

# XP and Itaú Unibanco: From the Products of Investment to the “Desbancarização” Process

## *A XP e o Itaú Unibanco: dos Produtos de Investimento a Desbancarização*

Raul Beal Partyka

Jeferson Lana

Rosilene Marcon

### ABSTRACT

This teaching case presents the narrative of the acquisition of XP Investimentos by Itaú Unibanco. The bank offered to buy XP Investimentos. This movement occurred shortly before the broker asked to register for its IPO (Initial Offering of Shares, acronym in English) on the Brazilian stock exchange (B3). The objective of the study is to encourage discussions of the acquisition operation for the themes of governance structure and the theory of transaction costs amid technological innovation in the Brazilian financial market. On the XP side, the plan was clear: in one stroke, stay with the asset and eliminate a competitor, and now you can not only dream of being the largest investment group in Brazil. For Itaú Unibanco - the largest player in the market - it now has the XP portfolio ready and eliminates a competitor that took its market share. The case indicates discussions about the logic behind Itaú Unibanco's acquisition of XP. Still, it allows asking whether the largest bank in Brazil would not be able to develop such capacities acquired from the broker, in addition to questioning whether XP's internalized capacities are so valuable to the point of such investment.

**Keywords:** Banks, Brokers, Transaction cost theory, Technological innovation, Economic scenarios.


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### RESUMO

Este caso para ensino apresenta a narrativa da aquisição da XP Investimentos pelo Itaú Unibanco. O banco ofertou a compra da XP Investimentos. Este movimento ocorreu pouco antes da corretora pedir o registro para realizar seu IPO (Oferta Inicial de Ações, sigla em inglês) na bolsa de valores brasileira (B3). O objetivo do estudo é impulsionar as discussões da operação de aquisição para os temas de estrutura de governança e a teoria dos custos de transação em meio a inovação tecnológica no mercado financeiro brasileiro. Pelo lado da XP o plano era claro: em uma tacada só, ficar com o ativo e eliminar um concorrente, podendo agora não apenas sonhar em ser o

Raul Beal Partyka   
 raul.partyka@fgv.edu.br  
 MSc. in Business Administration - Univali  
 Mestre em Administração de Empresas  
 - Univali  
 Fundação Getúlio Vargas - Escola de  
 Administração de Empresas de São Paulo  
 São Paulo/SP - Brazil

Jeferson Lana   
 jlana@univali.br  
 PhD in Business Administration - FGV/  
 EAESP  
 Doutor em Administração de Empresas -  
 FGV/EAESP  
 Universidade do Vale do Itajaí  
 Biguaçu/SC - Brazil

Rosilene Marcon   
 rmarcon@univali.br  
 PhD in Production Engineering - UFSC  
 Doutora em Engenharia de Produção -  
 UFSC  
 Universidade do Vale do Itajaí  
 Biguaçu/SC - Brazil

**RESUMO**

maior grupo de investimentos do Brasil. Já para o Itaú Unibanco – maior player do mercado - passa a ter a carteira da XP pronta e elimina um concorrente que lhe tirava *market share*. O caso indica discussões sobre a lógica por trás da aquisição da XP pelo Itaú Unibanco. Ainda, permite indagar se não seria capaz o maior banco do Brasil, desenvolver tais capacidades adquiridas da corretora, além de questionar se as capacidades internalizadas da XP são tão valiosas a ponto de tamanho investimento.

**Palavras-chave:** Bancos, Corretoras, Teoria do custo de transação, Inovação tecnológica, Cenários econômicos.

## The Case

“It was just a chat in which we commented on the IPO process. But the conversation was good. I had the opportunity to meet with Roberto Setubal to tell a little more about our project”, explain Benchimol, Grupo XP CEO, when talking about the first meeting he left from and defined the transaction between Itaú Unibanco and XP Investimentos. ““There was a super empathy, there was a nice chemistry”, said Benchimol, who knew Setubal, but was not close. From then on, a series of meetings with the bank’s dome followed, which also brought together Pedro Moreira Salles, also co-chairman of Itaú’s board, and Candido Bracher, president of Itaú’s Board of Directors. (DYNIEWICZ; LUZ, 2017).

The meeting with the Co-Chairman of the Itaú board was about two and a half months before May 10, 2017, when Banco Itaú Unibanco confirmed that it was negotiating the acquisition of the minority stake in XP, but without any agreement signed. Meanwhile, XP Investimentos informed that it continued with the IPO at B3 (REDAÇÃO VEJA, 2017).

It was just a matter of time. Done deal. The acquisition of XP is reminiscent of that of 2009, when Itaú acquired the insurance company Porto Seguro (GRADILONE; GALEMBECK, 2017) - both with long-term control option clauses (SAMOR, 2017). At that time, everyone coveted it, but Itaú was the one who really offered the best project for the future: autonomy and maintenance of the business success formula. Hours of meetings, many of them on the largest corporate avenue in Brazil, Faria Lima, culminated in the positive outcome of the purchase of the insurance company. In the case of XP, the deal was confirmed on Thursday, May 11, 2017. During the

talks, the CEO of Itaú would have pointed out the possibility of placing Guilherme Benchimol, CEO and founder of XP, in the race for the succession of the bank president. (GRADILONE; GALEMBECK, 2017).

