Implications of Foreign Bank Activities in Emerging Markets

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DEV-PSD Joint Project
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

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

- 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

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

*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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