Banking Activity Trends Following the Financial Crisis: Expansion or Retrenchment?

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Abstract

In the wake of the recent financial crisis, global banking in terms of "brick and mortar" operations has gone through some important structural transformations. OECD banks reduced their presence, although still controlling 89% of foreign banks' assets, while non-OECD banks more than doubled theirs. Banks from countries facing systemic crises at home exited more (especially distant) markets and curtailed their subsidiaries' growth. Banks also sold their smaller, more recent investments, and entered closer and more important trading partners, shunning crisis and euro zone countries. As a result, while not more fragmented, global banking encompasses now a greater variety of players and has a stronger regional focus.

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1. Introduction

In the wake of the global financial crisis, many commentators have posed that global financial integration has gone into reverse. The discussion has mainly focused on the collapse in cross-border bank flows globally (e.g., Milesi-Ferretti and Tille, 2011) and the fragmentation of financial markets within the euro zone (e.g., ECB, 2014, IMF, 2015). While the collapse in capital flows and signs of financial fragmentation in certain regions are well documented, the developments in local foreign bank presence, i.e., “brick and mortar” operations, are not, creating some confusion on actual facts. Drawing on our recent paper (Claessens and Van Horen, 2015), we show that in terms of foreign bank presence, the global banking system has not become more fragmented. Rather, the crisis has accelerated a number of structural transformations, with banks from a larger variety of home countries now active abroad and a system that, while globally less, is becoming regionally more integrated.

It should come as no surprise that the debate surrounding the impact of the crisis on global banking has focused almost entirely on the behavior of (large) European and US banks. After all, these banks were the main vehicles through which financial systems became more integrated before the crisis (Goldberg, 2009) and the ones most affected by the crisis. The need to restore balance sheets and profitability, meet stiffer capital requirements and other regulatory changes aimed at strengthening banking systems in the wake of the crisis have incentivized many of these banks to reduce their international operations. But focusing solely on the behavior of European and American banks does not provide a complete picture of the global banking landscape, as many banks from emerging markets and developing countries are important global players as well (Van Horen, 2011; Beck, Fuchs, Singer and Witte, 2014; BIS, 2014; Claessens and Van Horen, 2014a). Furthermore, developments in banking systems globally do not necessarily mirror developments in one region, e.g., Europe.

As such, in order to fully grasp how the crisis has affected global banking, it is important to study the behavior of all globally active banks in a large variety of countries, not just banks from advanced countries. This is what Claessens and Van Horen (2015) do. Their paper uses an updated version of the bank ownership database of Claessens and Van Horen (2014a), which now includes ownership information for 5,498 banks for the period 1995-2013 and covers 138 countries that widely differ in economic and financial development.[1] Importantly, the database covers foreign activities of both banks from advanced as well as emerging economies and is therefore ideally suitable to study how the crisis has affected the foreign activities of globally active banks.

The paper shows that the crisis has affected foreign bank presence in a number of important ways. First, while the crisis resulted in some retrenchment globally, as the overall importance of foreign banks in local financial intermediation declined somewhat, this was not a uniform trend. Some host countries experienced a decline in foreign bank presence between 2007 and 2013, but others saw the importance of foreign banks in their markets rise. Furthermore, while at end 2013 bank ownership by OECD home countries still represented 89% of foreign bank assets globally, this was 6 percentage points less than before the crisis, mostly on account of a retrenchment by crisis-affected Western European banks. To the contrary, banks from non-OECD countries continued to increase their presence abroad, mainly in their own geographical region, and more than doubled their presence. As a result, the global banking system encompasses now a larger variety of players and has become regionally more integrated.

These changes were driven by a number of factors. Banks from countries facing systemic crises at home exited (more distant) markets and curtailed their subsidiaries' growth. Furthermore, banks more likely sold smaller, more recent investments, and entered closer and more important trading partners, shunning crisis and euro zone countries. In terms of growth of existing operations, banks with systemic crises at home and more distant foreign banks expanded their foreign assets relatively less, while more recent entrants and banks with a small market share before the crisis grew their balance sheets more. Many of these patterns relate to the growing importance of foreign banks from non-OECD countries. All in all, results show that exiting and limiting expansions of foreign operations versus entering new and expanding existing markets is not only about crisis versus non-crisis home countries. Rather, the shifts and refocusing of strategies of internationally active banks relate to a number of factors previously identified in the literature and dynamics between them.

The remainder of the paper is structured as follows. Section 2 describes the database and provides an overview of how foreign bank ownership has changed in the wake of the crisis. Section 3 examines the key variables related to changes – exit, entry and growth – in foreign

[1] The original database covers the period 1995-2009.

bank presence. Section 4 concludes with reviewing some policy issues that are more important in light of these changes.

