6 Case Study

Foreign Direct Investment In Mexico: Acquisition of Banamex By Citigroup

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Abstract

The financial and banking services sector has always been one of the most important in the world economy. In Mexico it has had transitions from private to public and to private again, and it is one of the main sectors which have received Foreign Direct Investment since the opening trade economic policy of Mexico. The increase in FDI inflows to Mexico have been marked since the entry of NAFTA and one of the most important acquisitions of Mexican companies has been Banamex bought by the US global corporate CitiGroup. This work shows that in addition to having contributed to one of the most important amounts in the history of receiving FDI by Mexico, the acquisition of Banamex allowed competition in the financial sector and the entry of new competitor into the industry.

Keywords: *Foreign Direct Investment, Financial Sector, Acquisitions*

Introduction

According to Peng (2012) foreign investment, is divided into Foreign Portfolio Investment FPI (IEC), which is made in a portfolio of foreign securities such as stocks or bonds,andForeign Direct Investment (FDI), which is the investment trans-border that makes a foreign resident (direct investor) in a Mexican company or assets located in Spain (direct investment enterprise) with the aim of establishing a lasting interest. Through this investment, the direct investor seeks to exert a significant degree of influence on the direct investment enterprise (Ministry of Economy, 2015).

FDI is broken into three sections according to the mode of financing:

A. New investments: concerning the movements of FDI associated with:

1) Initial investments made by foreigners when they settle in Mexico, among them there are those expenditures and working capital to carry out acts of commerce in Mexico.

Contribution to the capital of Mexican companies (initial or increases by the IED).

2) Transfers of shares by Mexican FDI investors.

3) Initial amount of compensation trusts that give rights on FDI.

Reinvestment profits. The fraction of income that is not distributed as dividends and is considered to represent FDI increased capital resources owned by the foreign investor.

Intercompany accounts. Transactions originated by debt arising between Mexican companies with FDI in the social capital and other related firms living abroad.

Similarly Peng (2012) FDI disaggregated into two categories according to the direction that moves the IED:

A. Horizontal FDI is the kind of FDI in which the company performs the same activities at the same

stage of the value chain from its country of origin to carry out in the host country.

B. The vertical FDI is the kind of FDI in the company that is performing FDI moves either up or down in the value chain in the host country.

1) Upward vertical FDI is specified in the company to a stage of ascending value chain within the recipient country.

2) Downward vertical FDI is that which is intended in the company to a stage of falling value chain in the host country.

It is of great importance to mention that FDI flows is the amount of FDI which moves in given direction in a given period. The inflows and outflows of FDI are the amount of FDI in and out to and from a country in this specified period, usually in the statistics are taken as a year, although this year can be divided into three months periods, quarters or semesters.There is a fundamental difference between multinational enterprises (MNEs) and those that are not. Because the other companies can also have activities, transactions and business abroad through exports, imports, licenses and even hiring through outsourcing, or even if they engage in the FPI. That is, an exporter, to become MNEs should engage in FDI. Currently MNEs have submitted growth since the end of World War II; about 82,000MNEs controlled810,000foreign subsidiaries(Peng, 2012).

A key question for MNEs is why companies want to engage in FDI, why they want to become MNEs? According to Dunning Eclectic Paradigm (1974), these companies seek to gain advantages mainly in three contexts; property (P), location (U) and internalization (I), known as UPI advantages. Now the benefits of ownership are relating to the possession of certain assets for MNEs representing them as an advantage abroad. Locational advantages relate to the benefits that can be enjoyed by MNEs to operate in a specific place. The only and unique features of this place, as for example, natural resources or work, or location near certain markets in particular are those which provide benefits to companies that do business here.

Finally, internalization is the replacement of certain markets through the border of the company, i.e. export or import of MNEs that are located and have operations in more than two nations. In other words, internalization is a response to market imperfections, which regulate international transactions.

There are different perspectives or ways to react politically to FDI, specifically three. The first is the radical view to FDI, i.e. the policy is hostile to this type of investment, from its roots in Marxism, and FDI is treated as a tool of imperialism and as a mechanism for the exploitation of resources of nations and its population by countries that are in capitalism and foreign companies. Countries with this approach usually choose to nationalize the assets of MNEs and / or prohibit or discourage inflows of FDI.Second, the prospect of a free market of FDI provides that without state intervention, FDI will help countries to better exploit its comparative advantages through specialization in specific goods and services. And third, the pragmatic nationalism on FDI is used by most nations, which are considered the advantages and disadvantages of FDI, and only approved if the benefits outweigh the costs for the host nation (Peng, 2012).

