or sold out. The buyers were local banks. Banco Comafi purchased liabilities and personnel from Canada's Scotiabank Quilmes. Banco Patagonia first bought Banco Sudameris Argentina from Gruopo Intesa (Italy) and then bought Lloyds Bank's subsidiary. Banex acquired Société Générale's subsidiary. Banco Macro bought Banco Bansud from Banamex, Scotiabank Quilmes's assets, Banco del Tucuman, and two of Credit Agricole's three former subsidiaries: Nuevo Banco Suquia, and Nuevo Banco Bisel.[2] Nuevo Banco de Santa Fe bought the third of Credit Agricole's subsidiaries, Banco de Entre Rios.

In the long-run, foreign banks in general have no comparative advantage in retail banking vis-à-vis host country banks, especially in reaching rural areas and the unbanked. Even when the foreign banks are better than local banks at both wholesale and corporate banking on the one hand and retail banking on the other, the local banks will have a comparative advantage in retail banking. That is, the local banks will be less worse at retail banking than at wholesale and corporate banking. Even in countries where foreign banks initially dominate the banking sector, one should expect to see domestic banks come to dominate retail banking. The foreign banks will specialize in foreign activities *pari passu* with the emergence or growth of local competitors, even if they do not immediately exit retail banking. Still, often a foreign bank will sell its retail activities to a local bank while retaining a branch in the national financial capital to enable it to continue to offer corporate and wholesale banking services. For instance, when in 1991 Chase Manhattan Bank reduced the presence in Puerto Rico that it had had there since 1934, it sold its retail branches to Banco Roig, a leading local bank.

Denominator effects complement numerator effects to reduce the ratio of assets in foreign-owned banks to total assets in the banking system. As Huang and Di (2003) point out, the conditions that constrain foreign firms in a country may also constrain host country firms. When the conditions constrain host country firms more than they do

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[2] When Citibank acquired Banamex it sold several of Banamex's subisidiaries, including Banco Bansud. Banco Bansud had acquired Banesto Banco Shaw in 1994 from Banco Santander, after Santander acquired Banesto. Banesto had acquired control of Banco Shaw in 1992.

foreign firms, the foreign firms may increase their ownership of assets in the host country. However, the liberalization and regulatory reform that accompany the entry of the foreign firms benefits the domestic firms as well. It will take time for the domestic firms to overcome their administrative heritage from the earlier environment, but once they do, one can expect them to grow rapidly. Liberalization and regulatory reform may also make it easier for entrepreneurs to create new domestic firms that will target niches that the foreign firms ignore. The result will be an increase in the numerator, and a decline in the ratio, even without denominator effects.

Although one should expect to see foreign banks to exit retail banking, not all will. Some particularly well-run foreign banks may retain a presence for a long time. Currently, HSBC is striving to become, in the words of its slogan, "the world's local bank" (Tschoegl 2004b). However, managements change and so do their strategies;

Some would suggest that "Globalization" undermines the metaphor of ecological succession. However, Goldsmith (1969, 360-367), discussing financial systems outside Europe and North America during the 19th and early 20th Centuries, the first era of globalization, noted that foreign banks initiated the development of financial systems but that over time the lost their predominance to the subsequent rise of local banks. (Because Goldsmith's focus was on macroeconomics, he unfortunately did not go into detail.)

Still, we can summon some illustrative examples such as the development of banking and the banking sector in Brazil, especially after the reforms of 1905, which shows a pattern consistent with the ecological succession metaphor (Triner 1996 and 2002). Koford and Tschoegl (2005) argue that the metaphor well describes the history of foreign banks in Bulgaria since the late 19th Century. Tschoegl's earlier papers on the foreign bank presence in Japan (Tschoegl 1988) and Saudi Arabia (Tschoegl 2002b), and Phylatkis' (1988) paper on the eclipsing of British banks in Cyprus before independence, also offer support for the metaphor's applicability.

6.0 Applying ecological succession to the Mexican case

The first point we would make is that ecological succession has occurred twice before in Mexico. The first period began in 1864 with the arrival of the British bank, the London Bank of South America and Mexico (LBSA&M; Joslin 1963).[3] This was the first commercial bank in Mexico, at least in the post-Colonial period.[4] In 1875, an American founded the Banco de Santa Eulalia in Chihuahua, under a state charter (Maurer 2002). In 1881, French, British, and German financiers under the leadership of Banque Franco-Egyptienne, established the Banco Nacional Mexicano, with substantial, though minority, Mexican investment as well.