2. The global banking system before and after the financial crisis

2.1. Data

To examine how the global financial crisis has affected foreign bank ownership, the database of Claessens and Van Horen (2015) is used.[2] The database contains ownership information of 5,498 banks, currently and previously active, in 138 countries.[3] For each year the bank is active it is classified as either domestic- or foreign-owned. A bank is defined as foreign owned when 50 percent or more of its shares are held by foreigners. In addition, for each foreign bank the home country of its largest foreign shareholder is determined. The data is very comprehensive as it covers more than 90% of bank assets in all countries. It thus provides an almost complete picture of bank ownership around the world for the period 1995-2013. The ownership data are matched to Bankscope for balance sheet information.

2.2. State of foreign banking at the onset of the global financial crisis

The period before the global financial crisis was characterized by a sharp increase in foreign bank ownership. With the number of foreign banks rising from 755 in 1995 to 1,249 in 2007 (Figure 1 and Table 1). As over the same time period the number of domestic banks decreased, reflecting consolidation driven by technological changes and deregulation as well as the occurrence of financial crises, the relative importance of foreign banks increased substantially, from a market share in numbers of 19 percent in 1995 to 32 percent in 2007. In terms of assets, and covering a

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[2] The data were manually collected using many sources. These include but are not limited to (parent) bank websites and annual reports, banking regulatory agency/Central Bank websites, reports on corporate governance, local stock exchanges, SEC's Form F-20, newspaper articles, and country experts. For a detailed description of the database and its construction, see Claessens and Van Horen (2015).

[3] While coverage is comprehensive, a few limitations apply. First, as the database only include banks that report financial statements to Bankscope, it mainly covers foreign-owned subsidiaries and not foreign branches, which in general do not report separate balance sheet information. Second, the database only includes host countries with more than five active banks reporting to Bankscope in 2013. In addition, for the advanced countries in the sample, coverage is restricted to the 100 largest banks in each country in terms of 2012 assets, so smaller (typically regional) banks are not included in the database for these countries (which especially reduces the coverage of banks in the United States).

shorter period due to more limited data, the share was 13 percent in 2007, up slightly from 12.5 percent in 2005.[4]

This growth, however, was much more pronounced in non-OECD compared to OECD countries. As such, at the onset of the global financial crisis, market shares in OECD countries equaled 23 and 12 percent in terms of numbers and assets respectively, while in non-OECD countries they equaled 37 and 21 percent (see Table 1).[5] While large foreign bank presence is thus to more a non-OECD country phenomenon, most parent banks are headquartered in OECD countries. Table 2 shows that in 2007, banks from OECD countries accounted for 70 percent of all foreign-owned banks and 95 percent of all foreign-controlled assets. However, a substantial number of foreign banks (30 percent) came from non-OECD countries. While quite substantial in numbers, banks from non-OECD countries still tend to be (very) small, representing only 5 percent of all foreign assets as of 2007.

2.3. The impact of the global financial crisis

It will surprise no one that a crisis as severe as the recent one had important implications for foreign bank activity. While some banks, either voluntary or forced, had to retrench from foreign activities, others were able to grasp opportunities to increase their market shares in foreign countries or expand abroad. As a result, as highlighted by Claessens and Van Horen (2015), over the period 2007-2013 foreign bank presence has changed in four important ways.

First, the crisis led to some overall retrenchment as the importance of foreign banks in financial intermediation declined globally. Not surprising, the number of new entries declined sharply in the years following the crisis (Figure 2). In 2013, only 19 foreign banks entered, only about one-sixth as many as the peak of 120 in 2007. As the number of exits (that is, a sale to another foreign bank, to a domestic bank, or a complete closure) stayed roughly the same, net entry turned negative in the years 2010-2013, for the first time since 1995 (the year the bank ownership database starts). As a result, the number of active foreign banks declined from 1,249 in 2007 (after peaking at 1,295 in 2009) to 1,229 in 2013 (see Figure 1 and Table 1). As the number

[4] Balance sheet information in the current Bankscope database is very limited before 2005, making it not possible to provide reliable estimates of the assets share of foreign banks for earlier periods.

[5] The OECD group only includes the core OECD countries and the non-OECD group includes all other countries. As such, current OECD countries like Hungary, Czech Republic, Korea, Poland, Slovakia and Slovenia are included in the non-OECD group.

of active domestic banks fell even more, from 2,702 in 2007 to 2,384 in 2013, the overall foreign bank share still increased from 32 to 34 percent. However, since foreign banks' balance sheets grew relatively less than those of domestic banks, the share of total assets controlled by foreign banks globally declined somewhat, from 13 percent in 2007 to 11 percent in 2013 (see Table 1).