In the following Table 1, the effects of FDI on the countries of both origin and destination are shown as well as their costs and benefits for both countries.

Table 1: Impact of FDI on the countries of origin and host

Effects of FDI			
Host countries against countries of origin	Inflow of capital, technology, management, job creation	Loss of sovereignty, competition, capital out -flow guests.	Host countries receivers
	Profits, exports, learning foreign capital outflow	Capital outflow, job loss	Countries of origin
	Profits	Costs	

Source: Peng (2012, pp. 194)

Background of the problem

Now, the Mexican foreign policy since the entry into force of NAFTA in 1994, Mexico has made efforts to reform the national economy by enabling open trade, dismantle trade barriers and attracting foreign direct investment, substituting industrialization model based on import substitution to be promoted abroad and inserted into the global economy.

Import Substitution Industrialization (ISI) can be understood as a development strategy followed in most of the countries of the Organization for Economic Cooperation and Development (OECD) during the second half of the nineteenth century and after World War II in Latin America, which sought to create in their respective nations imported products, particularly manufactured. Initially replacing imported consumer goods and goods for further elaboration later, the ISI was based on encouraging the private sector in the context of a mixed economy (Baer, †1972).

The industrialization by import substitution (ISI) that began in Mexico during the government of Lazaro Cardenas (1934-1940) and remained in force until the early eighties had as a reference point for socio-economic development the domestic market. Socioeconomic modernization, taking as synonymous to the modernization and industrialization, required public intervention for the development of infrastructure and the industrial sector itself through multiple direct and indirect instruments, such as subsidies, tariff and trade policies and the selection of priority sectors. It was hoped from this “mixed economy” that in later times not only imports were replaced, but also come to export manufactured products and integrate the country into the world market (Dussel Peters et. al., 2003).

As an important example to quote Alvarez-Galván (2000), FDI flows during the ISI were important. With a shift from the beginning of the century of the mining and agricultural sectors in industry and services, and by 1970 it was estimated that the manufacturing sector accounted for about 20% of manufacturing GDP. Today it is clear that the constraints imposed by foreign trade policy which is applied to countries that do not have a Free Trade Agreement with Mexico, are affecting the country’s competitiveness negatively.

Therefore, in the above context, foreign direct investment has a key role in the strategy followed in Mexico since the end of 1987. On the one hand, FDI plays a significant role in the structural change, modernization and export orientation by integrating the global market, either through new investments or the purchase of existing assets, generating changes in the production plant, increasing the level of domestic competition and creating new links with the outside.On the other hand, from a macroeconomic perspective, FDI becomes a major source of funding of the strategy (Gurria-Trevino, 1994), also because the historical sources of financing such as oil and agricultural surpluses and external debt, are not sufficient or did not exist in the amounts required for structural change proposed since the eighties.

Structural change is based on six main lines: a) trade liberalization, b) changes in the regulatory framework for foreign investment, c) privatization of public enterprises, d) economic deregulation, e) modifications to the regulatory framework for land tenure, and f) regulation of monopolistic practices

through the enactment of the Competition Act (Gurria-Trevino, 1994). The international competition for capital flows, resource shortages and difficulties in obtaining financing, required deep trade negotiations, a process of deregulation, as well as changes in the legal framework because Mexico had one of the foreign investment regimes most restrictive in the world (White-Mendoza, 1994).

The nationalization of commercial banks in 1982 by President Lopez Portillo is a well-documented but under theorized Mexico's transition to neoliberalism dynamics. Right in the middle of a crisis, the nationalization of the bank, restored power to the state capital in what was intended to be an act to save the system and structural changes to reduce the development led by capitalism (Marois, 2008). Macroeconomic immediate circumstances included the decline in oil prices in the world in 1981, the increase in government debt to compensate for lost resources and a sharp contraction of currency successive peso devaluations, speculative currency and capital flight only aggravated the problems of public finances and balance of payments.

According to calculations based on data from the Ministry of Economy (Secretaría de Economía, 2015), the behavior of FDI in Mexico has grown significantly since the entry into force of NAFTA in 1994. The United States has been the country from which most of the investments come to Mexico. In the period from 1980-2014 US has led to Mexico $ 229,713.86 million in FDI, which are equivalent to 48.61% of the total FDI received by Mexico in the mentioned period.Figure 1 below shows the behavior of FDI from the United States and is marked with a red cross the point of greatest flow of FDI from the US to Mexico.