In 1882, a rival group of Mexican merchants (most of whom were Spanish immigrants) created the Banco Mercantil Mexicano.[5] Following a banking crisis, these two banks merged in 1884 to form the Banco Nacional de Mexico (Banamex). Although foreigner ownership out-weighed domestic ownership until quite late, almost from the beginning control rested with its directors in Mexico City, who were all Mexicans or resident merchants of foreign extraction (Marichal and Riguzzi (2006). Furthermore,

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[3] This bank was the result of the amalgamation earlier that year between the Mexican Bank, which had not yet commenced operations, and the London and South American Bank.

[4] In 1830 the government had created the Banco de Avió to provide industrial finance, especially to the textile industry, but this bank failed in 1842 (Haber 1991).

[5] I have not been able to clarify the relationship, if any, between the Banco Mercantil Agrícola e Hipotecario and the Banco Mercantil Mexicano. Some accounts treat them as different institutions and some as the same.

Banamex's General Managers were Mexicans, with only one exception in 1913-1915. What facilitated this domestic control was first, Banamex's close ties to the Mexican government, which meant that most decisions had to be made in Mexico City, not Paris, and second, the dispersion of the foreign ownership over a number of foreign banks and owners.

Two other banks also commenced operations in 1882, the Banco de Empleados, and Banco Hipotecario Mexicano, which in 1888 became the Banco Internacional e Hipotecario de México. In 1883 the state government in Chihuahua chartered another eight banks (Maurer 2002). In 1889, the LBSA&M liquidated its Mexican branch and incorporated it as the Banco de Londres y México (BLM) with one-third Mexican share participation. BLM acquired the still small Banco de Empleados and with it certain rights (Marichal and Riguzzi 2006). By 1895, Banco Nacional de Mexico, Banco de Londres y México, and Banco Internacional e Hipotecario together controlled more than two-thirds of Mexico's banking assets. In 1899, when BLM decided to increase its capital, a syndicate of Mexican investors became the majority shareholders and LBSA retained only 25 per cent ownership.[6] Throughout this period local investors founded federally-chartered (after 1884) local banks in Yucatán, Nuevo León, Durango, Zacatecas, and elsewhere so that by 1911 there were some 47 banks in all (Haber 1991).

The government of Porfirio Diaz (1876-1880; 1884-1911) strongly promoted inward foreign direct investment as well as migration. The largest group of migrants came from the US, and the French and Germans were also numerous. During this period the

[6] In 1912, Anglo South American Bank bought London Bank of South America.

Mexican economy started to see some industrialization. The foreign banks that entered were responding to these trends.

JP Morgan, Bleichroder & Co., and Deutsche Bank established the Banco Central Mexicano in 1899, but Deutsche withdrew in 1901 and the bank failed in 1913. In 1902, Banco Alemán Transatlantico opened a branch, which in 1905 merged with the newly established Banco Mexicano de Comercio e Industria (BMCI). Banco Alemán Transatlantico was the Spanish arm of Deutsche Bank's Deutsche Uberseeische Bank, and BMCI was a Deutsche Bank project (Marichal and Riguzzi 2006). As a result of the merger, JP Morgan of New York and Deutsche Bank, *inter alia*, controlled BMCI.

In 1903, the International Banking Corporation (IBC), then the leading US international bank, opened a branch. In 1907, Deutsch-Südamerikanische Bank, an affiliate of Dresdner Bank and some other German banks, too opened a branch. [The German government encouraged Deutsche Bank and Dresdner Bank to operate internationally to support German firms and as potential arms of foreign policy (Forbes 1978)]. Lastly, Bank of Montreal opened a branch in Mexico in 1906 (Denison 1967) and Canadian Bank of Commerce opened its branch in 1910 (Ross 1922). There were also some other minor, and unsuccessful entries by a Canadian and several US banks before 1910.

The Mexican Revolution of 1910-20 ended the first period of ecological succession. The governments of General Victoriano Huerta and Venustiano Carranza essentially looted the domestic banks. Bank of Montreal's operations were dormant between 1912 and 1920, though in February 1913 the Bank opened a temporary branch in the basement of the American Embassy at the Ambassador's request to provide traveling funds for fleeing US citizens (Denison 1967). IBC closed its branch in 1914, but the Ambassador's resort to the services of the Bank of Montreal would suggest that the IBC's branch had effectively already stopped functioning. The Deutsch-Südamerikanische Bank supported the pro-German Francisco Madero and his government, but closed its branch in 1913 after Huerta overthrew him. In 19196 the Mexican Government annulled all bank charters.

