

The Impact of Foreign Bank Entry in Emerging Markets: Knowledge Spillovers or Competitive Pressure?

March 2012

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BACKGROUND

- Central and Eastern European countries and Latin American countries have both undergone massive structural reform since the early 1990s.
- Structural reforms have taken the form of financial market liberalisation, a reduction in trade barriers and privatisation.
- As a result, foreign investment in banking has increased significantly in the past two decades.
- The positive impact of competition promoted by foreign banks is widely accepted. But little has been done to investigate the possibility of knowledge spillovers from foreign to domestic banks.

METHODOLOGY

- The author asks if, in addition to competition effects, there are managerial knowledge spillovers from foreign to domestic banks in Eastern Europe and Latin America.
- The analysis draws on bank-level data for the period 1995 to 2006 for seven Central and South American countries and 12 Central and East European countries.
- A measure of managerial efficiency is obtained which controls for factors beyond the influence of bank managers.
- The evolution of banking competition over the period is also examined.

KEY FINDINGS

- The analysis shows that the gap in managerial efficiency between foreign and domestic banks is narrowing over time.
- The gap narrows even for the period when, as a result of reforms and restructuring, significant concentration took place in these banking markets.
- Moreover, the extent of the presence of foreign banks is positively associated with the managerial performance of domestic banks.
- The author has not been able to provide direct evidence of the transfer of knowledge, but the empirical evidence is highly suggestive of knowledge spillovers that enable domestic banks to catch up with foreign banks in addition to competition effects.
- It can be argued that knowledge transfer serves as a plausible explanation of the survival of domestic banks in the face of fierce competition coming from strong waves of foreign bank entry.

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THE CCP

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