Internationalizing a financial firm in small developing markets

William W. Lawrence
Mona School of Business & Management
The University of the West Indies, Mona
Kingston, Jamaica

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Abstract

This study explored how the business model of a Jamaican financial firm evolved for regional expansion in the Caribbean. There is a paucity of research on firm internationalization in small markets. These markets constrain economies of scale and financial institutions often face more regulatory restrictions to foreign market entry than encountered by other firms.

The research methodology involved an in-depth case study of Jamaica Money Market Brokers (JMMB), a family-run financial firm, using qualitative and quantitative data from both primary and secondary sources, covering the period 1992 to 2016. A conceptual framework, derived from literature on the Uppsala model of multinational enterprise evolution and dynamic capabilities, guided the analysis.

JMMB followed the decision path described by the Uppsala model and leveraged its family culture to forge strategic partnerships for penetrating target markets. Dynamic capabilities enabled gradual business model replication overseas, based on psychic distance, and subsequent corporate transformation to diversify the range of services. However, market conditions forced JMMB to trade-off profitability for asset growth.

The findings imply that successful internationalization in small markets involve a differentiation strategy with product innovation to cope with market saturation. The study contributes to the development of internationalization theory by illustrating business model as a unit of analysis in the Uppsala model of MNE evolution.

Authors note
The author conducted this study at the University of the West Indies, Mona as part of the National Commercial Bank Jamaica Limited sponsored applied research programme in corporate renewal and transformation.

1.0 Introduction

Financial firms often pursue opportunities for profitable growth in more than one country (Engwall & Hadjikhani 2014; Grant & Venzin 2009). While several approaches exist for financial firm internationalization, the Uppsala model is a popular choice (Ahmad 2012; Parada, Alemany & Planellas 2009). This model posits that firms begin the internationalization process in nearby foreign markets, in terms of psychic distance, and then gradually enter other markets further away (Johanson & Vahlne, 1977, 2009; Vahlne & Johanson, 2017). During the process, firms learn from exploration and experience and use this knowledge to make decisions about the level of commitment, organizational processes, investment and risk. Multinational Enterprise (MNE) evolution and performance depend on firm resources, capabilities, and networking to build relationships.

According to Rask (2014, p. 147), 'When a firm decides to internationalize its activities, its focus is on business model innovation.' Business model refers to the architecture used by the firm to conceptualize, create, deliver and capture value for organizational stakeholders (Zott & Amit 2013). The MNE needs to design and orchestrate an appropriate business model and embed this intangible asset in routine operations for profitable entry and growth in foreign markets (Teece 2014). Extant literature on the Uppsala model presumes that the size of target foreign markets will accommodate business models based on economies of scale. However, this might not be the reality of the MNE and can be a problem for financial firms because they rely on asset growth in the normal course of business. Moreover, Ellis (2008) reported a negative relationship between market size and entry sequence. This suggests that small markets are less attractive for international expansion by way of the Uppsala model. Therefore, the purpose of this study was to explore how the business model of a financial firm evolves during internationalization in small markets that constrain economies of scale.

The Caribbean provides an interesting context for this study because this region consists of small island developing states weakened by low growth and high public debt (international Monetary Fund 2013). Moreover, the intensity of competition is high because Caribbean financial institutions tend to offer similar and mature services in saturated markets (Ogawa, Park, Singh & Thacker 2013). These factors constrain economies of scale. Yet, Jamaica Money Market Brokers (JMMB) adopted the Uppsala model to transform itself from a private, family-owned brokerage firm, serving only Jamaica, to a publicly traded and diversified financial institution with facilities and operations in three Caribbean countries. Therefore, this case study explored the answer to the following question: How did the business model of JMMB evolve for successful internationalization in Caribbean markets? The answer contributes to international business literature by illustrating a process for regional expansion in small markets.