The second period of ecological succession began in the 1920s as the Mexican banking system reconstituted itself after the ravages of the Revolution. The period from 1920 to 1925 saw the establishment of numerous Mexican banks, though a number failed almost immediately. Banco of Montreal opened four new branches (Veracruz, Puebla, Guadalajara, and Monterrey), and added two more in 1926 (a second branch in Mexico City and a branch in Tampico), giving it the largest network of any foreign bank (Denison 1967). American Foreign Banking Corporation opened a branch in 1919 or 1920, but closed it in 1922 or 1923. The Equitable Trust Company, which was actually an American international bank, opened a branch in 1921, after having been represented in Mexico for a number of years (Phelps 1927).

To restore confidence, in 1925 the government created a government-owned bank that would combine commercial banking with central banking functions, the Banco de México (Banxico). (In 1932 Banxico lost its commercial banking role to become purely a central bank.) Anglo-South American Bank and Canadian Bank of Commerce too established branches. In 1928, Banxico held 25 per cent of the banking system's assets, Banamex 19 per cent, Bank of Montreal 10 per cent, and Banco de Londres y México 5 per cent (Maurer 2002). As mentioned above, Citibank only opened its branch in 1929.

In 1930, Chase Bank (later Chase Manhattan) bought Equitable Trust, and with it the branch in Mexico that Equitable had established.

Yet by the mid-1930s, the only remaining foreign banks were Citibank and Deutsch-Südamerikanische Bank. The Great Depression hit business hard, and especially the international banks (Jones 1993). The Anglo-South American Bank closed its branch in 1932, due to problems at home, though the branch had not succeeded, and in 1936, the Bank of London and South America took over the bank (Joslin 1963). Bank of Montreal started to close branches in 1931, and its last branch closed in 1933 (Denison 1967). In 1934, Canadian Bank of Commerce closed its branch.[7] Lastly, that same year Chase downgraded its branch to a representative office.

From the mid-1930s to the early 1990s, there was an interregnum during which the Mexican banking system was closed to foreign banks so no ecological succession took place. A key factor was the passage in 1941 of major banking legislation that formally barred any further foreign bank entry.

The third period of ecological succession began in 1991 with the privatization of the Mexican banking system. The collapse of the newly privatized banks created the disturbed soil of the model. The government initially permitted too little foreign entry for it to have any major effect. The need to recapitalize the banks, while also bringing in strategic investors with the necessary know-how forced the government to deregulate entry further. The result is that first phase of the process is complete.

The second phase has barely begun. Competition among the banks is not yet intense enough to force foreign banks to reconsider their strategies (Schulz 2005). Nor have any

[7] Personal communication (4 April 2006) from Jill ten Cate, Archivist at Canadian Imperial Bank of Commerce.

of the foreign parents run into difficulties necessitating a rationalization of their overseas difficulties. As a result, we have seen minimal numerator effects, i.e., there has been no transfer of foreign banks to local ownership.

However, denominator effects, i.e., expansion by local banks, are already starting to occur. The data in Table 1 shows not just a reduction in the ratio of in assets in foreign owned banks relative to total banking system assets, but an expansion in the number of branches and employees at domestic banks. Here the erosion of the foreign banks' share has been much more dramatic than in assets, suggesting that the domestic banks have been expanding by targeting a less-prosperous mass-market clientele.

In 2002, the government granted its first new banking license since the Peso Crisis. Grupo Elektra created Banco Azteca to build on the retail credit that Elektra had been offering for 50 years to customers at its three big discount stores. (Elektra's financing activities had grown rapidly from the 1990s and it had been lobbying for some time for a banking license.) Azteca uses some 3,000 motorcycle agents as collectors of loan or savings installments to extend its services to the poor and lower middle class.

Two more new banks are expected to start soon, both modeled roughly on Banco Azteca. One, Banco Autofin México, is being organized by a large firm that that organizes "circle of savers" schemes (*consortios*), under the name "Autofin". The company was initially oriented towards purchases of cars, but then also offered home mortgage programs. Coppel, a chain like Elektra, is organizing another. Bansefi, the government-owned Banco del Ahorro Nacional y Servicios Financieros, is organizing a network of savings banks and credit unions. In time, some of these may become commercial banks, and Bansefi itself is a target for privatization. Lastly, there are a number of non-bank financial service firms and entities that are coming into existence or expanding their services and operations. In time, these too may give rise to banks.

