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The entry of multinational banks into Latin America: a source of stability or financial fragility ?

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L'entrée des banques multinationales en Amérique latine : facteur de stabilité ou de fragilité financière ?

Résumé

L'objet de ce papier est d'alimenter le débat sur la présence des banques étrangères en Amérique latine. Pour clarifier la discussion, nous effectuons un survey de la littérature théorique et empirique consacrée à la multinationalisation bancaire afin de mieux analyser les déterminants actuels des investissements bancaires étrangers. Les banques internationales proviennent en majorité de l'Union européenne, en particulier d'Espagne, et investissent en priorité dans les grandes économies émergentes de la région. Elles possèdent des indicateurs de rentabilité comparables aux banques domestiques, dégagent une efficacité opérationnelle sensiblement inférieure mais sont plus efficaces dans la gestion de leur risque. Les banques multinationales peuvent contribuer à renforcer la stabilité bancaire par la diffusion de nouveaux modes de gestion des risques, l'introduction de nouvelles procédures de contrôle et le renforcement de la solidité patrimoniale. Cependant, elles ont une part de responsabilité dans la restriction du crédit dont souffre l'Amérique latine. Les banques étrangères peuvent être à l'origine de nouvelles sources de fragilité bancaire comme l'exposition au risque de change, le renforcement du pouvoir de marché, le maintien des marges d'intermédiation à un niveau élevé et l'aléa moral.

Mots-clés : Banques étrangères, banques multinationales, Amérique latine, stabilité financière, restriction du crédit, fragilité bancaire

The entry of multinational banks into Latin America: a source of stability or financial fragility ?

Abstract

This paper aims to contribute to the debate regarding the presence of foreign banks in Latin America. To clarify the discussion, we shall conduct a survey of the theoretical and empirical literature devoted to internationalisation in the banking sector so as to provide a better analysis of the determinants that currently underpin foreign banking investments. The international banks concerned come mainly from the European Union, particularly Spain, and primarily focus their investments in the region's large emerging economies. They display profitability indicators that are on a par with those of domestic banks, generate a significantly lower level of operational efficiency, but are more efficient in their management of risk. Multinational banks can help reinforce banking stability by spreading new risk management methods, by introducing new control procedures and strengthening asset solidity. However, they are partly responsible for the credit squeeze from which Latin America is suffering. Foreign banks can be the cause of new sources of banking fragility such as the exposure to foreign exchange risks, the increase in market influence, persistently high intermediation spreads and the moral hazard.

Key words: Foreign banks, multinational banks, Latin America, financial stability, credit squeeze, banking fragility

JEL : F21, F23, G21

Introduction

The presence of foreign banks in Latin American is not something new, dating back to the period that preceded the first phase of globalisation at the end of the 19th Century. The first to arrive were the Europeans, notably the British, in the early 1860s. The process started with the *London and River Plate Bank* and the *London and Brazilian Bank* in 1862, followed a year later by the *British Bank of South America*, *English Bank of Rio de Janeiro* and *London Bank of Mexico and South America.* The prime objective of these banks was to finance Europe's and the United States' flourishing commercial exchanges with Latin America. Bank financing was equally directed towards the export of primary products as the import of manufactured goods from increasingly industrialised countries. Foreign banks were therefore able to help Latin American countries gain a foothold in the world economy, while at the same time maintaining them in the role of producers and exporters of primary products within the international division of labour which was taking root at that time.

This somewhat ambiguous role played by foreign banks at the end of the 19th Century is still prevalent today. The second phase of the globalisation process that we are currently experiencing has actually been accompanied by a vast process of financial liberalisation which has helped drive the rapid development of foreign banks in the emerging economies, especially in Latin America since the mid 1990s. Foreign banks now control almost 30% of the region's bank assets, with the figure exceeding 80% in the case of Mexico. Local currency loans granted by these foreign banks' subsidiaries and branches represent more than 65% of total lending.

This massive entry of foreign financial institutions into Latin America prompts a number of questions. What is the explanation for this craze for the Latin American markets? Does their attractiveness solely lie in the economic and institutional changes that are at work in these countries? Maybe one can also detect here the consequences of the banking sector restructurings that are taking place in developed countries? Likewise, it is worth homing in on the origins of the banks that are investing in Latin America to see whether they are rolling out identical or different strategies in relation to the subcontinent. Furthermore, such an influx of foreign banking investors is not without repercussions on the Latin American banking systems. Is it contributing to a better allocation of resources between the various economic players? Is it working to the benefit of financial stability or is it generating new risks?

To answer theses questions, we shall firstly identify the reasons behind the expansion of foreign banks in Latin America. We shall start by conducting a survey of the theoretical and empirical literature devoted to the subject of bank internationalisation. This will enable us to gain a better understanding of the current determinants behind foreign banking investments. Secondly, we shall examine empirically the recent expansion by foreign banks in Latin America. At that point we shall focus both on the origin and the geographical destination of their investments, at the same time highlighting their growing influence in the subcontinent's banking systems. After those two stages, we shall then study the impact of the entry of foreign banks from the angle of microeconomic efficiency and macroeconomic effectiveness. The accent will be put on their influence in terms of profitability, liquidity and efficiency together with their contribution towards financial stability. We shall conclude our review by analysing the risks generated by the presence of foreign financial institutions, concentrating on their role in relation to the credit squeeze and banking fragility.

I – The reasons for the expansion of multinational banks in Latin America

The analysis of the explanation behind the expansion of foreign banks in Latin America will be presented in three stages. Firstly we shall revisit the major theoretical causes of bank internationalisation. We shall then conduct a rapid survey of the empirical literature devoted to the determinants in banking investments abroad. Lastly, we shall check the validity of this theoretical and empirical work in the context of Latin America.

A - The theoretical reasons behind bank internationalisation

It was not until the late 1970s that theoretical studies devoted specifically to bank internationalisation began to appear. They are mainly focused on the factors which drive banks from developed countries to invest abroad, particularly in other Triad countries. These texts, in the vast majority, reiterate the precursory work on corporate internationalisation developed in the United States by authors such as Hymer, Kindleberger, Vernon or by Dunning in Great Britain.

Kindleberger (1969) and Hymer (1976) explain corporate internationalisation by the existence of specific advantages which can be transferred abroad. These specific advantages, which are the result of market imperfections, are of various kinds: brand image, know-how, privileged access to certain markets (capital, raw materials, specialised labour), achieving economies of scale and/or range, legislations which favour the entry of foreign capital. Vernon (1966), shows in the product life-cycle theory that the innovating firm loses its technological advantage as soon as its product reaches its maturity stage. To improve competitiveness, it is tempted to relocate production in countries which import its product so as to reduce transport costs and to better adapt itself to local demand. Once the product has become commonplace, competitiveness is measured essentially in terms of price, hence the search for a presence in countries which offer the possibilities of reducing production costs. In so doing, the oligopolistic structure of the markets risks prompting a reaction from other "copycat" corporations, enticing them to similarly relocate so as not to lose market share on the global arena.