The market’s astonishment at the transaction came for two reasons: the company had been preparing its IPO (initial public offering) and, above all, it had grown at an accelerated rate in recent years, anchored in the discourse of debunking. Benchimol thought it now has the best of worlds; “I have the freedom to control the company and Itaú gives me credibility. Whoever deals with investment must expose credibility. When we do business with Itaú, we address all these issues (credibility and governance). Going public is a huge challenge. There are times when action falls with crises. Then there is an opportunity to raise money at a price like what we thought we were going to raise in the market, being able to continue with a closed capital, and the partner still adds more credibility than the market.” (DYNIEWICZ; LUZ, 2017).

The message that Itaú sends is that it did not enter as a manager, but as an investor. His statements aimed to be the largest investment company in Brazil in ten years. With the purchase of XP this has changed so that the goal is reached in five years. (DYNIEWICZ; LUZ, 2017). Still, for the bank, the acquisition aims to stem the recent loss of investments from more exclusive customers, in addition to creating a barrier to the growth of XP’s competitors. (GRADILONE; GALEMBECK, 2017).

CADE counselor, Cristiane Alkmin Junqueira Schmidt, in her vote (CADE, 2018), she reports that Itaú’s real interest in buying XP may be: (1) that XP’s profit will not be manipulated by XP after 2024 (making it artificially inflate to sell the most expensive company), (2) that the price XP is in fact fair, so that Itaú does not have a financial loss and (3) that it owns XP in the future, to ensure that it has Maverick in its hands, which has taken part of its customers; and (4) Itaú’s real interest in buying XP is related to the interest in what XP has most valuable: its current and future customer base, remembering that part of the current base was Itaú and part of the future it could be too. Thus, Itaú wants to minimize its loss in migrating customers from Itaú to XP.

XP Investimentos requested registration for an IPO, on May 10, 2017, hours after admitting that it talks with Itaú Unibanco about a possible sale of stake in the company (ALVES, 2017). Little by little, the operation began to be designed, and gained traction in the last 45 days. “The focus was on the IPO, but a month and a half

ago, we were already convinced that we wanted the operation (with Itaú). As we were not sure if she was going to leave, we took the IPO process in parallel because it was the only thing we had on hand if everything went wrong.” (DYNIEWICZ; LUZ, 2017).

Also, on May 10, XP confirmed its intention to sell a minority stake, but said it would continue with its plan to sell shares in B3. The amount paid for the participation, according to calculations by Empiricus Research, points to a valuation of 25 to 30 times the profits (KAHIL, 2017). For Counselor Cristiane, from CADE, XP would exercise its PUT for at least two reasons: (1) either because XP understands that the company’s value is greater today than it expects it to be in the future, so it is worth sell today; (2) either because XP is in disagreement with Itaú, since Itaú will have several veto rights, it will appoint 2 members to the XP Board of Directors, as well as its CFO and the Fiscal Council. In other words, it is “influence as far as the eye can see” for a simple minority.

## The Context

Physical money is still the primary means of payment around the world. Commercial bank money brings security, allows remote transactions and access to other financial services. However, for the population of emerging countries and developing economies, this type of service is not very accessible. The “unbanking” live far from bank branches and the cost of these services is very high (NASCIMENTO, 2020).

The term “unbanking” refers to something quite common on the world finance scene. The World Bank stipulated that in 2011 there were 2.5 billion “unbanked” people in the world. “Desbancarização” is the flight of clients from traditional banks, also called large banks. Still “de-banking” is a practice that banks perform when closing accounts with customers considered “high risk”, minimizing their own exposure to risk. In 2017, with the emergence of fintechs - startups in the financial services area - the number dropped to 1.7 billion people. In Brazil, IBGE estimated 60 million “unbanked” people, almost half of the economically active population - 110 million. But with a high volume of transactions, classes B and C, previously neglected for failing to prove income, become a new market to be conquered. (OLD, 2019). On the other hand, the chief economist of Itaú Unibanco, Mario Mesquita, points

out that a possible increase in “*desbancarização*”, in the case of a new CPMF, may occur. This is because people would look for new forms of payment, even those without supervision (PASSARO, 2019).

Initially, XP started a major media campaign encouraging Brazilians to migrate applications from large banks to independent investment companies with the aim of increasing portfolio profitability. For Roberto Lee, XP’s marketing director, the “*desbancarização*” of investments - that is, the exchange of bad and expensive financial applications distributed by large retail banks for good financial products distributed by independent investment companies is far from being a novelty. In the 2000s, investors switched from large banks to independent brokers due to features and services such as a home broker that does not go offline, analyst reports, graphics, news and investment advice. What XP wants now “is to lead the “*desbancarização*” movement of the entire investment portfolio”, not just the movement for the stock market as before. (SANDRINI, 2015).