7.0 Conclusion

Foreign banks have responded to the opportunities that crises, deregulation, wars, or the transition from Communism have created. Some part of the entry was foreign banks pursuing normal international banking activity, and these branches and their activities will persist indefinitely, but never be of much quantitative importance. The part that draws the most concern in many countries around the world is foreign majority ownership of large domestic commercial banks. Discomfort can be especially acute when foreign-owned banks acquire major domestic banks and come to dominate the banking system, as is now the case in Mexico. However, one must understand that the foreign banks' initial presence is only the first phase in a process of ecological succession.

The foreign banks' initial success leads over time to the erosion of their predominance in the host banking system. As the banks, foreign and domestic-owned alike, become more competitive, the foreign owners will no longer have a comparative advantage in general retail and commercial banking, even if they retain an absolute advantage. Thus, in time, we can expect that many, if not all, foreign owners will sell their retail banking activities to domestic owners. The foreigners may retain a branch in the national financial center to conduct corporate and wholesale banking but will leave retail and general commercial banking to local banks. More importantly, the reforms that facilitated the entry of the foreign banks free the domestic banks to compete and grow.

The result will be that over time the proportion of banking system assets in foreign-owned banks will decline to a long-run proportion much lower than we observe today. This succession process has occurred twice before in Mexico’s history and though it will probably require decades to reach its steady state, it is ongoing.

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Table 1: The share of the largest foreign banks in the Mexican banking system shrank between 2001 and 2005

	Assets		Branches		Employees	
	Pesos (Bn)	%	No.	%	No.	%
2001						
Citibank-Banamex	390	26	1,549	22	31,404	29
BBVA-Bancomer	385	26	2,236	32	30,921	28
Serfin-Santander	225	15	924	13	11,800	11
Bital	118	8	1,387	20	15,697	14
Banorte	99	7	452	6	9,069	8
Scotiabank Inverlat	62	4	358	5	6,391	6
Others	199	13	133	2	4,286	4
Five major foreign	1,180	80	6,454	92	96,213	88
Total	1,478	100	7,039	100	109,568	100
2005						
Citibank-Banamex	468	21	1,372	17	29,139	23
BBVA-Bancomer	544	24	1,717	21	24,956	20
Serfin-Santander	372	17	908	11	10,274	8
HSBC (ex-Bital)	252	11	1,345	17	19,808	16
Banorte	179	8	968	12	10,274	8
Scotiabank Inverlat	119	5	405	5	6,714	5
Others	315	14	1,275	16	26,102	21
Five major foreign	1,754	78	5,747	72	90,891	71
Total	2,248	100	7,990	100	127,267	100
Growth, 2001 to 2005						
Citibank-Banamex		20		-11		-7
BBVA-Bancomer		41		-23		-19
Serfin-Santander		65		-2		-13
HSBC (ex-Bital)		114		-3		26
Banorte		81		114		13
Scotiabank Inverlat		94		13		5
Others		58		859		509
Five major foreign		49		-11		-6
Total		52		14		16

Table 2a: Between 2001 and 2005, assets per employee at the six largest banks in Mexico has not increased, but assets per branch has.				
	Dependent variable: Assets (Pesos Bn)			
	2001		2005	
2001	Coefficients	t Statistics	Coefficients	t Statistics
Intercept	-2.21	-0.04	10.4	0.07
Branches	-0.03	-0.29	0.17	0.72
Employees	0.01	2.29	0.01	0.56
	R Square	F stat.	R Square	F stat.
	0.89	11.6	0.69	3.28

Table 2b: The residuals from the regressions in Table 2a show that Serfin-Santander has much more in assets than one would expect given the number of its branches and employees, and HSBC Bital has less.				
	2001		2005	
	Pesos (Bn)	Standardized	Pesos (Bn)	Standardized
Citibank-Banamex	-7	-0.14	17	0.18
BBVA-Bancomer	13	0.27	61	0.65
Serfin-Santander	87	1.76	132	1.41
HSBC Bital	-63	-1.27	-130	-1.40
Banorte	-14	-0.28	-72	-0.77
Scotiabank Inverlat	-16	-0.33	-8	-0.09