What are the specific characteristics of internationally active banks? This is the research subject of international financial intermediation, the theoretical foundation for banks. Financial intermediation exists because risks and costs related to financial intermediation functions are expected to be lower when organized by a bank. A review of the literature is presented. Subsequently, what incentives can a bank have to pursue internationalization? Incentives to internationalize are reviewed and clustered, and their relative importance as drivers to internationalize assessed.

A separate section discusses the interaction between financial systems and internationalization. The role financial intermediation plays within the economy is considered, leading to a stylized description of different financial systems, each with distinct consequences for the internationalization motives of banks.

3.1. The theoretical groundwork for internationalization

In contrast to the growing body of financial intermediation literature, international financial intermediation has been relatively underexposed. A common denominator of international financial intermediation theories is that they incorporate a spatial dimension within mainstream economic analysis. The spatial dimension becomes visible when considering an applicable definition for an international operating bank which has the following characteristics:

1. Assets and/or liabilities other than in the home country and/or home country currency,
2. rights and/or claims other than in the home country and/or home country currency, part of which is
3. issued and collected outside the home country.

This definition agrees with the one the Bank of International Settlements (BIS) uses for international banking statistics (Bank for International Settlements, 2000) and is a slight expansion to the one given by Bryant (1987) and a broadening of Scholtens’ definition (1991): any financial transformation that has a cross currency and/or cross country dimension. A pragmatic definition stems from Casson who defined a multinational bank as a bank that owns and controls banking activities in two or more countries (Casson, 1990). Robinson defined multinational banking as “operating a bank in, and conducting banking operations that derive from, many different countries and national systems” (Robinson, 1972). With each of these definitions off balance sheet activities as well as balance sheet activities are covered. Gray and Gray (1981) limited their definition to a financial corporation which acquires deposits and initiates loans from offices located in more than one country, excluding non-interest income.

In theory, international banking activities might be conducted in the home country when the financial intermediary only trades with other financial intermediaries who are active internationally. To exclude the possibility of a narrow interpretation of international financial intermediation a third condition has been added to the definition: there has to be actual cross border activity implying real changes within the organization. With regard to the internationalization part of the definition, no restrictions are formulated with regard to the number of countries or the type of activities. It extends to the whole range of activities of a financial intermediary and international implies simply one or more foreign countries. This is more extensive than for example Cho (1985) who defined a multinational bank as specifically having branches in one or more foreign countries, since more organizational forms than branches can be identified.

### 3.2. Incentives to internationalize

A relatively small group of authors has explained the incentives to undertake international financial intermediation. Table 3.1 summarizes the incentives for banks to internationalize forwarded by several authors. Pecchioli (1983) investigated the incentives within the OECD countries, addressing the recent surge of international banking activity