Financial Crises and the Presence of Foreign Banks

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What is this paper about?

- This paper is an interesting and provocative study on the role of foreign banks in developing countries.
- It discusses the motives, strategies, and mode of foreign bank entry.
- It assesses the impact and role of foreign banks in financial crises.

What are the paper's main conclusions?

(1) There are two main types of foreign banks (i) those that come into developing countries primarily to serve their home clients, the so–called *traditional* or *classical* banks, and (ii) the *opportunist*, who come looking for profit (short or long-run) opportunities in developing countries.

(2) Foreign banks have a limited role during crises, in large part because generally they have not been present during these episodes.

(3) Foreign banks can assist with the recovery from financial crises by purchasing and restructuring weak banks.

(4) The presence of foreign banks is self-limiting.

As foreign banks enter, the conditions that attracted them disappear, therefore, foreign banks are likely to end up selling their subsidiaries to local banks and investors.

Comments will focus on:

- The motives/strategies for foreign bank entry.
- The modes of foreign bank entry (via subsidiaries and/or branches).
- The expected evolution of foreign bank presence in developing countries.
- The role of foreign banks during crises.

Comments on the motives/strategies for entry

Regarding the proposed taxonomy of foreign banks, it would be useful:

(1) To provide concrete examples of how and the extent to which different types of banks are present in developing countries.

(2) To discuss the consequences for the host country of receiving one type of bank vis-à-vis others. In particular, are there any consequences for financial stability? Conceivably "bettors" and "prospectors" are more fickle investors…

Comments on the mode of foreign entry

- The paper discusses the differences between agencies, branches, and subsidiaries.

- Perhaps it should also discuss ways in which these differences get blurred by regulations and laws enforced either by home or host countries:
  - E.g.,:
    - Minimum capital requirements for branches.
    - Ring fencing provisions that protect home banks from having to rescue their branches.

Comments on the evolution of foreign bank presence

- The evidence provided to support the theory of “ecological succession” applied to foreign banks- i.e., the idea that foreign bank presence is self-limiting and eventually will disappear- is questionable for a number of reasons:

  (1) In developed countries, foreign banks entering these markets had to compete with already well established and competitive domestic banks. This is not the situation that foreign banks face in developing countries.

  (2) Most foreign banks enter through acquisition so they are able to blend the knowledge that local banks have of local customers with their superior and more efficient technologies.

  (3) At most, given the small size of banking sectors in developing countries there might be a saturation of the market – meaning no more room for more foreign banks to come in and make a profit.

Comments on the role of foreign banks during crises

- The paper warns that foreign banks can bring instability by importing problems from their home countries.
- But, how about them being a channel for contagion? Given that banks are present in many countries within a region is a crisis in one country likely to be transmitted to others via the banking sector?
- The paper discusses the benefits to developing countries derived from the introduction by foreign banks of new financial products and services.
- Perhaps a more important benefit is the fact that foreign banks often bring new capital and liquidity to crises stricken countries.