Second, these aggregate developments did not affect all host countries uniformly. Figure 3 shows the distribution of the change in the asset share of foreign banks in each host country in which foreign banks were present in 2007. While only from one host country all foreign banks exited over the past five years (Greece), in 58 countries foreign banks' role in financial intermediation decreased, with a median decline of 14 percent (an average of 16 percent). Over the same period, however, foreign banks' relative presence increased in 44 countries, with a median increase of 10 percent (an average of 42 percent). And in one host country with no foreign bank present in 2007, Oman, a foreign bank entered (due to the acquisition of Oman International Bank by HSBC).

Third, ownership shifted away from OECD towards non-OECD countries' parent banks. Between 2007 and 2013, the number of foreign banks owned by OECD countries decreased substantially from 873 to 747 banks, while at the same time the number of foreign banks owned by non-OECD countries continued to grow, even at an slightly accelerated pace, culminating in a total increase of 106 banks (Figure 4 and Table 2). As a result, banks from non-OECD countries doubled the assets they control, from $734 billion to $1,549 billion. Although still small, non-OECD banks now account for 11 percent of total foreign bank assets. At the same time, OECD banks' controlled assets declined by some $2 trillion, or a 6 percentage point asset share decline.

Fourth, foreign bank presence became less globalized and more regionalized. While in 2007 on average 56 percent of foreign bank assets were owned by banks headquartered in the same region as the host country, by 2012 this percentage increased to 60 (Figure 5). This happened in all regions (but less so in Europe where foreign banking traditionally has been highly regional; see also ECB, 2013). Partly this related to the (forced or voluntary) sale of foreign operations by a number of crisis-affected European and American banks to some (well-capitalized) emerging markets' banks that were willing and able to seize investment opportunities within their own geographical region. To name a few: Russia's Sberbank bought the Central and Eastern European subsidiaries of Austria's Volksbank; Chile's Corpbanca bought the Colombian operations of Santander; and HSBC sold its operations in Costa Rica, El Salvador, and Honduras to Banco Davivienda of Colombia. However, it is also the result of some large acquisitions among OECD countries, like that of US Commerce Bank by Canadian TD Bank.

Summarizing, the recent financial crisis has been associated with important changes in global banking and patterns of foreign bank presence. While not becoming more fragmented, global banking has gone through some important structural transformations with a greater variety of players and a more regional focus.

3. Factors associated with the shifts in global banking

Analyzing the detailed bank-level information in the bank ownership database, Claessens and Van Horen (2015) provide some further insights into what factors at the individual bank, home country, host country and home-host country pair levels were related to the decision of a foreign bank to retrench from a particular banking system in the wake of the crisis, to stay active in it and expand (or not), or to enter in it. We summarize their findings here.

In order to investigate the factors associated with the shifts in global banking the authors create three dependent variables. The first one, *Exit*, is a dummy variable if a bank from a particular home country fully ends operations in a particular host country between 2007 and 2012, and zero when it remains present. Of the total 1,221 foreign banks from 80 home countries that were active in 116 host countries in 2007, 200 had exited by 2012. The second one, *Growth*, equals the (log) change in the assets of a particular foreign bank from a particular home country in a particular host country between 2007 and 2012, calculated for those foreign banks that remain active in the host country. This organic growth measure shows a big variation: while on average, assets grew by 30 percent, 276 banks experienced negative growth. The third one, *Entry*, is a dummy variable which is one if a foreign bank from a particular home country newly entered a particular host country by 2012, and zero if there was no new investment from a bank from that home country in the host county by 2012. Such new entries occurred between 2007 and 2012 in 178 out of the 10,036 possible home-host country pairs.

Table 3 presents the main regression results in summary form, using multivariate regressions, without and with interactions with bilateral variables.[6] It shows that banks from a particular home country are more likely to completely pull out when the country is experiencing a

[6] Probit regressions are used for the *Exit* and *Entry* variables and OLS for the *Growth* variable.

banking crisis and when it is from a euro zone country.[7] A systemic crisis in the host country does not significantly affect exit, which could reflect that on one hand, foreign banks support their subsidiaries when the host country is in crisis (and the home country is not), and on the other hand, that a host systemic crisis makes for less profitable opportunities and therefore increases a parent's desire to exit the market. Overall, these two effects seem to balance each other out. Competition from other foreign banks, proxied by foreign bank presence from the same or other home countries, does not play a significant role in a bank's decision to exit a market. Individual bank characteristics do matter, however, as banks with smaller market shares and more recently established ones are more likely to exit. Furthermore, banks from home countries that experienced a crisis especially withdrew from more distant markets and less important trading partners.