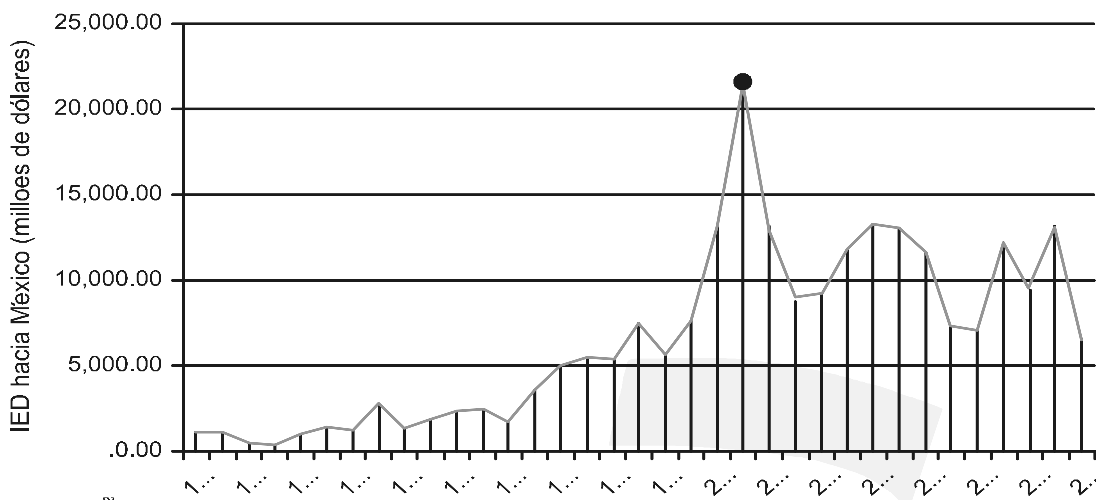

Figure 1: Behavior of the FDI received by Mexicoin1980-2014 from the United States of America

Source: Based on data from Secretaría de Economía (2015).

This point also represents the purchase of the Banco Nacional Mexicano (Mexican National Bank), the largest bank in Mexico, by US corporate CitiGroup, by a sum of $ 12.500 million dollars according to data from Salas (2002). The acquisition contributed to reach a historic high of FDI received by Mexico from US for $ 21, 549.20 million dollars in 2001, which has not been close to be repeated since.

Defining the problem

From the strategic point of view, companies seeking to engage in FDI have incentives both to exercise control, to have a degree of influence over the company and also to seek competitive advantages such as UPI. The question of this work lies in what were the causes that have led to increased FDI in Mexico, especially in the case of the acquisition of Banamex by Citigroup Corporate America?

Theoretical framework

Explanatory theories of FDI are generally divided into two broad categories: the explanation of FDI in microeconomic terms, industrial organization, and studies focused on macroeconomic factors of FDI, and labor costs. Theories explaining FDI in microeconomic terms, it is worth mentioning the summary by Bayoumi and Lipworth (1997). These theories have focused on market imperfections and the desire of multinationals to expand their monopoly power to penetrate profitable foreign markets and oligopolies, to retaliate or to anticipate the entry of competitors.

On the other hand, research has focused on the specific advantages of companies due to the superiority of their products or cost advantages derived from economies of scale, economies of several production plants and advanced technology, or distribution and higher marketing. According to studies by Vernon (1974) and Porter (1986) without neglecting the Eclectic Paradigm of Dunning (1974), which states that FDI exist if there are advantages in terms of property and location for a business producing abroad. Such advantages are better exploited through the internalization of production through FDI, also known as the OLI model for its acronym in English O for Ownership of property, L for location, and I for internalization.

As a microeconomic and controversial theory, it is the model introduced by Kojima (1973), where the situations in which FDI would promote or reduce business activity were studied. He claimed that the former occurs when a company has superior technology but do not have resources; invest in arises when a host nation raises tariffs, which attracts foreign investors, and a controversial point comes when the author, in an exaggerated effort to separate his model with those of other school, identifies charitable investments with Japanese and non-beneficial to the United States.

According to previous theories of microeconomic perspective, multinational corporations find cheaper to expand directly in a foreign country rather than through trade in cases where the advantages or costs associated with the product are based on domestic assets and indivisible composed mainly of knowledge or technology.However, there is also the macroeconomic approach of the theories of FDI. Of which, the classical theories of international trade have developed from classic authors like David Ricardo (1963), where his work attempts to explain the reasons why there is the mobility of capital and labor, even in their contributions are considered the distinct differences between countries and regions.