The next section of this article discusses how business models relate to the Uppsala model and dynamic capabilities to develop a conceptual framework for the case study. Then the methodology for data collection and analysis is described. JMMB's internationalization journey is documented. The article concludes by discussing the new insights, areas for future research, limitations of the study and implications for managerial practice.

2.0 Conceptual Framework

Based on earlier work by Penrose (1959) and Cyert and March (1963), Johanson and Vahlne (1977) proposed a model of internationalization they developed at Uppsala University from studies of Swedish firms. Johanson and Vahlne (2009) further developed the Uppsala model to recognize foreign networks of relationships for building trust and commitment to overcome liabilities of newness, foreignness and outsidership. Firms are often involved in a set of close and enduring relationships with critical suppliers and customers. These relationships arise from social exchange processes that build trust then reciprocal commitment between the firm and connected parties. Firms need effective participation in one or more networks of relationships for success. These networks can create new knowledge through exchanges in critical areas, such as resources and capabilities. The MNE can more easily build the relationships necessary for spotting and exploiting opportunities when there is minimal perceived difference in conditions, called psychic distance, between home and foreign country.

Some scholars challenged the prescriptions of the Uppsala model. Forgren and Hagstrom (2007) argued that the notion that firms begin internationalization in nearby markets overlooks e-Commerce that makes business transactions less constrained by time or geographic location. Furthermore, Oviatt and McDougall (1994) and other researchers posit an alternative to the Uppsala model, called "born global," to describe some entrepreneurial firms that begin internationalization very soon after their establishment rather than incrementally. Yet, Outreville (2013) observed that financial groups from emerging economies preferred to internationalize incrementally in their respective home regions. Ahmad (2012) attributed this behaviour to the perception of lower risk due to market familiarity. Parada, Alemany and Planellas (2009) noted that Banco Santander developed and mastered a business model to build a strong lead position in its home market and then took this architecture successfully to foreign countries. However, the literature does not address the issue of how to internationalize in small markets.

Vahlne and Ivarsson (2014) noted that MNEs develop dynamic capabilities for competing in varying institutional contexts of the global arena. Dynamic capability refers to the capacity for purposeful and agile bundling of resources and this enables the firm to create adjust, and replace business models (Teece 2014). The roots of scholarly research on dynamic capabilities reside in the resource-based view that firms achieve competitive advantage and growth by combining resources in ways superior to rivals in the marketplace (Penrose, 1959). Resources refer to tangible or intangible assets used to perform activities and are strengths or weaknesses relative to competitors (Wernerfelt 1984). Barney (1991) attributed sustainable competitive advantage to resources that are valuable, rare, inimitable and non-substitutable (called VRIN resources). Grant (1991) argued that distinctive resources and capabilities enable the firm to establish its identity and mission formulate strategy and earn corporate profits in excess of the cost of capital.

Dynamic capability determines the organization's capacity for strategic change to adapt to the environment (Winter 2003). Helfat and Peteraf (2015) assert that these capabilities involve the capacity to perform not only physical but also mental activities. Dynamic capabilities reside largely in the domain of top management although impacted by organizational systems and structures (Teece 2014). Dynamic capabilities are leveraged through three sets of organizational processes or activities:

sensing opportunities and threats through market probing, listening to customers and scanning elements of the ecosystem

seizing opportunities by securing and orchestrating the necessary assets, motivating employees by way of incentives and building strong relationships with critical constituents

transforming capabilities to maintain competitiveness by enhancing, combining, protecting and reconfiguring tangible and intangible assets

Importantly, dynamic capabilities do not lead automatically to superior firm performance. They need proper deployment for best results. Successful transformation becomes evident when the organization embeds behavioural change for long-term financial success (Blumenthal and Haspeslagh 1994).

Figure 1 combines the main elements of the Uppsala model with the concepts of business model and dynamic capabilities to show the firm internationalization process as four sequential and overlapping phases. The firm builds VRIN assets and capabilities for cost leadership or product differentiation in its home market, explores nearby markets overseas for opportunities to leverage these assets and capabilities, uses networks of relationships to enter foreign markets, and eventually reconfigures the assets and capabilities to pursue new opportunities.

