Implications of Foreign Bank Activities in Emerging Markets

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Recent Trends in Foreign Bank Investments

- Increasingly important component of economic growth
- Contribute to financial sector reform in poor countries
- Feature of globalisation and increased financial integration
- Links include common language and proximity

WHY?

- Global economic trends
- Looser regulatory framework and unified standards [LOWER COST]
- Improvements in ICT [LOWER COST]
- Growing number of expatriates
- Potential gains from risk diversification
- Search for higher returns (OECD), higher profitability
- Client base

Foreign Banks: Pros and Cons

Pros:

- Improving banking sector efficiency
- Economies of scale and risk diversification (than domestic banks)
- Increased competition
- Promote domestic banks to broaden the local customer base: increase access to finance
- Long-term (and stable) source of finance: lower cost of capital

Cons:

- Cream-skimming: lending only to large (state) or multi-national companies
- Capital flight at turmoil times (instability)

Cross-country Data and Regional Trends

Region	foreign bank assets in total bank assets	no. of foreign banks in total number of banks	total no of foreign banks	no of countries
East Asia&Pacific	13%	24%	55	8
ECA	55%	47%	262	25
LAC	37%	40%	265	23
MENA	10%	20%	41	10
S.Asia	4%	6%	11	5
SSA	55%	47%	148	31
All Developing Countries	40%	39%	782	102

- In MENA and S. Asia, the share of FB is higher in terms of number of banks than in terms of assets , many of the foreign banks have been relatively small.
- Not the case in SSA and ECA: many of the largest banks are foreign owned, possibly resulting from historical (colonial) link as well as proximity to potential investors. (Claessens and Lee, 2002)

Cross-country Data and Regional Trends

country	foreign bank assets in total bank assets	no. of foreign banks in total number of banks	total no of foreign banks	GDP (bio US$)*	GDP per capita (US$)*	population
Armenia	33%	27%	3	10.2	2,267	4,500,000
Azerbaijan	2%	9%	1	46.2	5,507	8,400,000
Georgia	50%	43%	3	11.9	3,711	3,200,000
Ukraine	45%	28%	13	141.2	3,083	45,800,000
Hungary	94%	91%	21	153.3	15,326	10,000,000
Poland	70%	76%	34	524.5	13,839	37,900,000
Czech Republic	89%	67%	16	216.3	20,759	10,500,000
Average	40%	39%	7.74			

**2008 figures*

Experience from the developing and transition economies

- Firms are less credit constrained in countries with more FB participation.
- In Eastern Europe, FB presence benefits all firms, though effects are more pronounced for large firms and connected lending decreases.
- Mexico, following the 1994 crisis: liberalisation, improved bank capitalisation, declining NPL and operational expenses, lending to private sector (regulatory changes necessary)
- India the 10% most profitable firms have benefited from FB entry
- CEE experience is a unique (and a positive) one: FB as strategic investors

Policy Recommendations

- Promoting stability and efficiency
- Reforming and streamlining the financial system
- Removing barriers to FB investments:
  - High uncertainty, information asymmetry and other unseen costs
    - Regulatory framework
    - Guarantees by IFIs (as in the recent crisis)
  - Lower uncertainty: less volatile capital flows
- Reinforce ownership transparency:

100% foreign bank penetration could still mean only 51% of the assets.

Thank You

For further information and questions

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