Foreign banks' asset growth importantly relates to the overall growth in host country banking assets, not surprising as general credit growth, including that of foreign banks, will to a large extent be driven by local host country factors, including overall economic growth. Furthermore, asset growth tends to be lower if the home country experiences a crisis, maybe as home banks were less able (or willing) to support their subsidiaries. And banks with a smaller market share and younger, which are often banks from non-OECD countries, experience higher asset growth. Distance has an (somewhat) adverse impact on asset growth of individual foreign banks, consistent with banks having greater difficulty managing far-fetched subsidiaries. Trade growth and asset growth are positively correlated, in line with foreign banks facilitating trade (Claessens, Hassib and Van Horen, 2015).

As regard to entry, excluding banks from two crisis-affected countries that expanded much (Russian Sberbank, which bought the Eastern European subsidiaries of Austrian Volksbank, and the pan-African expansion of Nigerian United Bank for Africa), banks from crisis-affected countries less likely enter other markets (but statistically insignificant). Not surprisingly, entry is less likely in euro zone host countries, and more likely when the foreign market share from the same home country is already high, perhaps as it increases information about opportunities. Entry is importantly less likely in far-away countries, consistent with the literature that banks, notably from non-OECD countries responsible for the majority of entries

[7] Note that all euro zone home countries experienced a banking crisis during the sample period, so the parameter captures an additional effect for these countries.

over this period, tend to invest in their own geographical region. Bilateral trade and growth in trade also positively correlate with entry, presumably due to greater familiarity and economic opportunities. Overall, distance between home and host, trade, and trade growth explain much of entry, albeit less so for crisis countries.

Claessens and Van Horen (2015) also show that the importance of these factors vary by the home country of the foreign bank. In terms of exit, the group of OECD home countries drive results. This is not surprising, given that most non-OECD banks were not selling their subsidiaries. Interestingly, foreign banks from euro zone home countries pull back less from euro zone host countries, i.e., foreign banks have a somewhat stabilizing influence within the euro zone. In terms of asset growth, banks from non-OECD home countries importantly drive developments. Also, competition faced from foreign banks of the same country and being at a greater distance matter more for non-OECD home countries, suggesting that prior familiarity is more important for these banks. For the decision to enter, trade matters similarly across OECD, non-OECD and euro zone home countries, and all home countries shy away from entering euro zone and remote host countries. A systemic crisis in the host country deters banks from non-OECD home countries, but not the other two groups of banks. And only banks from non-OECD countries more likely enter a country when there is a larger presence of banks from their own country. All in all, entry decisions of non-OECD banks can be better explained than those of OECD and euro zone banks.

Together, these analyses suggest that, under pressure to consolidate, foreign banks from OECD countries pulled out of countries with whom they were less connected, where they had a small presence, and in which they had only recently invested (behavior very similar to how global banks reallocate their cross-border lending after a crisis).[8] Furthermore, while, understandably, most banks shied away from starting new operations in the euro zone, foreign banks from OECD countries and especially from within the euro zone grew their balance sheet relatively fast compared to domestic banks in euro zone host countries, and as such seem to have acted as a stabilizing force in the euro zone. At the same time, non-OECD banks, with only limited desire to exit in the first place, exited in less systematic ways. They also grew their balance sheets faster, in part as their operations were (still) small, and were more willing to enter

[8] De Haas and Van Horen (2013) show that after the collapse of Lehman Brothers, banks reduced cross-border lending less to markets that were geographically close; where they were more experienced; where they operated a subsidiary; and where they were integrated into a network of domestic co-lenders.

new markets, provided markets were closer, had more trade links prior to entry, were not in a crisis or in the euro zone, and already had some banks present from the same home country. These analyses confirm many of the trends noted in the raw statistics and highlighted earlier.

4. Conclusions

The newly collected data by Claessens and Van Horen (2015) show that as a result of the recent crises, banking in terms of foreign bank presence has become somewhat less global, but not more fragmented. Rather, reflective of the global financial and sovereign debt crises affecting especially banks from advanced countries and the increasing international expansion of banks from emerging markets and developing countries, the global banking system has gone through some important transformations with a greater variety of players and a more regional focus. While, as their banking systems restructure and economies recover, the trend of less internationalization by banks from and in advanced countries could halt and possibly reverse itself, the increased importance of emerging markets and developing countries in foreign banking and the associated regionalization are likely to continue.