Further developing the work performed by Coase, Rugman (1981), Caves (1982) and Casson (1983) use the internalisation theory to justify overseas presence. These authors show that it is sometimes in corporations' interests to retain certain of the functions related to their international activities in-house, especially if they involve high transaction costs. Hence transactions are conducted between subsidiaries of the same group and no longer with external corporations (subcontractors, suppliers, intermediaries …).

Dunning (1977) in his eclectic theory paper, in addition to company-specific advantages and to those relating to internalisation, puts forward a third advantage, that of location. A firm will invest abroad if the three following advantages are combined at the same time (the OLI paradigm): *Ownership, Location, Internalisation*. The first refers to those specific assets which can potentially be exploited profitably on an international scale (patents, brand names, product differentiation, human resources, marketing networks …). Location reflects the attractiveness of certain countries (quality of production-related factors, labour costs, subsidies, country risk …). Internalisation means being able to avoid the costs associated with transactions between independent corporations, thereby reducing uncertainty and enhancing control over the offer and its market openings.

Dunning's eclectic theory was first applied to multinational retail banks by Gray and Gray (1981)[1]. These authors observe that the most competitive banks possess specific ownership advantages. As a result, the factors behind the expansion of banks abroad can be limited to location and internalisation advantages. The authors isolate six potential conditions for generating direct bank investments abroad: imperfections in product markets, imperfections in input markets, economies in internal operations, preservation of market share, entry into a high-growth market and security in raw materiel supply. The Gray and Gray approach is an attractive one but fails to embrace all of the determinants in banking activities abroad. For example, access to information and to domestic markets could be included under the advantages of internalisation. Similarly, under the heading of location advantages, banking regulations and entry barriers into the host country could be listed.

There are other authors who move away from the Dunning paradigm and who endeavour to construct their own theoretical framework. Smith and Walter (2003) with reference to Baumol's contestable markets theory, Panzar and Willig stress the comparative advantages which enable multinational banks to seize the opportunities that are available when they enter foreign markets. They illustrate their argument using the quality of human resources, the access to information and to the markets, technological competence, managerial culture and brand image.

Canals (1997) demonstrates that bank internationalisation is based on a combination of three factors: size, following the customers, transfer of resources or know-how. While the second two factors are indisputable, the size issue is more debatable. Certainly size will favour investments in research and development and forms a protection barrier in the event of any hostile takeover threats. Yet the mass of literature dealing with the realisation of economies of scale in the bank has shown that medium size structures are capable of delivering returns above those of the large banks.

B - The contribution from empirical literature

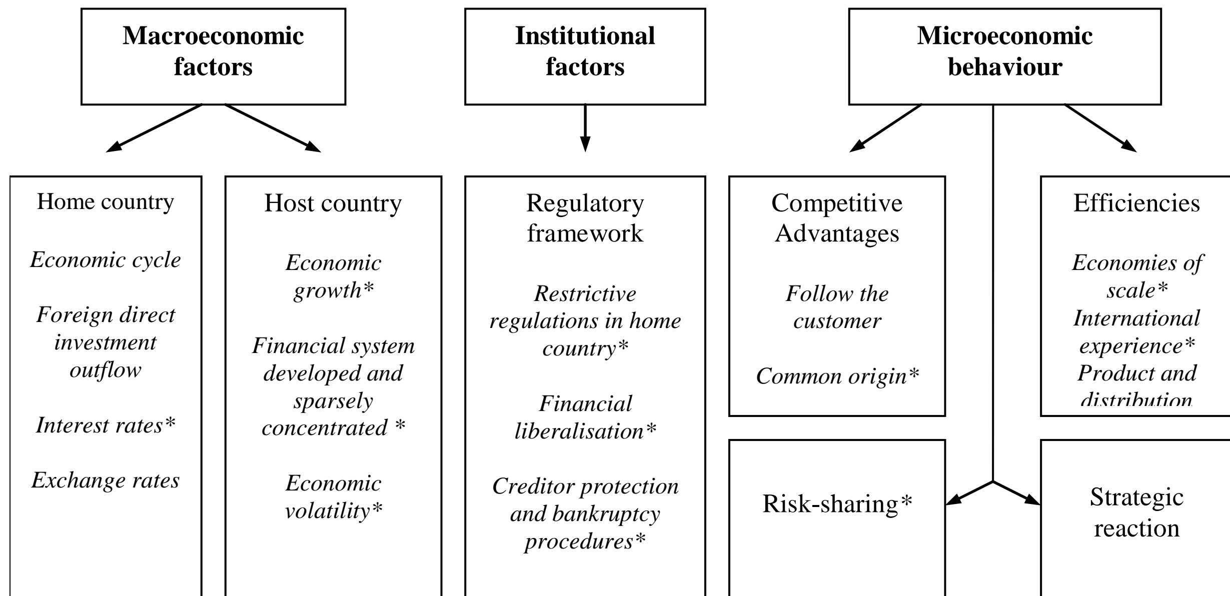
Garcia Herrero and Navia Simón (2003) in a survey[2] of empirical literature highlight three main determinants for the expansion of foreign banks (see figure 1). Firstly, macroeconomic factors in the home country can strengthen bank internationalisation. This can prompt the question as to the correlation between foreign direct investments (FDI) and economic cycles. Garcia Herrero and Navia Simón show the lack of consensus between authors and regret the absence of meaningful research into the influence of economic cycles on bank investments abroad. Likewise, the fluctuation in exchange rates has a direct bearing on investment decisions at an international level, but there too the authors who have investigated this area fail to agree on the consequences of currency appreciations or depreciations on foreign investments. On the other hand, there is broad consensus on the fact that the high level of real interest rates does hinder FDI flows. Calvo et al. (2001) stress that the FDI towards developing countries slows down when there is a hardening of American monetary policy. Conversely, Guillén and Tschoegl (1999) show that Spanish banks increase their investments abroad as soon as domestic interest rates are relaxed. In the case in point,

[1] These authors define a multinational bank as a finance company which receives deposits and grants loans from branches located in more than one country

[2] Given the mass of empirical literature, we shall only quote the authors which are the most representative. Readers can refer to Garcia Herrero and Navia Simón (2003) for a more complete review of literature.

they are tying to offset the low domestic intermediation spreads by seeking higher spreads in the emerging economies.

Figure 1 – Principal factors behind foreign banking investments referred to in empirical literature *



* A star indicates a broad consensus among authors for the factor in question
Source: Compiled by the author based on Garcia Herrero and Navia Simón (2003)

A larger number of publications have dealt with the macroeconomic factors in the host country. Focarelli and Pozzolo (2001) state that international banks take into account the economic growth prospects of the country likely to host a new subsidiary. The authors also indicate that foreign banks prefer investing in countries where the financial system is relatively developed yet sparsely concentrated. On the other hand, economic instability tends to discourage foreign investors.