Guilherme Benchimol, from XP, 36, from Rio de Janeiro, discovered in practice how education is the basis of prosperity. In 2002, he and his partner, Marcelo Maisonnave, 37, from Rio Grande do Sul, realized that many people stopped investing in stocks because they did not understand how the financial market works (FRANÇA, 2013). In Brazil, the most important transaction involving a large bank and a broker was *Ágora* in 2008. At that time, Bradesco disbursed R \$ 830 million for *Ágora Corretora*. A value corresponding to 10.53% of the Bank’s Profit in 2008, which had been 7.2 billion Brazilian reais. At the time of that transaction, *Ágora* was making 39 million Brazilian reais, so the price / profit ratio of the transaction was 21.3 times. The purchase price for each customer was 28.60 Brazilian reais per customer. (LAI e GALDI, 2017).

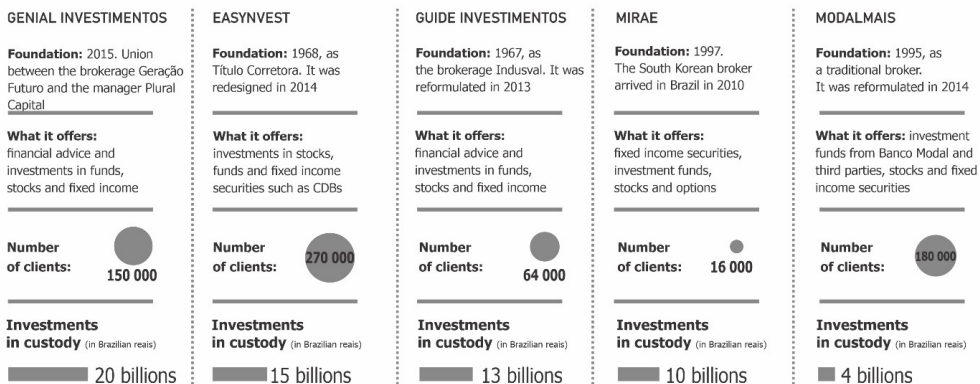
In 2016, Marcelo ended his share in society and in 2017, one year after the end of the term provided for by the non-competition clause, Maisonnave is back on the Brazilian market with a deal that promises to simplify the way of investing. In partnership with other executives from XP, the entrepreneur launched Warren in Brazil, a system that manages investments in an automated way. “I wanted a solution that could serve people like my mother’s friends, who always asked me for help to invest the money,” jokes Maisonnave. Although in the same segment, Maisonnave’s proposal is different: Instead of products, “we sell an objective, an investment port-

folio management” (LUZ, 2017). Over the years, Benchimol has developed a peculiar style of management. He defines himself as an “intense person”, something that, for those who worked with him, overflows in a difficulty of sharing decisions. “Guilherme was born to be an owner, not to be a partner”, says a former partner (FILGUEIRAS, 2016).

It has more than 660 offices of accredited agents in 25 states. 2 offices in the USA and 2 in Europe. The XP group’s ownership is divided between XP Controle, which holds the majority of the shares, and GA. Benchimol will try to balance itself between what it calls Itaú’s “seal of quality” and its open war with big banks, which includes stealing Itaú clients - about 30% of the R \$ 5 billion that the brokerage captures each month comes from its new shareholder. In his words, the operation comes down to having “the freedom of always” and “their seal”. (AGOSTINI, 2017).

Other brokers, such as Genial, from Banco Plural, and BTG Pactual, have national advertising campaigns extolling independence and versatility when advising on investments. (DYNIEWICZ, 2018). From 2017, with the reduction of the Brazilian basic interest rate (Selic), reaching 6.75% per year in June 2018 and in December 2019, the historical low of 4.50% per year - to attract the investor - the bet is that people are more open to different investment products as the return on conservative applications starts to shrink. Considering the last decade - 2009 to 2019 - that numerous gains of 14.25% per year - from July 2015 to October 2016 - is over.

### Figure 1 Benchmarking Brokers.



Source: Bertão (2018).

The purchase of XP by Itaú Unibanco has sparked the interest of dozens of competitors in the investment market as never before, reaching XP’s turnover in addition to billionaire contributions. XP, in the year of sale to Itaú, had fifteen years of experience in the market, 450 thousand active customers and 90 billion Brazilian reais in custody (WEBSITE XP INVESTIMENTOS, 2017).

In April 2016, the New York-based private equity fund General Atlantic (GA) increased its stake (from 20.50% to 49%) in XP with the purchase of the shareholding in the English fund Actis. GA joined the XP company in 2012 (ALVES, 2016). The evolution of XP’s shareholdings can be seen in Figure 2.