This transformation offers many opportunities and benefits. It also poses though a number of challenges. For one, in terms of monitoring developments in global banking, the increased variety of banks makes it more imperative to expand international banking data coverage to key emerging markets and developing countries. This will allow, among others, academics and policy makers to examine whether there is indeed a general retrenchment in cross-border lending as often thought, or whether new players are filling the gap left by retreating banks. Second, it will be important that the newly emerging foreign bank exporting countries adequately perform their role as home regulator and supervisor of foreign affiliates, including by making sure that their parent banks are adequately capitalized and weak banks are quickly restructured and resolved. Third, with banking becoming more regional, it is important to improve the understanding of not only the drivers of regionalization, but also its pros and cons. A more regionalized global banking system could be more prone to shocks, as diversification will be more limited. Also, regionalization may not allow for the best banking technology and know-how to be employed in every market. On the other hand, international coordination, including in supervision, could become easier to achieve. A priori, it is thus not clear to what extent (and under what conditions) the benefits of regionalization outweigh the costs, calling for close monitoring and more research.

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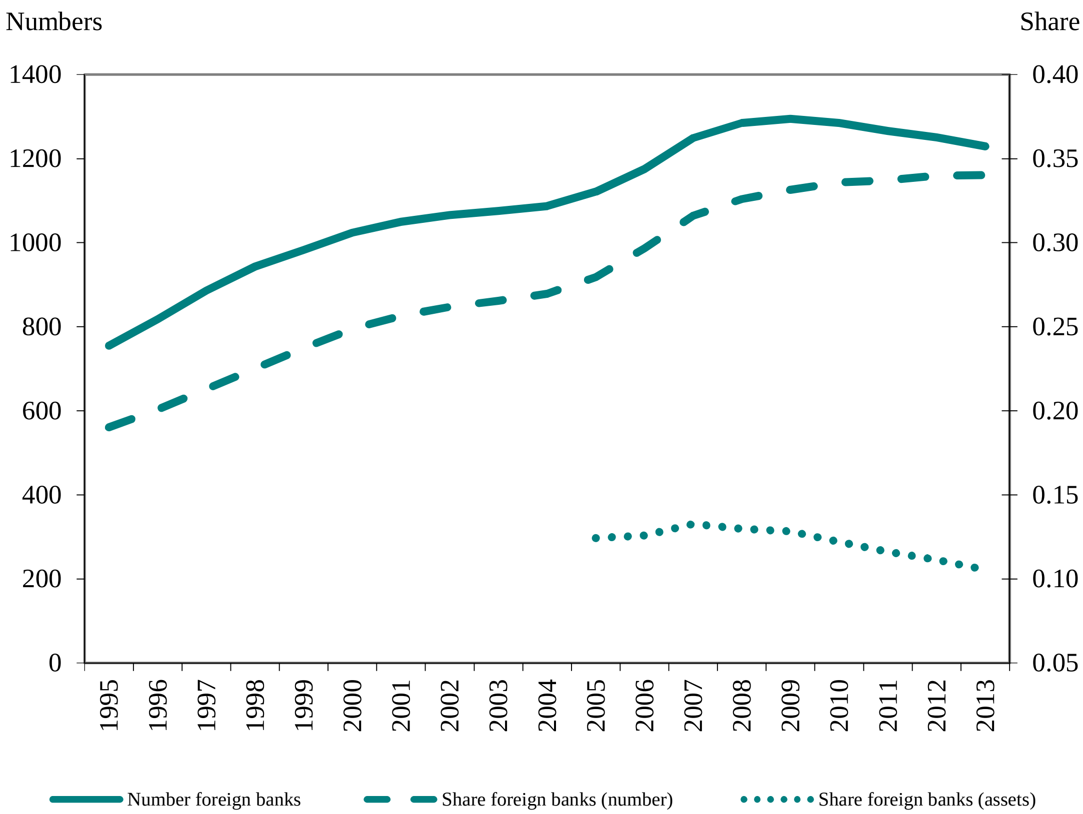
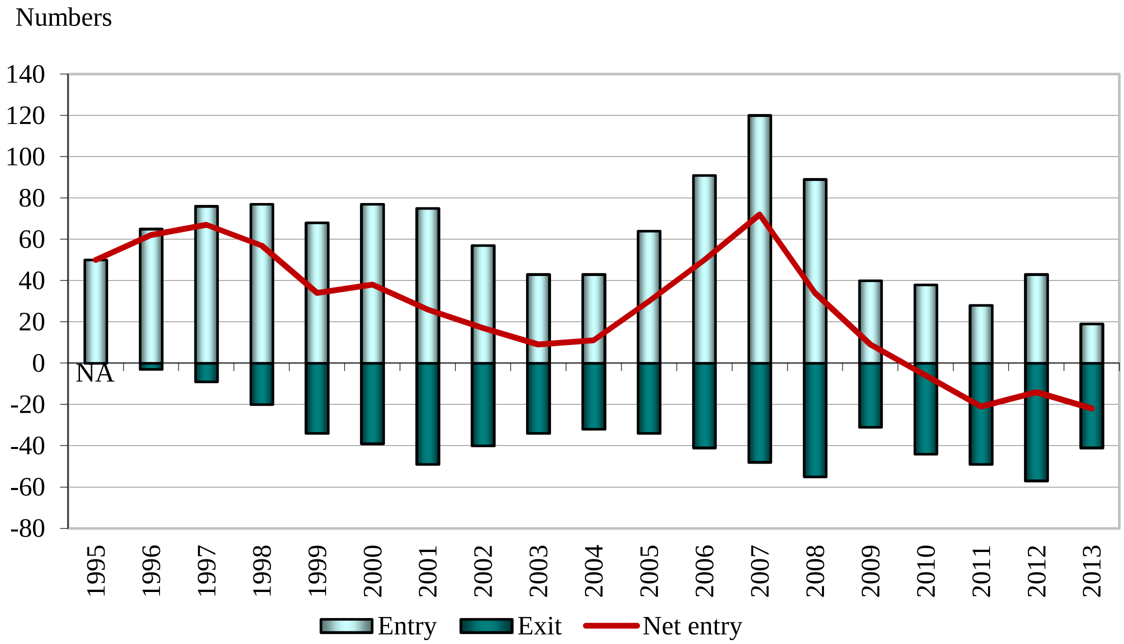
Figure 1
Number and share of foreign banks, 1995 - 2013