The institutional factors also have to be taken into consideration. Hence, national regulations that are restrictive towards certain banking operations will only serve to encourage financial institutions to leave their home territory. This will be all the more tempting if at the same time the host countries implement measures, particularly fiscal, to attract them (Barth et al., 2003). Banks may also be drawn towards countries where modern systems of jurisdiction have fostered creditor protection rights and bankruptcy procedures. In addition to low taxation levels, Claessens et al. (2001) point out that banks are also attracted by countries where the per capita income is increasing rapidly.

The third set of factors concerns microeconomic behaviour patterns. The most frequently tested hypothesis among the competitive advantages concerns the banks' decision to follow their customers. Several authors note a positive correlation between international trade flows and FDI and banks' foreign investments. Focarelli and Pozzolo (2001) confirm this correlation for all the OECD countries. Gruble (1977) shows that awareness of customer needs in their home country generates a competitive advantage and banks accompany their customers abroad to prevent local banks gaining access to that information. On the other hand, research providing evidence to support the correlation between real flows and banking

flows is still in the embryonic stage. As Garcia Herrero and Navia Simón (2003) underline, the amount of FDI targeting these countries can be restricted if the financial services offer is insufficient. Therefore, the entry of foreign banks can be considered as a prerequisite for future FDI and not as the consequence of having followed their customers into external markets.

Among the other competitive advantages, a common origin between the host and home country is recognised by several authors as playing an important role in the decision to invest abroad. Galindo et al. (2003) show that colonial links, cultural proximity and speaking the same language, influence the geographic destination of the investments. As regards efficiency, the size of the bank, the standing of the host country and its financial system are also deemed to be variables that have to be taken into account. The potential economies of scale, the more recent its international activity, or even the possibility of using a joint distribution network are additional reasons in favour of launching the conquest for overseas markets.

Bank investments abroad also provide the opportunity to acquire greater risk diversification. Admittedly the process will create new risks, (cf. the Latin American risk for Spanish banks) but at the same time they help to provide a better geographic spread of risks worldwide. As Jeffers and Pastré (2005) point out, they also offer the opportunity of finding new revenue sources, and hence a less degree of dependency on the domestic market. The last determinant mentioned in the empirical literature concerns the strategic reaction. Financial globalisation and the oligopolistic structure of the banking markets actually lead banks into wishing to maintain or enlarge their market share on a worldwide scale. This search for a critical size has mainly been carried out by restructurings in the form of domestic mergers and acquisitions. Despite the geographical distances, the cultural inertia, the regulatory constraints and the difference in supervisory structures, recent examples at a European level[3] would indicate that future restructurings could also take place on a cross-border basis (Plihon et al., 2006).

C - The determinants for the recent entry of foreign banks into Latin America

As the survey suggested, macroeconomic factors have played a key role in the recent inflow of foreign banks into Latin America, particularly regarding the transformations that the countries in the region have undergone since the beginning of the 1980s. After the "lost decade" period of the 1980s, marked by a decline in the standing of living in several economies, the 1990s saw the region implement, under the influence of international financial bodies, adjustment policies which led to higher growth rates (table 1). Admittedly, the growth rates are less sustained and less homogenous than in Asia, but they come as a marked contrast to the earlier period. The first three years of the new century brought a renewed upturn in growth, still below the Asian level but ahead of that recorded in the other regions of the world. This macroeconomic performance has attracted foreign investors, all the more so in that it has been accompanied by a sharp drop in inflation. From an annualised rate of 162.8% between 1988 and 1997, price increases have now actually fallen below the symbolic 10% mark, since the years 2000. This massive disinflation has encouraged a greater degree of confidence in monetary and financial assets. At the same time, the current account balance,

[3] Cf. the acquisition of Abbey National by Banco Santander Central Hispano, of Banca Antoneveneta by ABN Amro, of BNL by BNP Paribas or of Crédit Uruguay Banco by the Crédit Agricole

which was running a substantial deficit during the 1990s, showed a surplus in 2005. This improvement in "macroeconomic fundamentals" and the significant rise in per capita GDP (+9% between 1995 and 2005) have broadened Latin America's market prospects despite the fact that the structural adjustments have created disparities within the population[4]. Furthermore, demographic dynamism has materialised with young people representing a higher proportion of the population (1/3 of the population is aged under 15) hence making it an attractive market for the retail banking sector. Even if young people are displaying a negative savings rate, banks are looking to the longer-term loyalty of this customer sector with the aim of offering them a wider range of banking and financial products and services in the future (property loans, consumer credit, bank card, life insurance …).

Table 1 – Latin America: macroeconomic and demographic indicators

Countries	Growth rate of GDP			Inflation rate			Balance on current account [2]			Per capita GDP [3]			Population in millions [4]
	1988-1997[1]	2000	2005	1988-1997[1]	2000	2005	1998	2000	2005	1995	2000	2005	2006
Argentina	3.2	-0.8	9.2	159.4	-0.9	9.6	-4.8	-3.2	1.9	7199.3	7730.2	7518.5	37.9
Bolivia	4.2	2.5	4.1	12.5	4.6	5.4	-7.8	-5.3	5.0	947.7	996.4	1009.3	9.2
Brazil	2.0	4.4	2.3	576.3	7.1	6.9	-4.2	-4.0	1.8	3327.1	3444.0	3541.5	184.2
Chile	7.9	4.4	6.3	13.9	3.8	3.1	-5.0	-1.2	0.6	4261.7	4883.6	5443.7	15.6
Colombia	4.0	2.9	5.1	24.5	9.2	5.0	-4.9	0.9	-1.6	2076.4	1979.3	2081.2	46.6
Mexico	3.0	6.6	3.0	28.0	9.5	4.0	-3.8	-3.2	-0.6	4886.0	5873.6	5899.7	105. 1
Peru	0.6	3.0	6.4	267.1	3.8	1.6	-6.4	-2.8	1.3	1978.9	2056.2	2230.6	28.4
Venezuela	2.6	3.7	9.3	51.4	16.2	15.9	-4.9	10.1	19.1	5119.6	4818.7	4595.9	25.3
Latin America	2.9	3.9	4.3	162.8	7.6	6.3	-4.5	-2.5	1.4	3602.2	3886.0	3925.9	553.9

[1] Annual average
[2] in billions of US dollars
[3] in US dollars (year 2000 constant prices)
[4] Estimate

Source: World Economic Outlook, Financial Systems and Economic Cycles, IMF, 2006; CEPAL, Anuario estadístico de América Latina y el Caribe, 2005

Another reason for the entry of foreign banks was the structural problems faced by the domestic banks. Moguillansky et al. (2004) cite the series of handicaps the Latin American banking systems were suffering from: the low lending/GDP ratio, the preponderance of short-term loans, the high rates on private financing, the impossibility for the majority of households and companies to have access to credit. To improve the efficiency of the banking industry, governments started to institute substantial liberalisation measures leading to the so-called "first-generation" financial reforms (table 2). These are materialised by the liberalisation of interest rates, the lowering of entry barriers, a wave of privatisation and a financial opening to the exterior. This deregulation was accompanied by a huge growth of lending with its stream of non-performing loans, but also the financing of speculative investments on the property and stock markets (Minda, 2003). The banking crises which followed this financial liberalisation (Mexico in 1994-1995, Brazil in 1999, Argentina in 2001) paved the way for second-generation reforms characterised particularly by the enhancement of bank supervisory mechanisms (cf. the adoption of minimum capital requirements in accordance with the Basel 1 Accord). In addition to their local repercussions,

[4] See Salama (2006) on the demonstrations and the causes of the disparities in Latin America

the reforms of the financial system encouraged the entry of foreign banks. This was facilitated by the deregulation measures which opened up new areas of banking activity (leasing, stock market operations, bancassurance, pension fund management), but also sparked the spate of mergers and acquisitions that ensued in the wake of the banking crises and in which the international banks were to play an active role.