**Figure 2** XP Investimentos timeline.

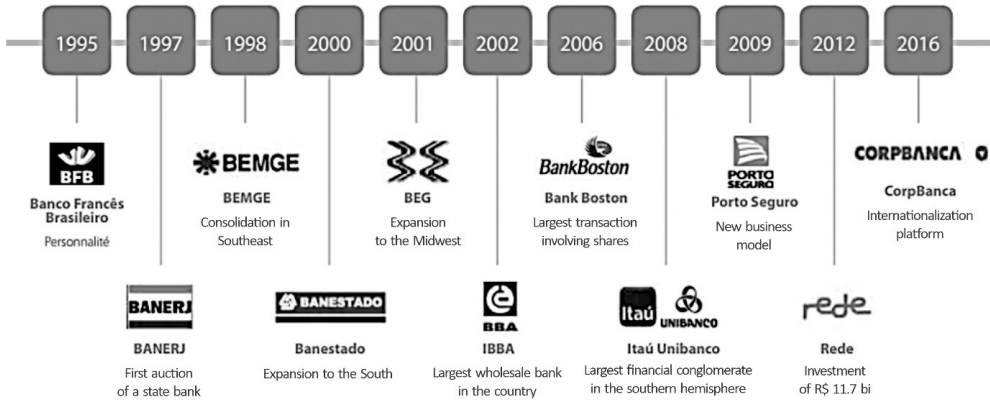


**Source:** Itaú Unibanco (2017).

Itaú Unibanco’s president, Candido Bracher, called XP’s performance in the investment distribution and third-party asset management market innovative. For him, it is time to enable shareholders to also participate in the growth of this platform (ITAÚ, UNIBANCO, 2017). Bracher also seeks, with the completion of the purchase of the stake in XP, to ensure that management independence remains. The bank’s contribution is to the growth of the company and the generation of shareholder value (EQUIPE INFOMONEY, 2017).

From the point of view of the largest bank in Brazil, the history of mergers and acquisitions carried out (Figure 3) shows that Itaú Unibanco is gradually adding new ideas. In 1995, it bought BFB (French and Brazilian Bank). In 2002, it bought BBA, strengthening its investment area, making the creation of Itaú BBA real. In 2008, Itaú acquired Unibanco and, in 2010, Redecard. For WhatsCall Independent Consulting, Itaú’s decision to buy Unibanco was marked by the impossibility of replicating the business model in a suitable time frame, in a cheaper way (KAHIL, 2017).

**Figure 3** taú's most relevant mergers and acquisitions in the Roberto Setubal era (1994-2016).



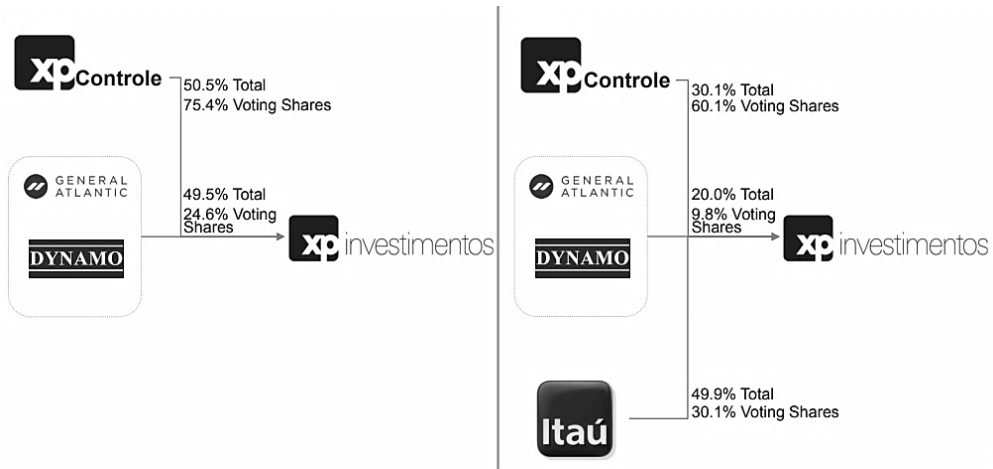
**Source:** Itaú Unibanco (2017).

## The Transaction

A total of 239 XP partners and associates will sell 37.4% of their shares to Itaú, jointly pocketing approximately 2.26 billion Brazilian reais. They are all part of XP Controle, the holding company of the company's individual partners and which represents the partnership. Most of the 239 names on the list are associated, who own a fraction of the capital. In any case, in many cases, the operation will put a few million in the executive's pocket. The sale to Itaú boosted the immediate generation of wealth, when compared to the effect that the initial offering of shares would have. (ADACHI; MANDL, 2017).



Figure 4 Before and after equity participation.



Source: Itaú Unibanco (2017).

In theory, Itaú Unibanco becomes only a minority shareholder of XP Investimentos, without interference in the conduct of day-to-day business. In this context, the operation would not generate direct advantages for the investor, as he could continue using XP normally, in the same model currently available (CALAZANS, 2017).

However, at the time of the official announcement of the purchase, the bank signaled that it has the purpose of acquiring control of XP while the agreement allows. This may occur, initially in 2020, with an additional purchase of an additional 12.50% of the share capital (without voting rights) and reaching 74.90% of XP's total share capital in 2022. In 2024, XP could fact exercising the 100% selling power of the company to Itaú and, in 2033, Itaú would have the right to purchase 100% of XP. (LIS, 2018).