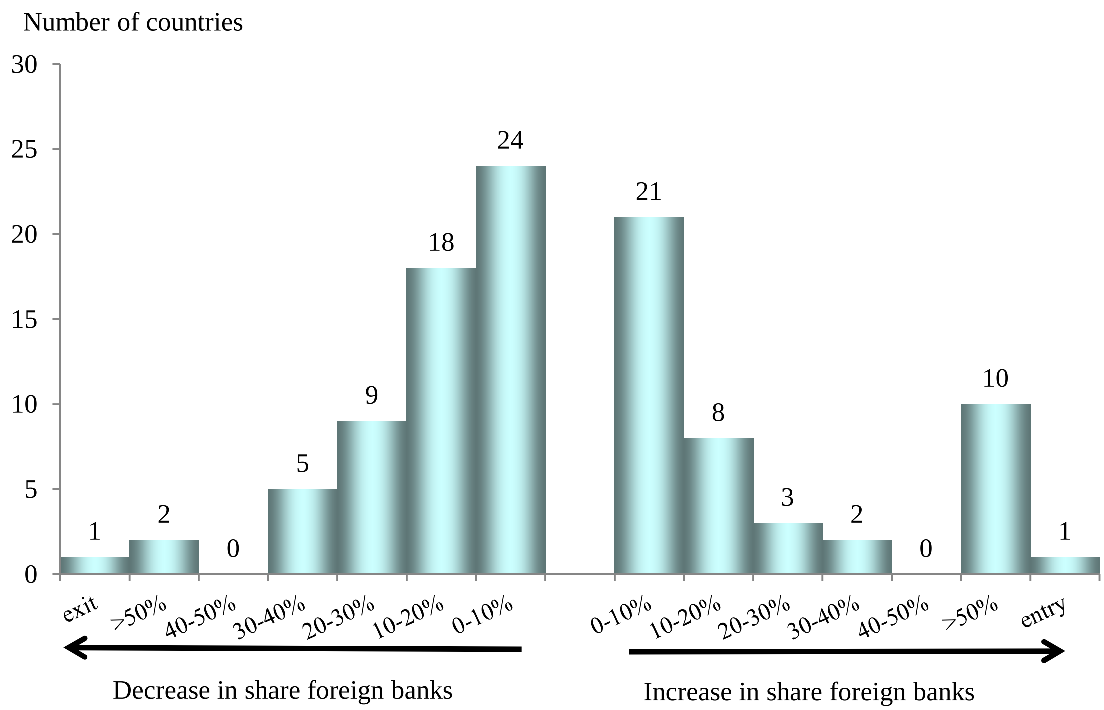
Source: Claessens and Van Horen (2015)