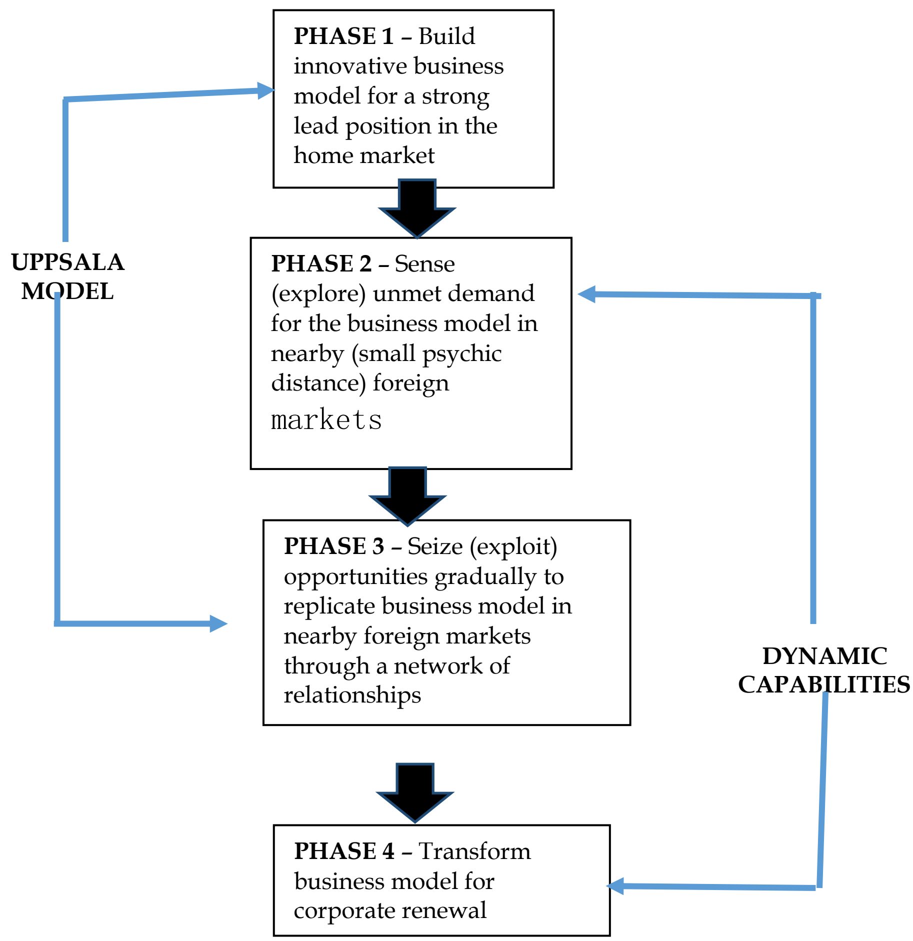

Figure 1. Four sequential and overlapping phases for financial firm internationalisation

During Phase 1, the firm builds superior assets and competences in its home market. Phase 2 involves probing the ecosystem to detect latent demand, for existing resources and competences, in foreign markets that have short psychic distance or cultural conditions similar to those of the home market. Managers should discern potential opportunities, risk exposures and regulatory conditions by searching for evidence and testing assumptions under different scenarios of market, profit potential and competitor responses. Phase 3 involves developing a business model by configuring the firm for around the fundamental areas for competitive advantage (Rask 2014). During Phase 4, managers learn from research and experience to generate new knowledge for business model innovation and redeployment to strengthen competitive advantage and seizes new opportunities (Teece 2014). Aspara, Lamberg, Laukia and Tikkanen (2011, p. 622) asserted, 'The difference between success and failure of transformative activities boils down to the firm's ability to change its business model effectively and in rhythm with the dynamics of the external business environment.' The main concepts in Phase 4 include organizational learning and business renewal.

