

Comments on
“Banking competition in Developing
Countries: Does Foreign Bank entry
Improve Credit Access?”

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Findings

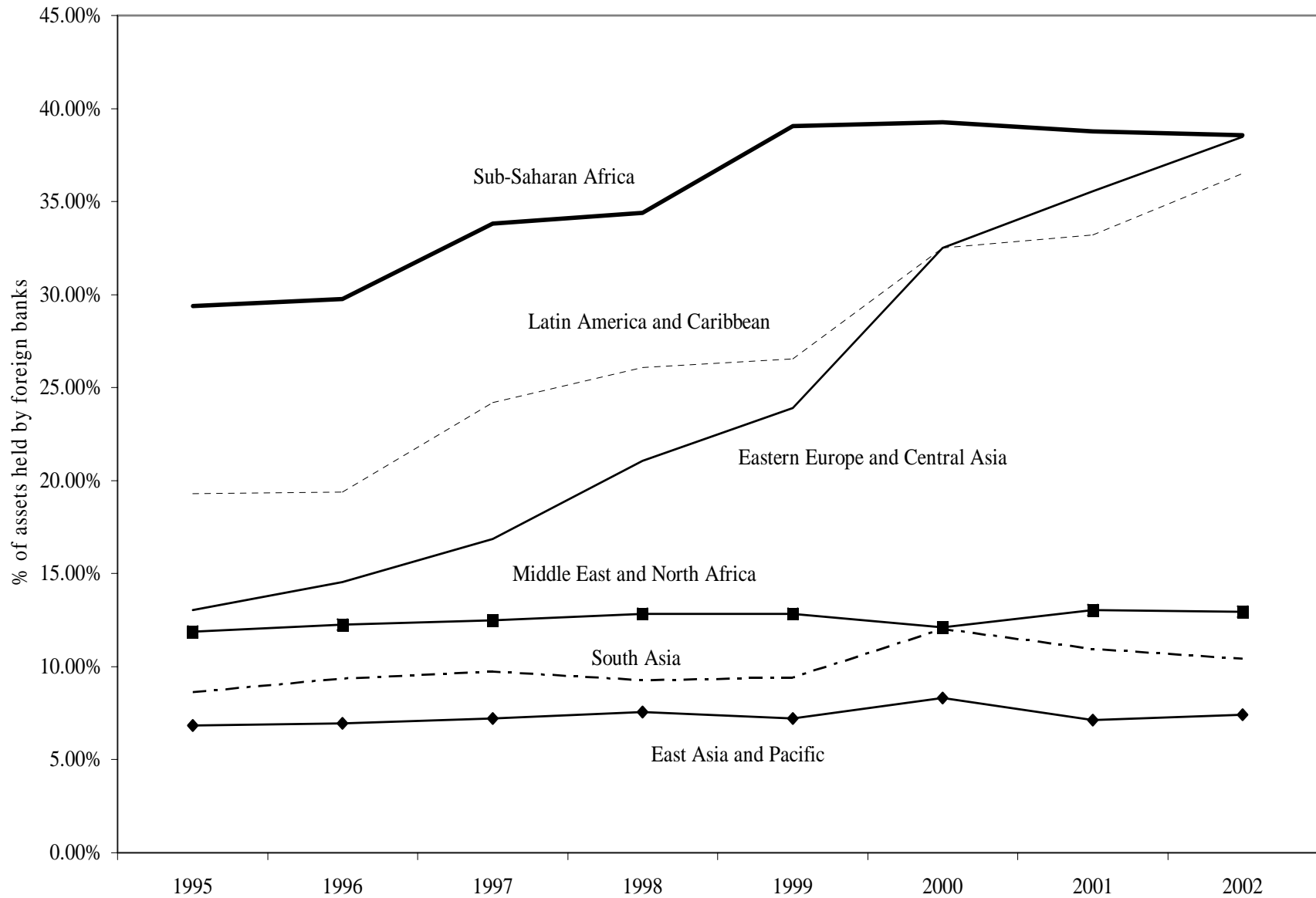
- Using a quasi-experimental design, finds:
 - Firms 7.6 pctg pts less likely to receive long term loan in areas where foreign banks recently opened a branch.
 - But profitable firms in same areas receive more l-t loans (and amounts aren't lower for others).
 - Drop in l-t loan likelihood is for DFI loans, not commercial bank loans (foreign + domestic)
 - Increase in loans to profitable firms is from commercial bank loans, not DFI loans.

Concludes that....

- “Domestic development banks respond to competition from foreign banks by systematically reducing the number of domestic firms they extend long-term credit to, regardless of their potential, and this decrease...is not offset by an increase in loans from foreign banks.”
- “[F]indings support the theory that information asymmetries are particularly difficult for foreign banks to overcome leading them to only finance the most profitable and largest firms...”

Questions

- Is this an accurate description of what happened in India? Did the arrival of foreign banks cause development banks to pull back?
- Is the Indian example reflective of the effects of foreign bank entry in other LDCs?



How Liberalized?

- Foreign banks not allowed to own controlling stakes in domestic banks, only de novo entry branch entry.
- Limits on branch openings per year (5, 8, then 12) still restrictive in a large country.
- Barth, Caprio, Levine: 75.3% of banking assets in state-controlled banks.
- Heritage: India scores 4 (of 5) on banking restrictions index at end of period.