Table 2 – Latin America: first-generation reforms to the financial system

Countries	Liberalization of interest rates	Start of an intensive period of privatization	Adoption of capital adequacy requirements	Bank reserves (%)		Tensions (1) or systemic crises following reforms (2)
				1990	2000	
Argentina	1989	1995	1991	34	4	1995 (2)
Bolivia	1985	1992	1995	25	9	1985 (1)
Brazil	1989	1997	1995	15	12	1994 (1)
Chile	1974*	1974-1987	1989	6	5	1982 (2)
Colombia	1979	1993	1992	38	8	1998 (2)
Costa Rica	1985	1984	1995	43	18	1994 (1)
Mexico	1988	1992	1994	5	7	1994 (2)
Paraguay	1990	1984	1991	33	26	1995 (1)
Peru	1991	1993	1993	31	26	1995 (1)
Uruguay	1974	1974	1992	45	22	1982 (2)
Venezuela	1989	1996	1993	18	29	1994 (2)

* The banks were intervened between 1982 and 1984; the system was reliberalized staring in 1985
Source: Moguillansky et al. (2004)

Not only did the privatisation of banks play a major contribution in the entry of foreign banks, it also influenced the privatisation trend among other public sector companies. Of the 500 largest Latin American corporations, 93 were publicly controlled during the period 1990-1992 compared with only 40 in 1998 (CEPAL, 2000). In addition to the internal liberalization and the opening to the exterior encouraged by international organisations, the privatisations also aimed to establish public sector finances on a healthier footing (Hawkins and Mihaljek, 2001). This foreign influx was facilitated by the low valuation of Latin American corporations, including the banks, compared to corporations from developed countries. Sebastian and Hernansanz (2000) illustrate how, at the end of the 1990s, it was ten times cheaper to acquire 1% of the banking deposits market in Argentina or Mexico compared to the cost of the same proportion in Germany.

International banks also increased their presence in Lain America so as to follow the international expansion of their existing clients. Between 1990 and 1997 the region absorbed an average of almost 37% of the net flow of private capital directed at emerging economies (table 3). Over the same period it was the number one host region for portfolio investments realised in emerging markets with 62% of the total and the second region in terms of FDI (31%). From 1998 to 2002, it even secured top position in attracting nearly 47% of private capital inflow, of which 37% was in the form of FDI, compared to 34.7% for Asia and 13.8% for Central and Eastern Europe. Even if Latin America's relative share has more recently decreased, this massive entry of foreign investors during the Nineties, particularly multinational companies, provided the incentive for the banks from developed countries to accompany them, and in some cases even to arrive before them, so as to satisfy their requirements for financial products and services. International banks were better equipped than the domestic banks in meeting multinational company needs as regards foreign currency loans, international issues, clearing techniques, exchange risk management or even in terms of advice on mergers-acquisitions and preliminary help for their set-up abroad.

Furthermore, during the 1990s the Latin American banking system presented profit opportunities for foreign establishments. Intermediation spreads were much higher than those generated in developed countries. The average spread on loans was 5.76% between 1988 and 1995 compared to 2.8% for OECD member countries. (Claessens et al., 2001). At the same time, another problem confronting Latin American banks was that of their inefficiency. Their operating costs were significantly higher than those observed in other emerging markets. Moguillansky et al. (2004) attribute their lack of efficiency to the high level of inflation undergone during the 1980s which enabled banks to have high spreads and not to pay too much attention to their cost base.

Table 3 – Net private capital flows to emerging market economies (in billions of US dollars)

Emerging market economies	Annual average 1990-1997	Annual average 1998-2002	2005
Asia	55	-1	54
of which Direct investment	36	58	72
Portfolio investment	15	-5	-31
Other private flows	4	-54	13
Latin America	48	37	25
of which Direct investment	23	62	51
Portfolio investment	31	1	28
Other private flows	-6	-26	-54
Central and Eastern Europe	9	34	108
of which Direct investment	7	23	41
Portfolio investment	4	2	29
Other private flows	-2	9	38
Total flows	130	79	254
of which Direct investment	74	167	212
Portfolio investment	50	-3	39
Other private flows	6	-85	3

Source: BIS (2006)

II – The expansion of foreign banks in Latin America

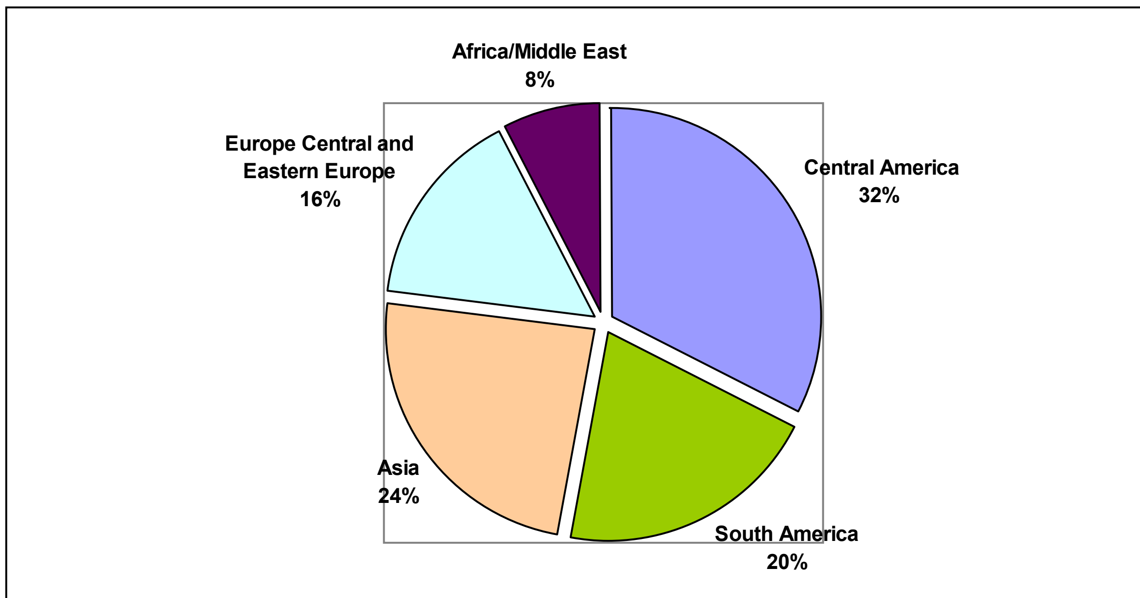
To analyse the recent expansion of multinational banks in Latin America, we shall start by examining the dominant position occupied by the subcontinent within the emerging economies. This will then enable us to measure the growing weight of multinational banks within the Latin American banking industry as well as highlighting the role played by European, and notably Spanish, banks.