Risks are embedded in all decisions made for firm internationalization (Vahlne & Johanson 2013, p. 199). Risk refers to the likelihood that an outcome can vary from expectation and may present an opportunity or a hazard (Bromiley, McShane, Nair & Rustambekov 2015). Financial firms need to manage strategic and financial risks during the process of internationalization (Grant & Venzin, 2009).

3.0 Methodology

3.1 Research Setting

The research setting is the Caribbean comprised of the islands and surrounding coasts of the Caribbean Sea (Caribbean Centre for Money and Finance 2013). Economic growth in the region remained anaemic with high levels of poverty and underemployment (International Monetary Fund 2013). Jamaica's public debt became the highest in the region, following liberalisation of trade and foreign exchange controls in 1991, rising to over 130% of GDP by 2011 compared with the regional average of 79%. The financial sector is large relative to the size of Caribbean economies in terms of GDP (Ogawa *et al*. 2013). Banks represent the largest category of assets with consumer transactions their main business (Holden & Howell 2009).

The rest of the Caribbean financial services sector is comprised of insurance companies, credit unions, securities dealers, microfinance firms, cambios, and building societies (Holden & Howell, 2009). Securities dealers buy and sell securities, such as stocks and bonds, for fees and hold securities for resale. They offer a distribution channel for new issues and those resold on the secondary market. JMMB is the largest securities dealer in the Caribbean and listed among the top eight regional financial institutions (Ogawa *et al*. 2013).

3.2 Research Design

Similar to Parada et al. (2009), this study uses a single case study to explore the Uppsala process of internationalization at a financial firm. This qualitative method can provide a holistic account of the nuances of specific phenomena to uncover organizational concepts and dynamics hidden from other forms of empirical inquiry (Cresswell 2008, p.476). While the case method is susceptible to researcher bias and the findings are not generalizable to the population of interest, this approach is particularly useful for understanding the way a decision-making process unfolds (Eisenhardt 1989). The intention of this single case design is not to generalize findings to the population but instead illustrate a decision pathway and mechanisms.

3.3 Data Collection and Analysis

The conceptual themes in Figure 1 formed the basis of data collection over a period of four months to track JMMB's business model evolution and performance during internationalization. The method of data collection is similar to the approach taken by Ahmad (2012) and Parada *et al*. (2009). Table 1 summarizes the data types, sources, collection methods, documents and information retrieved for this study. JMMB's business model was the unit of analysis. The study made observations of JMMB's regional expansion in accordance with the phases shown in Figure 1. Phase 1 (1992 to 1999) focused on how JMMB created capability to retail debt securities on the secondary market in Jamaica. Phase 2 (1998 to 2003) identified how the firm sensed opportunity to replicate its business model in other Caribbean countries. Phase 3 (1999 to 2007) looked at how JMMB extended its business model from Jamaica to seize opportunities in Trinidad and Tobago and, subsequently, the Dominican Republic. Phase 4 (2004 to 2014) noted how JMMB transformed its business model to enter the banking segment of the market. The measures of financial success of the internationalization process were growth of total assets, an indicator used to rank financial institutions, and return on equity (ROE) which is an indicator relevant for company shareholders.

Data types	Sources	Collection methods	Documents	Data extracted for content analysis
Primary	Two JMMB Board directors	Face-to-face interviews	Two transcripts	Insights on corporate governance and risk management
Primary	Two JMMB senior managers	Face-to-face interviews	Two transcripts	Insights on managerial cognitions, decisions, strategy and operations
Secondary	JMMB's website	Collected at source	12 Annual Reports	Financial data and commentaries from the Board and Management
Secondary	Jamaica Stock Exchange yearbooks and website	Retrieved from website	14 public releases and one prospectus for initial public offering	Stock market data; financial reports, and company releases to shareholders
Secondary	Bank of Jamaica economic and social statistics	Publications in the University's library	Annual social and economic surveys and statistical digests	Economic on and social data on GDP, exchange rates, interest rates and financial sector profile and performance
Secondary	Newspapers (Gleaner, Observer, Guardian)	Collected from archive	67 Articles	Public commentaries on JMMB's decisions, events and performance
Secondary	Google Scholar (Internet)	Retrieved from website	4 Articles	Published research articles on JMMB's performance
Secondary	ABI/Inform (from the UWI electronic library)	Retrieved from website	2 articles	Published research articles on company structure and operations