**Figure 5** Acquisition schedule.

Year	Motion	% of Itaú Unibanco in XP
2017	Itaú Unibanco buys 49.9% of XP's total capital.	49.9
2020	Itaú's purchase option, up 12.5%.	62.4
2022	New acquisition, by the bank, of 12.5%.	74.9
2024 or 2033	XP may choose to sell the remaining 25.1%. Itaú may exercise the option to purchase the remaining%.	100.0

**Source:** Prepared by the authors, based on Gradilone and Galembeck (2017).

XP controlled between 40 and 50 percent of transaction volumes between open investment platforms in 2017 (FEDEROWSKI; GOY, 2018). Benchimol also reciprocates what Bracher envisioned with the partnership between the two giants. For the founder of XP, the inclusion of the bank in the corporate structure brings even more credibility and solidity. Still, it becomes a platform for XP to become the largest and best investment company in Brazil (EQUIPE INFOMONEY, 2017). With plans to go public in 2017, even with the presentation of a prospectus to Brazilian securities regulators earlier this week, some of the company’s customers may even have preferred that the company went public. XP has long considered itself the alternative to banks, and even used an aggressive anti-banking advertising campaign to win customers in mid-2015 and 2016, as a commercial that urged people to “desbancarizar their investments”, as an example the video “A Fuga dos Bancos” (CANAL XP INVESTIMENTOS, 2015).

If, on the one hand, XP would like to convey an image that it would follow a model outside the standards of traditional banks, Itaú acquired it for the “simple” opportunity to stop this driver from a disruptive model of technological innovation in the financial market. As hierarchical governance, the parties come together to form a single legal entity with unified ownership of assets. The now unified owner, Itaú Unibanco, absorbs the risk of the asset associated with the transaction through simple contracts with an indefinite term (for example, for property and

jobs). This new configuration - moving from competitor to its subsidiary - provides a relatively safer distribution of risk and a contractual structure that is simple and transparent enough to alleviate the restrictions associated with the level of contracting of the parties.

In addition, on October 11, 2019, the Central Bank granted authorization for XP to act as a bank. Yes, that’s what you read. XP Bank may operate with the commercial and investment portfolios and is authorized to carry out operations in the foreign exchange market. XP not only set aside debunking, but now that it is in fact part of a traditional banking model, it wants to participate in this competition. He wishes, “to offer [...] the cheapest credit in Brazil, without any tax, with an integrated experience with the means of payment and all your investments in an extraordinary way” (EQUIPE INFOMONEY, 2019).

Guilherme Benchimol, president and founder of XP Investimentos, was an employee of the former Investshop, the financial supermarket that Unibanco bought in the 1990s and that had its activities closed after Itaú’s purchase of the Moreira Salles bank, which it did not want to offer to its employees. investment products competing with yours. Destiny wanted that same Itaú now to see a billion-dollar value in the business created by Benchimol and some partners in 2001, inspired precisely by what was the Investshop. The transaction makes Benchimol, 40, the youngest billionaire in Brazil. As Itaú valued XP at 12 billion Brazilian reais before the capital increase, its share of 22.5% automatically is worth 2,7 billion Brazilian reais today (ADACHI; MANDL, 2017).

For CADE’s counselor, Cristiane Alkmin, “XP bothers Itaú, not only because of its current base, but because of the potential of customers. Banks like Itaú, with plastered structures, would find it difficult to create a customer base like XP’s” (TOLEDO, 2018). In the same opinion of the two councilors, it is the former president of the Central Bank, Armínio Fraga. He was an adviser to Itaú for five years and is a friend of the bank’s controllers. For him, the country needs more competition, and what XP had won was the beginning of this fight. “The most relevant issue [...] has to do with XP’s success in developing a customer base, from which one can compete with the big banks”. XP, in a remote platform model, sparked this interest from Itaú (SAFATLE, 2018).

**Figure 6** Rationality of the operation.

From XP's point of view	From Itaú's point of view
XP wants to remain the leader in the open platform market, considering that it currently holds about 50% of this market, followed by Planner which has between 9% and 13%. Although the initial plan may have been an IPO, it chose to sell 75% to Itaú and have a definitive exit until 2033.	Itaú, like all retail banks, has been losing customers mainly to XP. Itaú's strategy is to minimize its losses resulting from this new investment model, buying the company that has most drained its customers (and employees!). With the operation, Itaú would have a lower loss, which may represent the "buyback" of customers lost by Itaú to XP, including the "purchase" of those who were only from XP and the "buyback" of all customers who could in the future migrate there.

**Source:** CADE (2018).

## Developments

But then, what is the benefit for XP and Itaú Unibanco, in the acquisition transaction? Does XP no longer care about “desbancarização”?

With the step taken by Itaú “we believe that the decision to buy the competitor was based on the lack of the possibility of replicating it in a timely manner, in a cheaper and more efficient way”, emphasizes WhatsCall consultancy, which calculates the price acquired per customer around 52 thousand Brazilian reais (EQUIPE MONEY TIMES, 2017). On December 27, 2017, the General Superintendence of the Administrative Council for Economic Defense (CADE) decided to recommend the agreement between XP Investimentos and Itaú Unibanco, subject to the conclusion of the merger control agreement proposed by CADE (FEDEROWSKI; GOY, 2018), because it involves the largest private bank in the country and the largest investment broker and distributor (WIZIACK; CARNEIRO, 2018).

After the opinion, on Wednesday, March 18, 2018, CADE approved by 5 votes the 2 agreement between the brokerage XP Investimentos and Itaú Unibanco. Among

the main requirements, is that Itaú undertakes not to discriminate against competing platforms from XP, also that the broker remains independent and autonomous in its management (FEDEROWSKI; GOY, 2018). The agreement’s opinion states that “it is understood that, given the context of the transaction, the negotiated ACC (proposed agreement between Itaú Unibanco and CADE) is sufficient to remove competitive concerns” (DANTAS, 2017). The agreement is valid until December 31, 2022 (WIZ-IACK; CARNEIRO, 2018).