A - The rapid development of multinational banks in the emerging economies

The FDI in the financial sector of the emerging markets experienced a period of rapid growth as from the mid 1990s. As we shall see, Latin America ranks highly in the strategy of international banks. The value of cross-border mergers and acquisitions in the banking sector of emerging countries jumped from 2.5 billion dollars between 1991 and 1995 to 51.5 billion for the period 1996-2000, and to 67.5 billion from 2001 to October 2005 (Domanski, 2005). The proportion of mergers and acquisitions targeting banks in emerging economies moved up from 13% of the world total over the period 1991-1995 to 35% from 2001 to October 2005. In the first three years of this century, more than a third of all cross-border mergers and acquisitions have taken place in the emerging economies. Latin America figured as a prime

choice for these bank restructuring operations, accounting for 48% of the cross-border merger and acquisition flows towards the emerging world between 1991 and October 2005, compared to 36% for Asia and 17% for Central and Eastern European countries. Albeit over a shorter period, Focarelli (2003) obtains similar results, giving Latin America a 52.9% share between 1999 and 2002 against 24.1% for Asia, 15.5% for Central and Eastern European countries and 7.6% for Africa and the Middle East (figure 2).

Figure 2 – Cross-border mergers and acquisitions in the financial sector of emerging countries:1999-2002 (as a % of transaction values)



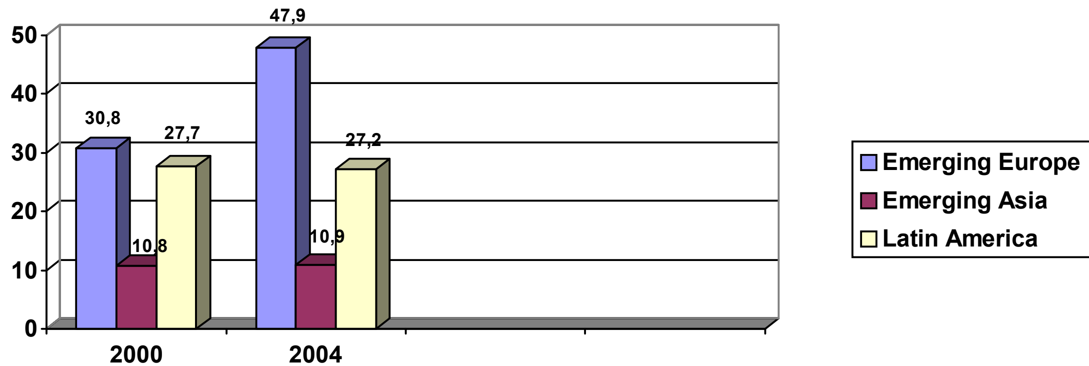
Source: Focarelli (2003)

This acceleration in restructurings brought with it greater participation by foreign establishments in the emerging banking systems. While the proportion of foreign bank holdings in the total bank sector assets of emerging economies barely exceeds 10% in Asia, the figure is as high as 30% and 50% respectively in Latin America and in the countries of Central and Eastern Europe (figure 3).

From one region to another, there are some well-known differences. The entry of foreign banks into Central and Eastern Europe started to accelerate in the mid-Nineties in the wake of the privatisation programmes and their application to join the European Union. It was particularly the Czech Republic and Poland that benefited from the entry of foreign establishments, which in 2001 controlled 93% and 68.8% respectively of total bank assets (table 4). In Latin America, foreign bank positioning mainly focused on the large emerging markets, particularly in Mexico where they own more than 80% of all bank assets. On the other hand, their presence in Asia is still relatively low-key, even though some recent domestic bank acquisitions have been concluded as well as some holdings acquired, for

example in China, India and South Korea[5]. As Domanski points out (2005), the recapitalization of insolvent banks in Asia has tended to be carried out more by local investments, such as the state-controlled asset management companies whose aim is to solve the unproductive loans issue.

Figure 3 – Foreign bank assets as a proportion of total bank assets in emerging economies (as a %)



Source: Compiled by the author from Bankscope data

Table 4 – Foreign bank ownership in selected emerging markets (2001)

Host Country	Total assets (in billions of US dollars)	Number of foreign banks	Foreign control (as a %)
Central and Eastern Europe			
Czech Republic	50.3	21	93.0
Hungary	28.2	29	68.8
Poland	85.4	39	63.6
Latin America			
Argentina	166.0	97	54.5
Brazil	397.0	138	30.6
Chile	77.1	28	43.7
Mexico	156.0	38	76.5
Asia			
China	1090. 0	37	0.2
Korea (South)	496.0	27	8.7
India	273.0	75	0.8
Indonesia	87.4	67	4.9
Malaysia	180.0	51	16.8

Source: Wezel (2004)

B - The growing importance of foreign banks in the banking industry

It was immediately after the 1994 Mexican crisis that foreign banks started to accelerate their penetration of the Latin American market, favouring a presence in the form of

[5] By way of example, Bank of America took a 9% holding in the capital of the China Construction Bank, BNP Paribas acquired almost 20% of Nanjin City Commercial Bank, the Société Générale now owns 75% of Apeejay Finance

subsidiaries at the expense of branches and minority holdings. In many cases the establishment of subsidiaries paved the way for the acquisition of existing local banks. The creation of subsidiaries by acquiring domestic banks gives the parent company numerous advantages: the existence of a network with its inherent infrastructures, the ability to retain a centralised decision-making process, flexibility of commercial strategies, the transfer of its brand name and image.

As table 5 clearly illustrates, the presence of foreign banks has accelerated in most countries, with the exception of the Bahamas and Chile where their number remained relatively stable between 1994 and 2001. As a proportion of total baking institutions, they exceed 50% in many countries: Paraguay, Bahamas, Peru, Chile and Mexico. In Paraguay they have even ousted national bank presence completely.

Table 5 – Foreign banks as a proportion of total banking institutions

Countries	Banks under foreign control				National banks with foreign participation			
	Number		% of total number of banks in the country		Number		% of total number of banks in the country	
	1994	2001	1994	2001	1994	2001	1994	2001
Bahamas	23	23	88	88	0	0	0	0
Bolivia	4	5	24	42	0	0	0	0
Brazil	37	71	14	33	30	14	11	7
Chile	20	18	61	64	5	1	15	4
Colombia	6	10	20	36	3	0	10	0
Mexico	2	17	6	57	0	2	0	7
Paraguay	15	20	37	100	0	0	0	0
Peru	6	10	25	67	0	3	0	20
Venezuela	5	14	4	19	13	16	11	22

Source : Foro regional sobre asuntos relacionados con la estabilidad financiera (2002)

The acceleration in the number of foreign banks has been accompanied by an increase in their market share. In terms of resources they now corner a large proportion of customers' deposits, ranging, for example, in 2001 from 20% in Brazil, to 44% in Chile and Venezuela, to 57% and 73% in Peru and Mexico respectively (table 6). In terms of the utilization of these deposits, they play a key role in credit distribution, holding a dominant position in Mexico and Peru with 68% and 58% respectively of the total loans granted. In the other countries, their share continued to increase throughout the 1990s, reaching 45% and 34% in Chile and Bolivia in 2001.