Table 1. Data collection for content analysis of JMMB's internationalisation process

4.0 JMMB's Internationalization Journey

The JMMB Group began operations, in 1992, as the first licensed money market broker in Jamaica. By 2006, the company was the Caribbean's largest investment brokerage firm with diversified operations in Jamaica, Trinidad and Tobago and the Dominican Republic. JMMB's stock traded on exchanges in Jamaica, Trinidad and Tobago, and Barbados and ranks among the top eight regional financial institutions (Ogawa *et al*. (2013). JMMB's total assets increased from US$0.2 billion in 1998, before internationalization, to US$2.1 billion by 2015 with the number of clients growing from under 40,000 to over 200,000 (Figure 2). However, return on equity declined from over 50% in 2003 to less than 15% in 2015 because of declining interest rate spreads in Jamaica and maturation of financial products in Caribbean markets.

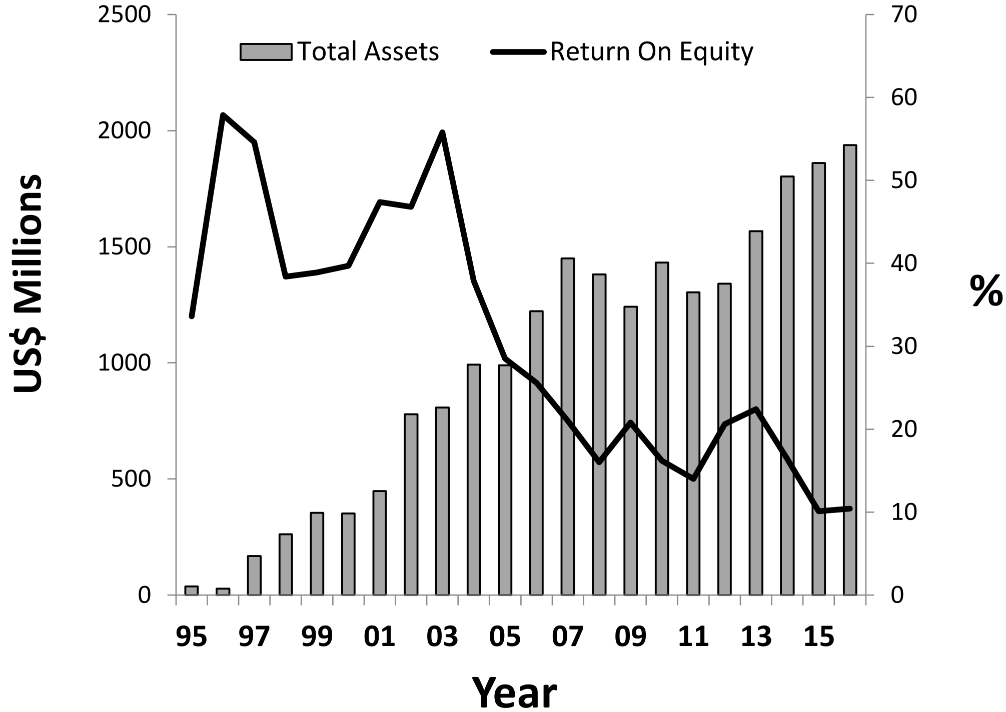

Figure 2. Financial performance of JMMB during internationalization

4.1 Phase 1 - Building Competitive Advantage at Home (1992 – 1999)

JMMB began in 1992 as a joint venture entity with financing from four Jamaican financial firms. The founder leveraged her banking experience to make JMMB the first retailer of Government debt securities on the secondary market, using repurchase agreements with clients. This money market trader had a small staff of mainly family members. By 1994, the workforce grew to 30 employees operating in 1,600 square feet of office space in the capital city, Kingston. JMMB became proficient at managing the spread between long-term and short-term interest rates. The institution also earned fees by placing the idle cash balances of companies in government secured promissory notes. Clients earned returns above bank rates and could use their investments as collateral for loans from JMMB. The other financial institutions were unwilling to take the higher risk associated with small investors on a secondary market, especially in the aftermath of the local financial crisis of the mid-1990s. JMMB established an effective risk management system. According to JMMB's risk manager:

Our [risk management] practice far exceeds the requirements of regulators … The mission of our risk team is not risk elimination but risk management. We ensure that we understand our risks and have sufficient capital to support our business activities.

The owner/managers infused their family values, called the vision of love, in the organization by providing a home-like office climate with genuine and personalized care for stakeholders. Management held frequent meetings with clients and employees to obtain feedback on how to improve customer service and risk management practices. Employees benefited from attractive compensation, performance incentives, day-care facilities for their children, subsidized meals, and a fitness gymnasium.

4.2 Phase 2 - Sensing Threats and Opportunities (1998-2003)

