

# Large Foreign Banks and Small-Medium Sized Enterprises (SMEs): Friends or Foes?

## BACKGROUND

- The number of foreign banks is growing fast. Yet arguments supporting a policy of openness to foreign participation are far from universally accepted, especially for emerging markets where banking markets are undergoing structural reforms and liberalisation.
- One aspect of particular concern is lending to small-medium sized enterprises (SMEs) which are argued to be an important source of growth in the economy.

## METHODOLOGY

- The author explores the importance of foreign banks for industry dynamics in the SME lending market.
- These dynamics are explored by studying the impact of three aspects of banking market structure on lending to SMEs: bank size and its distribution, bank market concentration, and foreign bank presence.
- The study draws on data from major Central and East European countries. These are countries where banking reforms, combined with financial crises in the region, promoted the highest presence of foreign banks compared to any other region in the world.

## KEY FINDINGS

- Larger banks are associated with increased lending to SMEs; but high inequality in bank size and high concentration are harmful to SMEs.
- The negative effects of high inequality of bank size and high concentration are largely offset by increasing foreign bank presence. This offsetting effect is more obvious in the case of inequality of bank size.
- When the effects of bank size and foreign bank presence are allowed to depend on each other, the two effects on lending to SMEs enhance each other positively. The results therefore point to the dynamics brought by the presence of large foreign banks creating more, not less, opportunities for financing SMEs.
- Results imply that industry dynamics in the presence of foreign banks break down the barriers to lending to SMEs. This is possibly because foreign banks are either more willing to lend to SMEs or they induce competition between banks of different sizes and ownerships associated with different market concentration levels, or both, thus increasing lending to SMEs.

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The ESRC Centre for Competition Policy (CCP), at the University of East Anglia, undertakes competition policy research, incorporating economic, legal, management and political science perspectives, that has real-world policy relevance without compromising academic rigour.

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The full working paper (12-6) and more information about CCP and its research is available from our website: [www.competitionpolicy.ac.uk](http://www.competitionpolicy.ac.uk)

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