Figure 2
Number of entries and exits of foreign banks, 1995-2013



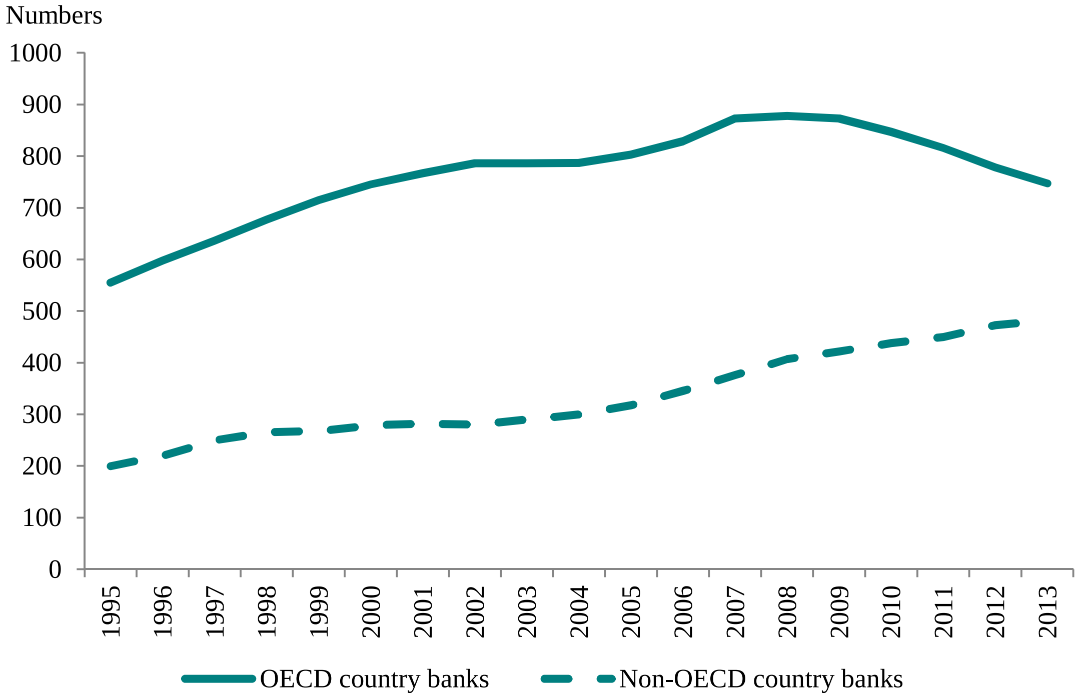
Source: Claessens and Van Horen (2015)
Note: As the database starts in 1995 the number of foreign banks that exited the market in that year cannot be determined.

Figure 3
Change share foreign assets, 2007-2013



Source: Claessens and Van Horen (2015)
Note: Only banks are included that have asset information for both years. Banks that were only active in 2007 or 2013 are also included if asset information is availalbe for the year the bank is active. Countries in which less than 60 percent of the banks qualify are excluded from the sample altoghether.

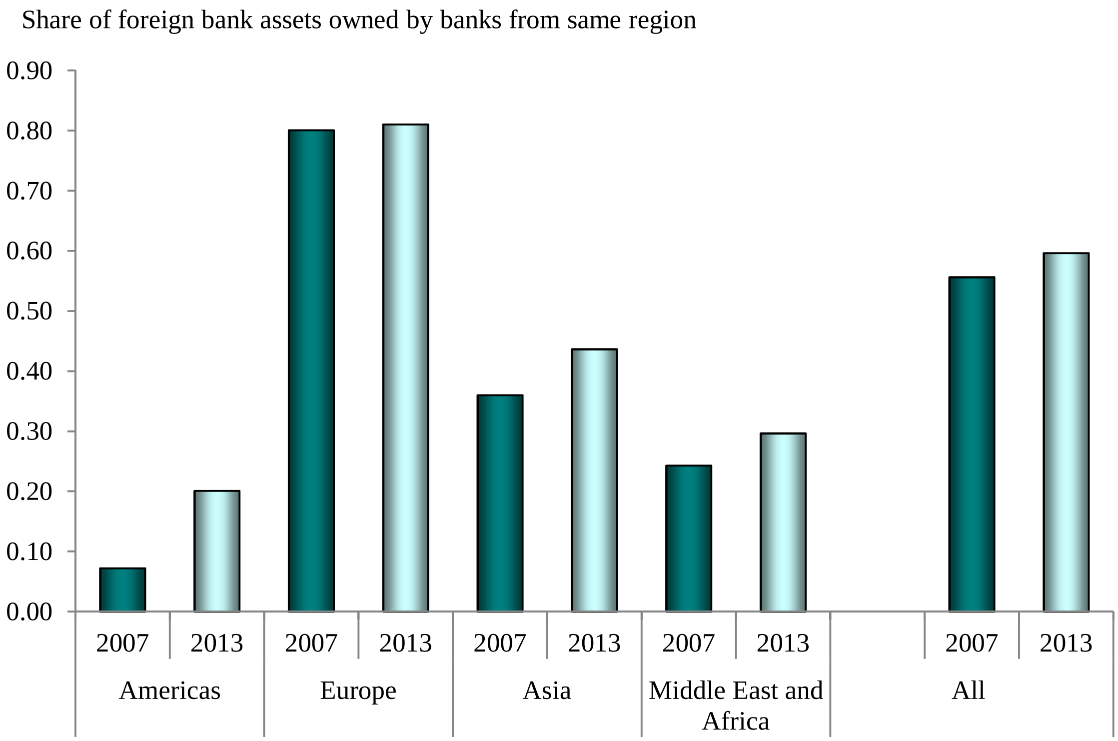
Figure 4
Number of foreign banks from OECD and non-OECD countries, 1995 - 2013