By the late 1990s, there was a crisis in financial sector due to liquidity problems. The Government of Jamaica intervened to restore stability and tighten financial regulations. The spread on interest rates declined and JMMB searched for opportunities to provide other services in Jamaica and replicate its business model elsewhere in the Caribbean. JMMB expanded its range of loan products to clients using their investments as collateral and developed a strategic plan for growth and country risk mitigation. JMMB listed on the Jamaican Stock Exchange in 2002 to obtain capital for regional expansion. This initial public offer (IPO) was oversubscribed. JMMB's 70,000 clients took a substantial amount of the shares on offer. The corporate governance practices were strengthened for the increased public scrutiny and information disclosure. JMMB changed its corporate slogan from "Nobody knows the money market better than we do. Full Stop." to "Your Goals. Full stop." JMMB's IPO prospectus stated in 2002:

We intend to fulfil our mission of being an international institution by continuing local and regional expansion in the short term and going truly international in the long term.

The criteria for foreign market selection included unmet customer demand, regulatory regimes, and cultural similarities. The psychic distance between Jamaica and Trinidad and Tobago was short because both countries are English-speaking members of the Caribbean Common Market (CARICOM) with similar political and regulatory regimes. Furthermore, Trinidad & Tobago had a strong oil-based economy and an underserved capital market (Ogawa *et al.* 2013).

4.3 Phase 3 - Seizing Opportunities for International Expansion (1999-2007)

JMMB extended its business model overseas by entering a joint venture agreement with two reputable local firms, CL Financial (10% ownership) and its subsidiary CLICO Investment Bank (45% ownership) to form Caribbean Money Market brokers (CMMB) in Trinidad and Tobago. CMMB traded fixed income securities including government treasury bills, bonds and commercial paper on the secondary market in the two major cities, Port-of-Spain and San Fernando. JMMB provided management oversight of CMMB's operations of CCMB with mostly local employees, including the Chief Executive Officer. In mid-2004, CMMB opened an associate company in Barbados aimed at taking at least 10% of the island's fixed income market. This full service brokerage house also offered stocks and money markets funds. JMMB owned 50% of CMMB Barbados with 10% owned outright and 40% through its joint venture partner Caribbean Money Market Brokers (Trinidad). CMMB Barbados had six employees and the company operated from rented space in Bridgetown, the capital city, with a capitalization of US$5 million.

In 2006, JMMB started operations in the Dominican Republic, a Spanish-speaking country in close geographic proximity to Jamaica. The company launched its subsidiary JMMB BDI America at a cost of US$5 million, in equity partnership with Banco BDI and Corporacion de Credito America (CCA), to retail Government repurchase agreements. A senior JMMB executive commented:

JMMB was attracted to the Dominican Republic because this market is larger than the combined markets of the CARICOM [Caribbean Common Market] states and the services that JMMB have pioneered in Jamaica could be appreciated by potential clients in this market.