Table 6 - Participation of foreign banks in the overall bank sector balance sheet (in %)

Countries	Assets				Liabilities				Capital	
	Credit		Total assets		Deposits		Total liabilities		Total	
	1994	2001	1994	2001	1994	2001	1994	2001	1994	2001
Bahamas	86	82	83	81	86	80	83	91	88	83
Bolivia	6	34	6	35	6	36	6	32	50	40
Brazil	5	26	7	28	6	20	7	28	7	29
Chile	15	45	15	57	16	44	21	57	n.a.	53
Colombia	6	23	6	23	6	21	6	23	36	25
Mexico	1	68	1	73	1	73	1	76	3	73
Paraguay	n.a.	n.a.	46	96	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Peru	6	58	6	59	4	57	6	59	10	61
Venezuela	1	43	1	43	2	44	2	43	2	43

Source: Foro regional sobre asuntos relacionados con la estabilidad financiera (2002)

The massive entry of foreign banks has led to an increase in their share of total bank assets in Latin American countries. Still relatively very low in 1990, the percentage moved up rapidly from 1994 onwards. In Mexico, foreign institutions accounted for 82% of total bank assets in 2004 compared to only 2% in 1990, for an amount equating to half the country's GDP (table 7). In Argentina, Peru and Chile the proportions range between 40% and 50%.

Table 7 – Foreign banks' percentage of total bank assets

Countries	1990	1994	1999	2004
Argentina	10	18	49	48
Brazil	6	8	17	27
Chile	19	16	54	42
Mexico	2	1	19	82
Peru	4	7	33	46
Venezuela	1	1	42	34

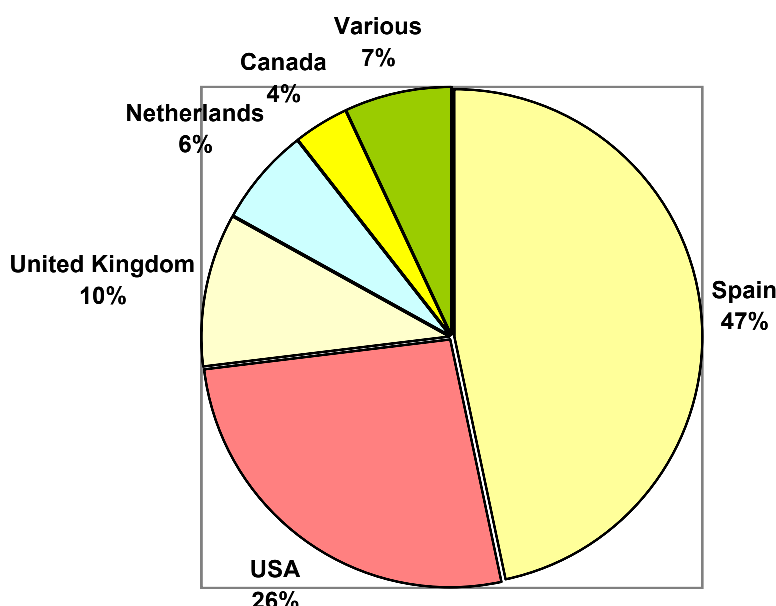
Source: Compiled by the author from national central bank and IMF statistics (2000)

C - Spanish banks: prime movers in conquering the Latin American market ?

Domanski (2005) distinguishes three categories of foreign investors operating in the emerging economies, particularly in Latin America. The first comprises the all-purpose banks such as Citigroup who have been implementing "one-stop shopping" strategies, aiming to provide a complete range of banking and financial services throughout their whole global network. Citigroup, born in 1998 from the merger of Citibank and Travelers is therefore very present in Latin America, also in pension-fund management. Citigroup's acquisition of Banamex, the number two Mexican bank, for $12.5 billion in 2002, represents the largest foreign investment transaction to date realised in Latin America. The second group consists of the commercial banks which have relatively saturated home markets and which are focusing their strategy on an emerging region with the aim of realising economies of scale and product offer. In Latin America, this is notably the case of the European banks which account for more than 60% of the financial sector's FDI, with the Spanish banks heading the pack. The last category involves the non-bank investors such as finance companies which deal in consumer credit and capital investment funds whose prime objective is acquiring and restructuring credit institutions.

The geographical origin of foreign investors points to a clear domination of European banks. On the basis of the cross-border mergers and acquisitions recorded in Latin America in 2004, nearly two-thirds were realised by European banks (figure 4). The relatively low presence of the United States (26% of the acquisitions in 2004) can be explained by several reasons. Firstly, throughout the whole of the 1990s American banks underwent a huge consolidation process[6] which ate into a large part of their resources (CEPAL, 2003). Secondly, these banks concentrated more on developed countries, particularly the European Union whose markets were better suited to their all-purpose bank strategies. Furthermore, the European financial systems were also undergoing substantial reform which potentially opened up opportunities for the American banks. Lastly, the debt crisis of the 1980s had exposed the American banks more acutely, hence explaining their more marked risk-aversion stance towards Latin America.

Figure 4 – Origin of cross-border mergers and acquisitions realised in Latin America – 2004 (as a %)



Source: Compiled by the author using Bankscope data

It was the Spanish banks meanwhile that took advantage of the 1990s to penetrate the region massively. In 2004, almost half the finance sector's FDI was realised by operations involving Spanish institutions (figure 4). There are several reasons for the attraction of Spanish banks to Latin America: accompanying the increase in Spanish companies' FDI as from 1997, the reduction of interest rates in Europe, the ageing of the Spanish population, the high level of profitability attained by Spanish banks, saturation of the Spanish market, the difficulty to obtain increased market share within Europe, cultural proximity. The principal players in the conquest of the Latin American market were SCH, which favoured direct 100% acquisitions and BBVA which preferred to establish its presence by taking majority holdings. SCH was born in 2000 from the merger of Banco Santander with Banco Central Hispano.

[6] In addition to the Citibank-Travelers merger, Bank of Boston, JP Morgan, Chase Bank also restructured during this period

BBVA was the result of the merger in 1999 between Banco Bilbao Vizcaya and Argentaria. It only took a few years for these two groups, which together represent more than 30% of the balance sheet totals of Spanish credit institutions, to occupy the leading positions on the Latin American market as regards retail banking, pension fund management, bancassurance, and investment banking activities.

III – Foreign banks: a source of microeconomic efficiency and banking stability ?