The transaction would still be subject to approval by the Central Bank. And it happened. On August 10, 2018, the Central Bank issued approval for the purchase, restricting Itaú Unibanco’s share. The bank will not be able to control XP until 2026. In addition to this restriction, the Bank has committed itself not to appoint executives for the financial and operations areas, nor to have access for 15 years to XP’s customer base and service providers. (NAPOLITANO, 2018). But the discussion in this case is about the strategies in making the purchase and sale decision. Benchimol outlined a strategy to grow 700% in just three years - reaching the mark of 4 thousand customers - and move from 126 billion Brazilian reais in custody to the 1 trillion Brazilian reais mark. Today, the company has 1,100 people on its team and will reach 1,500 by December. In 2017, it grew 92%. In May, the broker will transfer its office to a space of 12 thousand square meters, more than double the current (DYNIEWICZ, 2018).

On the other hand, “not everything is flowers”. For Luis Miguel Santacreu, of Austin Rating, a Brazilian risk rating agency, the advancement of other independent brokers may also harm the XP project. “Her model is being copied. Before, she used to swim alone. XP has been growing at a favorable rate but perpetuating this is very optimistic.” (DYNIEWICZ, 2018). The Benchimol project is quite “audacious”, but it does not consider it impossible. “Interest rates are favorable, but it will depend on how much the market as a whole will be able to grow,” commented the innovation director at consulting firm Accenture, Guilherme Horn (DYNIEWICZ, 2018).

So, what is the logic behind Itaú Unibanco’s acquisition of XP? Wouldn’t the largest bank in Brazil be able to develop such capabilities acquired from the brokerage? Are XP’s internalized capabilities so valuable?

## Teaching Notes

### DATA SOURCES

The teaching case was constructed with data sources of secondary origin. The construction of the company’s historical plot and the description of the people involved in the case were obtained through articles from national and international magazines, digital magazines, internet pages and website of the respective companies that make up the case.

The data and information presented in the case history part are real. The collection took place through reports in magazines, websites, policies, statutes and bylaws of the companies. Examples of this are: Folha de São Paulo, Revista Exame, Revista Isto é Dinheiro, Revista VEJA, Valor Econômico, Estadão e Reuters. Therefore, it is a real problem situation experienced by real protagonists, including the newsroom is supported by public documents from government agencies, actors of the referred transaction.

### TEACHING OBJECTIVES

- Provide knowledge about the governance structure and the theory of transaction costs in light of the partial acquisition of XP Investimento by Itaú Unibanco, in the technological innovation scenario of the Brazilian financial market.
- Develop a critical view to decide - the purchase of brokerage operations - especially in the difficulty of developing internally due to the high specificity of the asset.
- Understand the illustrated economic scenario, based on the current migration to technological innovation and the “*desbancarização*” environment.

### TEACHING PLAN

This teaching case can be used for discussion in undergraduate, MBA, master and doctorate courses, both academic and professional, in Administration and Management, especially in disciplines related to finance, capital markets and strategy.

Students are invited to take the place, on the one hand, of the company XP, which sold 49.9% of its share capital, and on the other hand, of Itaú Unibanco, the buyer of this slice. We recommend that, before starting Step 3 (Figure 7), read the data sources in full and the works in references.

**Figure 7** Suggested lesson plan.

Step	Estimated time	Activity	Mobilized Concepts
1	0-15 min	Presentation of the case and presentation of the objectives	Objectives
2	15-20min	Seminar to discuss the motivations of the case and expected results with the objective proposed by the case.	Context
3	90-120min	Divide the room into two groups (plenary). One half of the class is responsible for responding favorably to all questions, and the other, defending the contrary.	Governance structure Transaction costs theory
4	20-40min	Class closing with a report of decision-making since then and possible alternative outcomes.	Companies' decisions in the short, medium and long term

**Source:** Prepared by the authors (2020).

Alternatively, we also suggest that the recommended questions be prepared in small groups (assignment questions) different from the questions that guide the discussion in plenary (discussion questions). This form of preparation in small groups should serve to deepen the participants’ understanding of the case without anticipating the articulation of the case with the theory. It is expected that the articulation of the case with the theory will be facilitated by the professor at the time of the discussion, where the specific question is also debated at this time: Wouldn’t the largest bank in Brazil be able to develop such skills acquired from the brokerage? Are XP’s internalized capabilities so valuable?

Finally, we also suggest that the teacher presents transition questions, that is, in the midst of the proposed questions, discuss current issues, bringing to the

present moment what happened in the case or even comparing it with other cases of acquisition of fintechs and small banks by large market players.

## QUESTIONS PROPOSED FOR DISCUSSION

In this section, we present questions that can be used, following the educational objectives, to discuss the themes of the governance structure and the theory of transaction costs.