Little Foreign Bank Participation in India

(% of banking sector assets)

Foreign Bank Participation in Developing Countries 1995-2002

	1995	1996	1997	1998	1999	2000	2001	2002
South Asia	8.60%	9.40%	9.70%	9.30%	9.40%	12.00%	10.90%	10.40%
Bangladesh	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
India	0.90%	1.10%	1.30%	1.30%	1.30%	1.70%	1.40%	0.50%
Nepal	38.90%	41.70%	42.00%	39.40%	40.00%	52.80%	46.70%	45.40%
Pakistan	1.40%	1.50%	2.30%	2.40%	2.40%	3.40%	4.30%	6.00%
Sri Lanka	2.20%	2.50%	3.10%	3.20%	3.30%	2.30%	2.40%	0.30%

Interpreting the Indian Results

- Not exactly the data we want
 - Commercial bank data combines loans from foreign and private domestic banks.
 - Is it that foreign banks are taking the best clients of the DFIs? Or is it the domestic commercial banks?

We don't really know.

2 Pools of Loans

- A. Not much happening on the commercial lending side (in terms of loan amounts), except improvements for the most profitable firms.
- B. Reductions on the non-commercial (DFI) side, regardless of firm quality.

Though these two are concurrent, foreign bank actions in A don't necessarily cause credit reduction in B.

Does competition change how DFIs behave?

DFI Governance (in Africa)

“State-owned DFIs generally did poorly in reaching the ostensible target market, failed to recover loans, and overall imposed heavy fiscal costs. Part of the problem was political interference, part was poor alignment of incentives, and part was excessive intermediary cost structures.”

Honohan and Beck (2007), p. 99.
“Making Finance Work for Africa”

Some Robustness Checks Convincing

- Pre-entry trends in DFI & commercial lending not significant predictors of post-entry trends.
- Increase in commercial loans to most profitable occurs one or two years after entry of foreign branch.
- Drop in likelihood of DFI loans starts two years prior to entry, but steeper in three years after entry.

Others Less Convincing

- Selection into high-growth districts by foreign banks could still bias estimates.
- Presence of non-financial foreign firms in 1993 used as instrument for foreign branch entry.

IV Estimates From Table 9

	Indicator for...			Amount/1991 Assets for...		
	DFI Loan	Bank Loan	Either Loan	DFI Loan	Bank Loan	Either Loan
Foreign Bank	-0.131 (0.089)	-0.124 (0.137)	-0.124* (0.068)	-0.346 (0.279)	0.011 (0.113)	-0.336 (0.360)
Foreign Bank * ROA	0.000 (0.004)	-0.001 (0.005)	-0.002 (0.003)	0.019 (0.017)	0.010*** (0.004)	0.030 (0.019)

Lending to Affiliated Firms

“[T]he extent and nature of the drop in loans to informationally opaque firms, as captured by a firm’s group affiliation, suggests that some firms with positive net present value projects may have found it difficult to obtain loans after foreign entry.”

- But group affiliation is a choice, not exogenous
- And DFIs play the role of informed lender?
- What was the quality of these loans?
- And why so easy to replace with inter-firm loans?
- Looks like crony lending is being reduced in urban areas (that have a foreign bank)

Alternative explanations: Crisis

- Caprio, Klingebiel (2003) classify India as having (non-systemic) banking crisis from 1993 to 2002
 - “Nonperforming assets of the 27 public banks estimated at 20 percent in 1995. Nonperforming assets reached 11 percent in 1993-94. At the end of 1998 NPLS estimated at 16 percent.”
- Fiscal: 29% of DFI deposits held as govt. securities (only 24% in 1992-93)
- Real value of external capital raised by DFIs declining after 1998.

Were these effects stronger at DFIs located in districts w/ new foreign branches? Don't know.

A Suggestion (or Two)

- Tell us what happened in districts that already had foreign presence.
 - How much additional entry?
 - Did entry coincide with dip in DFI loans?
 - Did DFI loans dip in districts with no new entry?
- Also, what happened to foreign firms in these locales?
 - Did foreign banks really follow customers from home country? Did those firms get more credit?

What were the banks doing?

- Did DFI portfolios improve?
- Did the sectoral orientation of DFI portfolios change?
- What about the sectoral orientation of foreign banks?
- What were the private domestic banks doing? Were they competing directly with foreign banks?

Dependent Variable, Credit to the Private Sector/GDP

Explanatory Variables	Sample Initial FOB \geq 10%		Sample Initial FOB $<$ 10%	
	1	2	3	4
Banking Crisis		-0.006 [0.35]		0.054 [1.73]*
Post-Crisis	0.022 [0.85]	0.022 [0.84]	0.067 [3.84]***	0.067 [3.85]***
FOB Share	0.12 [2.79]***	0.121 [2.68]***	0.102 [1.51]	0.098 [1.45]
FOB x Post-Crisis	-0.224 [3.16]***	-0.225 [3.11]***	-0.14 [1.55]	-0.126 [1.38]
Initial FOB x Post-Crisis	0.233 [3.27]***	0.234 [3.23]***	-0.663 [1.21]	-0.752 [1.30]
Inflation	-0.001 [3.34]***	-0.001 [3.28]***	0 [0.83]	0 [0.83]
GDP growth	-0.002 [1.25]	-0.002 [1.25]	-0.003 [2.82]***	-0.003 [2.39]**
Banking Index	-0.016 [2.18]**	-0.016 [2.18]**	0.022 [1.87]*	0.022 [1.86]*
Property Rights	0.013 [1.17]	0.013 [1.17]	-0.03 [2.62]***	-0.033 [2.73]***
Concentration	-0.067 [1.37]	-0.066 [1.36]	-0.053 [1.07]	-0.035 [0.69]
Constant	0.271 [5.93]***	0.274 [6.04]***	0.328 [4.82]***	0.29 [3.96]***
Observations	285	285	251	251
Number of countries	43	43	36	36
R-squared	0.2	0.2	0.13	0.15

Robust t statistics in brackets, *, ** and *** denote significance at 10, 5 and 1 percent.