However, in 2007, JMMB sold its shares in CMMB to its partner and withdrew from Barbados. Shortly after, JMMB also sold its 45% stake in CMMB (in Trinidad) to CL Financial. This decision arose from unforeseen differences in risk appetite and management styles between JMMB and CL Financial.

4.4 JMMB Transforming Capabilities for Corporate Renewal (2004-2014)

According to Vahlne and Johanson (2013, p. 199): 'While exchanging products, services and knowledge in the network relationships, new opportunities emerge.' JMMB became adept at managing the spread between savings and loans based on lending practices in Jamaica. This added capability created the opportunity for the company to enter the banking industry. In 2004, JMMB purchased 50% equity stake in Intercommercial Bank (IBL), a small commercial and merchant bank in Trinidad with two branches. In the 2006 annual report, JMMB's Board Chairman declared:

Diversification spreads our risk, enhances our understanding of financial markets elsewhere, strengthens our management capabilities and has added to our profitability.

In 2009, JMMB acquired 80% ownership of CCA. JMMB Investments Trinidad and Tobago opened in late 2012. By June 2012, the company also acquired the Capital and Credit Financial Group in Jamaica to offer merchant banking, remittance and unit trust products. JMMB gradually reduced its reliance on repurchase agreements and increased its loan portfolio, traded equities, and offered insurance brokerage services. In 2013, the company acquired the remaining stake in IBL to assume 100% ownership and further pursue its goal of being a fully integrated regional financial services company with securities dealing, stock brokering, foreign exchange trading, banking and insurance brokerage. In 2014, JMMB acquired 90% ownership of Banco Rio de Ahorro y Credita with plans to merge this entity with CCA to offer a broad range of savings and loan products. JMMB also acquired a Trinidad-based firm, AIC Securities. Management transferred the shares of all JMMB subsidiaries to a newly formed holding company JMMB Group.

5.0 Conclusion

JMMB's process of internationalization was consistent with the stipulations of the Uppsala model and dynamic capabilities theory as shown in Figure 1. During Phase 1, the institution used product innovation to satisfy unmet demand, from small investors, for higher interest rates. In Phase 2, declining spreads on local interest rates triggered JMMB's active search to replicate the business model overseas. During Phase 3, JMMB accepted a minority stake in its first overseas venture to overcome liabilities, of newness, foreignness, and outsidership. During Phase 4, JMMB displayed dynamic capabilities to transform its business model by entering the banking segment of the financial services industry. JMMB had to trade-off return on equity for asset growth and focused on economies of scope, by offering various financial services, rather than economies of scale.

Contrary to literature that family firms tend to avoid external ownership to stay independent (Kraus, Fink and Harms 2011), JMMB leveraged the Jamaica Stock Exchange to obtain equity financing for regional expansion. The presence of non-family members on the Board and in management provided knowledge, competencies, and network contacts. However, JMMB family members retained majority stake in the parent company and occupied senior positions in management including the post of Group Chief Executive Officer. Family control was a critical component of JMMB's enterprise risk management to propagate its vision of love during the process of internationalization.

A limitation of the study is the single case examined. This constrains the extent to which the observations are generalizable to all financial firms. The impact of country-of-origin on the relationship between internationalisation and performance is an area for study (Elango & Sethi 2007). Teece (2014, p. 24) noted that "regional and national systems of innovation. For instance, shape firm experiences, knowledge, and capabilities." The role of family as a concept also needs further investigation.

The findings imply that successful internationalization in small markets involve a differentiation strategy with product innovation to cope with market saturation. Although JMMB had asset growth during regional expansion, its return on equity declined (Figure 2). This may be due to product maturation of securities brokerage and banking. The study contributes to the development of internationalization theory by illustrating business model as a unit of analysis in the Uppsala model of MNE evolution.

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