1. What was so important about XP Investimentos for Itaú Unibanco to take the decision to acquire the broker? Cite the differentials and characteristics that the bank's directors saw.
2. Knowing the decision of Itaú Unibanco to internalize the activity of brokerage, through hierarchy, justify this decision.
3. What are the direct benefits of Itaú Unibanco when buying XP Investimentos, a securities broker?
4. What is the main interest in the acquisition for Itaú? And for XP?

## SUGGESTED ANSWERS TO THE PROPOSED QUESTIONS

### **Question 1.**

Ronald Coase's (1937) article was the pioneer in the study of transaction costs, recognizing its existence beyond the costs of production - the industrial economy. Coase's vision was deepened in later works (WILLIAMSON, 1981; 1991). Williamson (1981) understands that a transaction is the transfer of a good or service from one activity to another, guided by a separate technological base.

In practice, for Coase (1937), at a given moment there is an equal cost of carrying out transactions via the market and carrying out internally. This happens as the size of the company grows. The decision between internalizing and making the market is related to the transaction costs involved in the specificity of the assets. Also, in the amount of value that is lost when using an active asset that is not specific.

Specifically, for the case presented here, Itaú has a customer portfolio that XP has built by taking customers from other banks. Soon, he would be rescuing customers from all banks that ended up Itaú failing to retain them, as well as the ones that XP attracted. The XP and Itaú case still reminds General Motors of the



USA, during the 1920s, when it realized that the electric trams that transported 9 out of 10 trips in the USA were a threat to the auto business. The solution found by GM President Alfred P. Sloan Jr, was to join with others interested in the issue such as tire manufacturer Goodyear, Firestone and oil companies like Standard Oil, to buy several electric tram companies in the USA, to close them, and so simply eliminate competition (LAI; GALDI, 2017).

For Williamson (1981), high economic performance would be obtained by the ability to adapt the company’s activities efficiently, bypassing uncertainty. Uncertainty is an uncalculated risk, difficult to predict. As a result, transactions become more costly. Thus, within the understanding that the organization itself is complex and that the agents involved in the transactions have cognitive limitations, it is understood that the economic exchange must be mediated by a contract.

### **Question 2.**

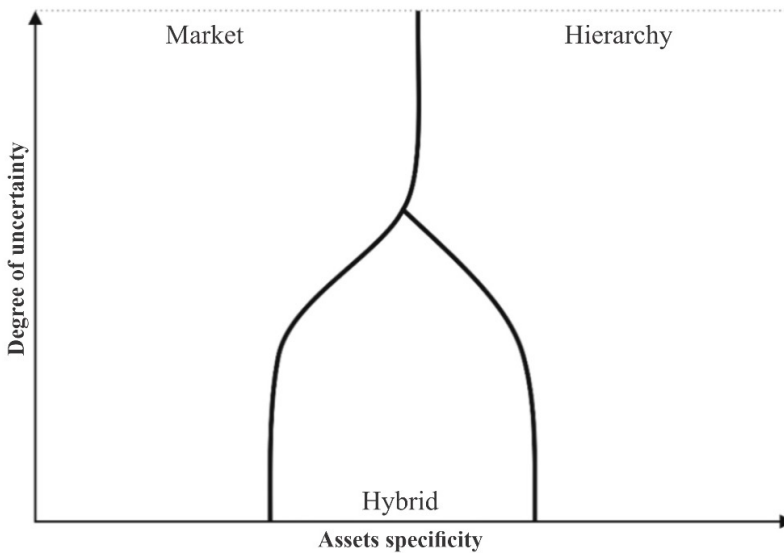
The governance structure is the unit where the transaction costs represented by the hierarchy reside (WILLIAMSON, 1981) (when the specificity of the assets is high, and the firm opts for its production instead of purchase). The transaction costs economics holds that saving transaction costs is the main process by which to think about a means to save in limited rationality and mitigate the risks that accumulate to opportunism. And governance is a means by which to generate order in a relationship where the potential for conflict threatens to undo or varied opportunities to realize mutual gains. (WILLIAMSON, 1999).

Three basic taxes define the transaction: i) frequency, ii) uncertainty and iii) specificity assets specificity involved. The assets specificity is the main element, the one that will determine whether the activity will be required by the market or carried out by the firm. As resources become more and more specialized, the economic choice of governance shifts from markets to hybrids and hierarchies (ARGYRES; MAHONEY; NICKERSON, 2019), with long-term contracts. The converse is when assets with less specificity can be managed to market. The theory of transaction costs connects the protection of opportunistic behavior to the adoption of governance mechanisms, therefore, the greater the specificity of assets - the greater the chance of opportunistic behavior - the closer the form of governance is to payment, also called verticalization (RODRÍGUEZ-LOPES; DIZ-COMESAÑA, 2016). The pur-

pose of the choices, on one hand, or the other, is also to reduce transaction costs through efficiency, with a view to achieving sustainable competitive advantages. In addition, incomplete contracts and risks may occur during negotiation. Therefore, in this case, opting for the hierarchy system, internalizing transactions, the company needs to obtain an efficient organizational structure, which reduces governance and production costs (WILLIAMSON, 1981).

Between the two structures indicated above - market and hierarchy - there are hybrid structures, basically carried out via long-term contracts. In short, the cost of carrying out the transactions reaches such a high level that the organization prefers to internalize the transaction and carry it out on its own, sometimes even obtaining better results than when carried out on the market. Figure 8 summarizes the three forms of the governance structure discussed.