For all that, has the entry of foreign banks into Latin America contributed to increased stability within the Latin American banking industry? In order to answer that question, we shall look at the impact of international banks on microeconomic efficiency, basing our analysis on indicators such as profitability, efficiency and liquidity. The contribution of foreign banks to greater economic effectiveness will be studied by examining their role particularly as regards product and services engineering, risk management and financial profitability.

A - The impact of foreign banks on microeconomic efficiency

The indicators used to measure microeconomic impact are comparatively similar from one study to another. Moguillansky et al. (2004) isolate three indicators in order to compare local and foreign banks – profitability, efficiency and liquidity, basing their review on the data available for the 20 largest institutions present in the seven largest countries which make up 80% of the Latin American banking system. Moguillansky et al conclude that between 1997 and 2001 there are no significant differences in profitability, as measured by the return on assets and the return on capital, between local banks and foreign banks (table 8). Over that period, the return on assets coefficient is significantly higher in the national banks. The return on capital ratio is higher for foreign banks in Argentina, Mexico and Venezuela.

Table 8 – Indicators of the profitability of local and foreign banks (as a %)

Countries	Return on assets						Return on equity					
	Local banks			Foreign banks			Local banks			Foreign banks		
	1997/ 2001	1997	2001	1997/ 2001	1997	2001	1997/ 2001	1997	2001	1997/ 2001	1997	2001
Argentina	0.8	0.3	1.8	0.3	-0.7	0.3	3.1	2.5	5.9	6.0	2.1	7.4
Brazil	0.9	1.0	0.5	0.7	0.2	0.6	12.3	13.1	5.3	8.5	6.0	7.2
Chile	0.8	0.9	1.0	0.6	0.4	0.7	13.1	12.4	15.8	10.5	6.3	14.2
Colombia	-0.1	1.3	1.0	-0.6	-0.1	0.2	7.4	8.2	9.8	1.4	-2.7	0.2
Mexico	1.2	0.6	2.5	1.2	1.1	1.8	6.9	0.5	9.4	11.2	7.6	14.7
Peru	0.8	0.7	1.2	0.4	-0.2	0.2	7.8	10.6	6.9	4.5	11.0	5.1
Venezuela	2.2	2.2	2.2	1.9	2.1	-	14.9	20.7	2.6	16.2	15.7	-
Latin America	0.9	1.0	1.5	0.6	0.4	0.6	9.4	9.7	7.9	8.3	6.6	8.1

Source: CEPAL (2003)

In terms of efficiency, table 9 shows that the ratio between operating expenses and total income clearly favours local banks. Only Chilean and Mexican banks have a higher operating ratio than foreign banks. It can be seen that this ratio reduces substantially in both types of bank between 1997 and 2001. As Moguillansky et al. underline, this improvement in operational efficiency is linked to the development of rationalisation processes in bank operations, the optimization of human resources and the introduction of new technologies, including multimedia platforms.

Table 9 – Indicators of the efficiency of local and foreign banks (as a %)

Countries	Overdue loans/gross loans						Operating expenses/ total income					
	Local banks			Foreign banks			Local banks			Foreign banks		
	1997/ 2001	1997	2001	1997/ 2001	1997	2001	1997/ 2001	1997	2001	1997/ 2001	1997	2001
Argentina	10.9	13.0	12.1[1]	5.9	5.8	6.0	79.9	102.1	21.9	85.1	163.9	19.6
Brazil	10.3	5.8	14.1	4.7	1.9	7.4	79.7	84.4	76.3	93.1	115.9	67.2
Chile	1.6	1.0	1.8	1.0	0.4	1.3	82.8	77.9	69.8	65.0	63.7	62.9
Colombia	8.0	5.5	4.0	6.1	4.9	3.7	102.8	82.1	64.6	125.3	92.4	74.5
Mexico	6.2	6.2	6.4	2.0	1.5	2.1	108.6	102.4	73.2	90.3	86.0	63.7
Peru	6.8	4.6	7.7	6.4	4.9	6.4	91.7	83.7	78.2	114.8	106.4	84.9
Venezuela	7.0	3.4	12.2	6.6	2.1	-	73.9	65.3	70.9	75.3	72.0	-
Latin America	7.2	5.7	8.3	4.7	3.1	4.5	88.5	85.4	65.0	92.7	100.0	62.0

[1] 2000

Source: CEPAL (2003)

On the other hand, risk management as measured by the ratio of overdue loans to gross loans appears to be more tightly controlled by foreign banks as they display significantly better results in all the countries. Is this because of a more selective loan policy towards some customer sectors? It can be seen that the percentage of non-performing loans increased between 1997 and 2001 for foreign and local banks alike. The increasing number of households and corporate customers unable to honour their commitments is partly due to the consequences of the economic crises that have taken place, particularly in Mexico, Brazil and Argentina, during this period.

The indicator of liquidity as measured by the ratio of total credits net of provisions for non-performing loans to total deposits varies considerably from one country and from one type of bank to another. In Brazil and Colombia, foreign banks are more liquid than local banks, while it is the opposite in Chile and Mexico where the liquidity ratio is higher in local banks, and likewise, albeit to a lesser extent, in Peru. However, this indicator of liquidity is more homogenous in local banks (a spread of 30 points between Brazil and Mexico in 2001) whereas there is a much greater deviation in foreign banks (a spread of 164 points between Mexico and Colombia). Foreign banks appear to adopt different stances in different countries, a fact which would indicate differing risk evaluation scenarios.

These results partially corroborate other studies that have been conducted into the impact of foreign banks in the emerging economies. Claessens et al. (2001) find that, as a general rule, foreign banks have wider interest rate spreads and higher profitability than local banks. Levine (2001) notes that foreign banks encourage competition, thereby enhancing local bank efficiency. Among other studies focusing on Latin America, Crystal et al. (2001) show that foreign institutions have experienced higher growth levels in their lending and react more aggressively in the face of non-performing loans. On the other hand, Levy-Yeyati and Micco (2003) observe that foreign banks are confronted by high insolvency risks as a result of high gearing and greater fluctuations in income.

Table 10 – Liquidity indicator: effective availability of loanable funds in relation to total deposits (in %)

Countries	Local banks			Foreign banks		
	1997/2001	1997	2001	1997/2001	1997	2001
Argentina [1]	84.5	97.0	90.9	91.9	93.9	82.1
Brazil	95.2	102.1	71.9	201.5	163.8	167.3
Chile	111.6	118.3	108.7	95.2	139.6	85.2
Colombia	142.0	105.5	128.9	192.9	112.2	208.1
Mexico	106.9	108.2	132.9	74.9	90.0	44.1
Peru	134.0	113.2	118.2	130.2	165.7	95.4
Venezuela	74.2	66.1	107.5	68.5	73.4	-

[1] 2000

Source: CEPAL (2003)

B - Foreign banks and macroeconomic effectiveness

Several empirical studies tend to prove that foreign banks help to improve the functioning of the local banking markets. Claessens et al. (2001) show that international banks increase the degree of competition between institutions, introduce new financial products and services and possess better risk management techniques. Crystal et al. (2001) stress the fact that foreign bank loans are less volatile compared to local banks and that their lending significantly increases during times of crisis.