In the assumptions of these models based on the following tasks that determine the theories of FDI location, such as the Heckscher-Ohlin (1933) and later the model of specific factors by Samuelson (1971) and Jones (1971). These models in turn are based on the proposed model by Helpman and Krugman (1985) with the additional assumption of unequal distribution of productive factors. These various models despite being old, are still valid, likewise these theories work for theories of the location of FDI.

Brief review of the literature

According to Salas (2002), the US universal bank Citigroup, had in the late twentieth century presencein over one hundred countries and was looking for opportunities for geographic expansion and penetration especially in emerging economies. And only in Mexico, just over three years, it acquired two major financial groups and therefore, the internationalization of the Mexican financial system proved burdensome for Mexicans who paid the high

cost of bank bailouts in the mid-90. In the future, the real sector of Mexico will be funded by organizations with global networks, such as access to funding in international capital markets on favorable terms and internal transfers of recruitment,which will now be from abroad. But the consequences of the loss of control of the national payment system are yet to be seen.

Method

For the analysis of the strategic case of the purchase of Banamex by Citigroup, it has been used a descriptive method. This involves collecting information from various sources for analysis and description of the case and the effects caused by the acquisition between companies are also analyzed.

Analysis of results

According to the article published by Global News (2001), the purchase of Banamex by that amount came as a surprise to the world market, as it was the most profitable financial institution in Mexico. So,Citigroup sought to improve its presence in Brazil and Argentina. Therefore, about a quarter corporate earnings come from emerging economies.The three major banks in Mexico were purchased by foreign financial institutions. First Bancomer, was acquired by the Spanish bank BBVA. Banamex was acquired by Citigroup.

Later, Serfin was purchased by another Spanish bank, Banco Santander CH,and at that time was awaiting what would happen to Banorte which had constant discussions with Bank of America. At the time of the acquisition, Banamex had assets of $ 15,000 million dollars, around 32,000 employees and 720 branches around the country. According to Ramirez (2001) it has proposed seven economic policies to promote the market, without compromising economic interests without generating excessive inequalities of wealth distribution;

A. Antitrust laws and regulatory systems should be imposed either before deregulation or financial privatization to a given industry, also prevent the privatization of various sectors in a short period of time because that could allow private companies to consolidate and come to exert considerable monopoly power.

B. To avoid becoming "captured bodies" of industries, must regulate and monitor, regulatory agencies must be strong and financially independent institutions with their boards staggered through the political cycle.

C. The regulatory staff should be technically qualified, highly paid in relation to the industry to be regulated, and they have access to opportunities for promotion, training and travel, and that they have prohibited having worked in the regulated industry for a period specific of time after their boards are finished.

D. To avoid the risk of large losses and government intervention to socialize the losses, the state should "lean against the wind". In other words, to regulate privatized firms in a more comprehensive way, including its lending practices, debt accumulation, diversification of assets, investment policy and merger activity,

E. Regulatory systems must be transparent in the sense that they are based on impersonal rules which are clearly defined and consistent with the management skills of national regulators, and understanding not only for owners and management, but also for consumers and the general public.

F. Finally, although the transparent and effective regulation at first decrease in discounted present value of the firms to be privatized, they compared to those that are guaranteed have extensive monopoly power.

Since 2009, most recently in 2014 and early 2015, the owners have been negotiating to sell Banamex Citigroup back to Mexican investors, such as Carlos Slim and Ricardo Salinas Pliego. The reasons for that Citigroup could get rid of Banamex are among others that Citigroup has had financial problems

internationally, and has been shedding assets worldwide. Mexican law prohibits state resources from other nations have a stake in Banks in Mexico, so the US government aid to Citigroup to retain the Mexican bank is discarded.

Conclusion / Discussion

According to the review of the prior information and their analysis, it can be concluded that the causes of the acquisition of Banamex by Citigroup were:

A. CitiGroup was looking for opportunities to consolidate its presence in emerging economies, particularly in Latin America.

B. Banamex was then the second largest financial institution in Mexico therefore proved of particular interest its purchase by the potential benefits represented.

C. Since Spanish financial institutions had invested in Mexican banks, and the interest of other American banks by Mexican banks, Citigroup carried out the strategy for investing in Mexico as well.

D. Transition of the Mexican economy to neoliberalism, led to many industries towards, even today, in the process of deregulation and privatization, from the point of view based on the institutions, the state has allowed and encouraged FDI sectors which were previously public.

E. The potential market of Mexico has increased considerably since the bank was privatized again.

Finally, the study shows that in addition to having contributed to one of the most important figures in the history of attracting FDI to Mexico, diversification of FDI is achieved, the acquisition of Banamex allowed competition in the financial sector.

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