**Figure 8** Organizational responses to uncertainty.



**Source:** Based on Williamson (1991).

Hierarchy and/or authority exist to delimit the employee’s limit with the employer’s power, thereby avoiding opportunism. The governance structure chosen by companies is defined based on price and technology conditions. In this way,

the governance structure of the specificity of assets to market is benefited by the minimum amount of specific assets between the parties. On the other hand, hierarchical structures are favorable for use when there is a high specificity of assets. (WILLIAMSON, 1981).

Finally, market failures (opportunism and limited rationality) associated with complete and asymmetric information, as well as imperfect markets, are aspects that affect transaction costs, in this sense, a company to decide on the level of internalization of production processes, a way to establish your “governance structure” (PEREIRA; LOPES, 2018).

### **Question 3.**

Itaú’s acquisition of XP, in part, was based on the threat that “*desbancarização*”, that is, that financial transactions will increasingly take place outside the banking system, which could be the next major trend in the financial sector, and with that the bank’s business could be severely penalized. Perhaps I did not believe in the “*desbancarização*” thesis so much. XP realized that it is better to offer a full range of banking services than just brokerage services (LAI; GALDI, 2017).

Not all companies can be equally competent in implementing their institutional capabilities to protect their knowledge. For the theory of transaction cost economics, economic agents can look ahead and recognize contractual risks and investment opportunities (WILLIAMSON, 1999).

Even before Coase’s initial studies, the price system prevailed, which regulated the production and consumption of goods by determining value, in the conception that: the price reflected everything. However, the flawed point is that when the price is set, the buyer and seller have no defined information. If the company outsources, it will lose what it had internalized, and it could be a competitive advantage for it beyond a market barrier for that technology or resource.

From another point of view - of limited rationality and hierarchy - governance structures with unified asset ownership may emerge as a response to asymmetric contracting capabilities and the inability of a weaker party to protect its interests in negotiations. This argument is in line with research that suggests that actors inside and outside companies are organized to mitigate limited transaction costs based on rationality. (FOSS; WEBER, 2016).

In addition, the desire to move quickly to a new market position can cause an increase in transaction costs. This additional cost can be offset by advantages that result in faster repositioning - such as the purchase of a major competitor, or the advantage of the pioneer (ARGYRES; MAHONEY; NICKERSON, 2019).

Institutions exist to reduce transaction costs, increase volume and create value. Those are formed in “pyramidal” styles, they diversify their activities with other subsidiary companies, besides Gerdau and Votorantim being examples. In a practical example: I create my own bank, so that I can generate value and profit, and avoid the expropriation of value from institutions for me. Another example is business groups, which are formed to respond to transaction costs.

#### **Question 4.**

Companies that increase in size throughout their life trajectory face greater difficulties (transaction costs) to coordinate activities that are farther from their plant. On the other hand, innovations, such as improvements in communications, make it possible to reduce these management costs of this distance and thus, allow the company to continuously move forward with its expansion projects. (COASE, 1937).

The interests behind the large acquisition operation are, especially, for Itaú: it gains access to the 2,000 investment advisers in more than 660 offices accredited by the broker. In addition, XP’s control may pass on integrity to Itaú. In 2024, XP may fully sell its stake in the brokerage. If not, in 2033, Itaú may purchase all XP shares (KAHIL, 2017).

As for XP: it is strategic, it will kill the competition. Although, Bradesco, supposedly, would also kill the competition when buying Ágora, at the time, Ágora was much bigger than XP. If you take one competitor out of the game, another one is born in place if, in fact, there is a market space to be filled”, says Felipe Miranda, chief strategist at Empiricus Research (KAHIL, 2017). XP’s strategy was perfect. The purchase by Itaú shows how coherent and aggressive marketing can scare even a financial giant the size of Itaú, which is reminiscent of a German saying: Fear makes the wolf seem bigger than it really is (LAI; GALDI, 2017). Although some brokers have improved their financial education programs, these institutions are not a symbol of strength for investors. Traditional banks still represent an image of security and trust.

The transaction also takes place with this prerogative, given that XP, uniting in partnership with Itaú, takes the image and solidity of the large bank as a “tray”.

## CLOSURE OF THE CASE DISCUSSION

As a suggestion for ending the discussion of the case, there is the proposition of a challenging situation. Bring in plenary the other mergers and acquisitions that occurred in the Brazilian scenario in the last five years, in the sector. Also, filtering by the ones that most reverberated in history, making an analysis of the point of view, of the acquiring companies or that merged, on their decision making of these acts. Also, to raise the new treatments given and generated strategies, with the opening of the capital of XP in the American stock exchange (NASDAQ). Also, whether the bank had not made the purchase, or had backed down after any of the obstacles between CADE and the Central Bank, would XP have concluded its intention to carry out the IPO on the Brazilian stock exchange (B3)? There would be another competitor interested in its acquisition.

In a teaching case, there are no single correct answers, but the most appropriate answers that can lead to a better decision. Certainly, closing the case with a new and challenging situation can encourage students to think more about the topic outside the classroom.

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