Source: Claessens and Van Horen (2015)
Note: OECD country banks includes foreign banks from all core OECD home countries. Non-OECD country banks includes all foreign banks from other high-income, emerging markets and developing country home countries. For exact country classification see main text.

Figure 5

Share foreign banks from within the region, by region before and after the crisis



Source: Claessens and Van Horen (2015)

Note: Countries are grouped in four geographical regions irrespective of the income level of the countries. "America" includes Canada, United States and all countries in Latin American and the Caribbean, "Europe" includes all Western and Eastern European countries "Asia" includes all countries in Central, East and South Asia and the Pacific countries including Japan, Australia and New Zealand. "Middle East and Africa" includes all countries in the Middle East and North and Sub-Saharan

Table 1
Number and assets of banks by host country, Aggregates by income level and region

		2007		2013		2007		2013	
		Number	**Share**	**Number**	**Share**	**Asset**	**Share**	**Asset**	**Share**
All countries									
	Domestic	2,702	0.68	2,384	0.66	97,057	0.87	115,216	0.89
	Foreign	1,249	0.32	1,229	0.34	14,850	0.13	13,590	0.11
	Total	3,951	1	3,613	1	111,907	1	128,806	1
Income groups									
OECD									
	Domestic	1,087	0.77	925	0.77	83,817	0.88	81,587	0.91
	Foreign	319	0.23	280	0.23	11,385	0.12	8,409	0.09
	Total	1,406	1	1,205	1	95,202	1	89,995	1
Non-OECD									
	Domestic	1,615	0.63	1,459	0.61	13,240	0.79	33630	0.87
	Foreign	930	0.37	949	0.39	3,465	0.21	5181	0.13
	Total	2,545	1	2,408	1	16,705	1	38,811	1

Source: Claessens and Van Horen (2015)
Note: OECD includes all core OECD countries, non-OECD includes all other countries. Current OECD countries like Hungary, Czech Republic, Korea, Poland, Slovakia and Slovenia are included in the non-OECD group.

Table 2

Number of foreign banks by home country, Aggregates by income level and region

	2007		2013		2007		2013	
	Number	**Share**	**Number**	**Share**	**Asset**	**Share**	**Asset**	**Share**
All countries	1,249	1	1,229	1	14,850	1	13,590	1
Income groups								
OECD	873	0.70	747	0.61	14,116	0.95	12,041	0.89
Non-OECD	376	0.30	482	0.39	734	0.05	1,549	0.11

Source: Claessens and Van Horen (2015)

Note: OECD includes all core OECD countries, non-OECD includes all other countries. Current OECD countries like Hungary, Czech Republic, Korea, Poland, Slovakia and Slovenia are included in the non-OECD group. The sum of foreign banks in the different income groups does not completely correspond with the total number of foreign banks at the top of the table. This discrepancy is caused by the fact that when a foreign bank is owned by an international investor no home country has been assigned. In addition, for some foreign owned banks no home country could be determined. Therefore those banks could not be assigned to an income group or region. The same holds for total assets. "Share" reflects the share with respect to the total

Table 3
Factors associated with changes in foreign bank presence

	Exit	Exit	Growth	Growth	Entry	Entry
Asset growth host			+	+		
Home crisis	NS	NS	NS	NS	-	-
Home in euro zone	+	+	NS	NS	-	-
Host crisis	NS	NS	NS	NS	-	-
Host in euro zone	NS	NS	+	+	-	-
Foreign market share - Same country	NS	NS	NS	NS	+	+
Foreign market share - Other country	NS	NS	NS	NS	+	+
Market share	-	-	-	-		
Young	+	+	+	+		
Distance	NS	NS	-	-	-	-
Trade	-	NS	-	NS	+	+
Trade growth	NS	NS	+	NS	+	NS
Distance * Home crisis		NS		NS		+
Trade * Home crisis		-		NS		NS
Trade growth * Home crisis		NS		NS		+

Notes: Regression results, with + (-) statistically significant posiitve (negative), and NS not statistically significant. Based on multivariate regressions, without and with interactions. Results reported in Claessens and Van Horen (2015).