It would also appear that foreign banks generate greater macroeconomic effectiveness due to their dissemination of new risk-management approaches, new control and corporate governance procedures throughout the rest of the banking sector. They had a stabilizing and deepening effect on the financial sector, particularly by the role they played in developing wider and more professionalized inter-bank markets. They also played a by no means insignificant role in restoring and strengthening the solidity of the asset base within the banking system. Local customers tended to have greater confidence in financial institutions which had an international standing. Evidence of this confidence can be seen in the “flight to quality”, failing which customer deposits would have left the country[7].

But did the entry of foreign banks actually reinforce the stability of Latin American banking systems? Moguillansky et al. (2004) put forward three factors which could have engendered this virtuous relationship. Firstly, international banks used their more sophisticated risk-management techniques, based on more rigorous supervision by the authorities in their countries of origin. Given their wider international risk diversification, as shown by their presence on the other continents, this would make them less vulnerable to the region’s domestic cycles. The parent companies could always act as a lender of last resort if their subsidiaries encountered liquidity problems.

Table 11 shows that economic profitability measured by the ROA (return on assets), and financial profitability, measured by the ROE (return on equity), improved substantially in

[7] Conversely, foreign banks can facilitate the flight of capital by the intermediary of transactions conducted between the subsidiaries and the parent company

Latin America between 2001 and 2005. It is clear that improvements in profitability encourage banking stability. To begin with it means that risks can be better covered by constituting reserves and provisions. It also means an increase in equity which represents an additional security to lessen the impact of any potential economic crises. At the same time, the use and dissemination by foreign banks of more sophisticated risk-management techniques also contributed to greater financial stability. Table 11 shows that the proportion of non-performing loans in relation to total lending decreased substantially between 2001 and 2005, including in those countries which have a high concentration of foreign institutions such as Mexico, Chile, Argentina and Peru. This improvement in managing counter-party risk contrasts with the period 1997-2001 when non-performing loans as a proportion of total lending had increased for both local and international banks alike (table 9). The best credit risk-management is the fruit of a narrower segmentation of target customers, resorting to scoring techniques which restrict the amount of loan commitments to those customers who score less well, and the use of financial instruments such as credit derivatives and debt securitisation. However, the increase in the provisions for non-performing loans in all countries, except for Brazil, between 2001 and 2005 visibly proves that continuing efforts are required to better select and control risks.

Table 11 – Performance and quality of the banking systems (as a %)

Countries	Bank return on assets			Bank return on equity			Non-performing bank loans to total loans			Bank provisions to non-performing loans		
	2001	2003	2005	2001	2003	2005	2001	2003	2005	2001	2003	2005
Argentina	0.0	-3.0	0.9	-0.2	-22.7	7.1	13.1	17.7	5.2	66.4	79.2	124.6
Brazil	-0.1	1.5	2.1	-1.2	17.0	22.8	5.6	4.8	4.4	126.6	74.0	81.1
Chile	1.3	1.3	1.3	17.7	16.7	17.9	1.6	1.6	0.9	146.5	130.8	177.6
Colombia	0.1	1.9	2.8	1.1	16.9	22.5	9.7	6.8	2.7	77.5	98.5	167.3
Mexico	0.8	1.7	2.4	8.6	14.2	19.5	5.1	3.2	1.8	123.8	167.1	232.1
Peru	0.4	1.1	2.2	4.3	10.7	22.2	9.0	5.8	2.1	63.1	67.2	68.4
Venezuela	2.8	6.2	3.7	20.3	44.0	32.6	7.0	7.7	1.2	92.4	103.7	196.3

Source: IMF (2006)

IV – The risks created by the entry of foreign banks into Latin America

Even if foreign banks can, under certain conditions, contribute to grater financial stability, does not their growing importance at the same time create new risks? As we shall observe, their entry has not solved the restriction of credit from which Latin America is suffering. In some instances it may actually have provoked new sources of fragility.

A - Foreign banks and the restriction of credit to the private sector

The banking system plays a key role in the mobilisation and spread of capital in emerging countries, where it is even more involved in financial intermediation than it is in developed countries. Intermediating funds, transforming short-term into long-term financing, facilitating payment flows, managing liquidity, granting loans, maintaining financial discipline among borrowers, all of these banking functions are essential for the correct functioning of the real economy. In Latin America, where capital markets have developed to

different degrees, banks are the only institutions capable of supplying suitable information in order to produce positive externalities.

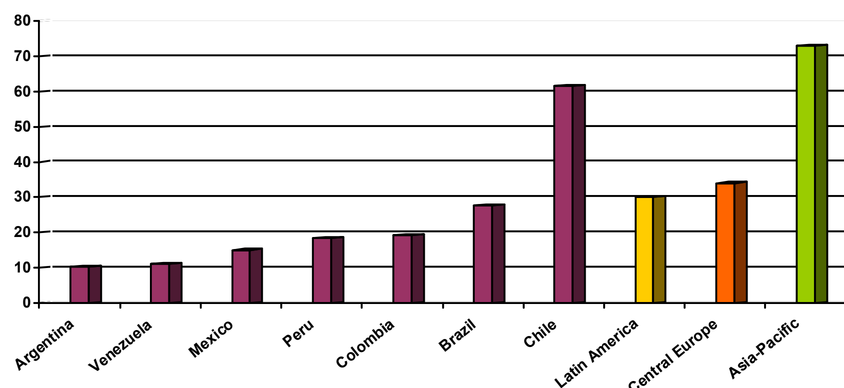
Indeed, as Peltier (2005) underlines, Latin America is suffering from a major shortage of credit, so much so that the pace of growth is being curbed, hindering economic development. Financial liberalisation, structural reforms and the inflow of foreign capital brought with them a significant rise in domestic borrowing in the early Nineties. In the case of Mexico, de Luna Martínez (2002) notes that between 1991 and 1994 bank loans increased at eight times the rate of real growth in GDP. During that period, portfolio investments attracted by the high yields, provided credit institutions with substantial resources. The emerging countries which were the major beneficiaries of the flows of private capital are also those whose banking sector experienced the most rapid expansion. But the speed of this expansion means that the banks are had difficulties in identifying the good borrowers from the bad, because when economic growth is buoyant, a lot of borrowers give the impression of being a profitable and liquid investment, but these characteristics are merely temporary (Minda et Truquin, 2005). The turn-rounds in the economic climate together with major price fluctuations on the financial markets make these borrowers insolvent and depreciate the value of collateral assets. Hence, the banking crises which followed one another from 1994 onwards prompted a slowdown in the expansion of credit.

Figure 5 shows how Latin America is suffering from a shortage of credit compared to the other emerging economies. Lending to the private sector represented only 30% of GDP in 2004 against 34% in Central Europe and 73% in the Asia-Pacific region. Even if Chile and Brazil appear to be less affected by this credit standstill, private companies and households in the other countries mentioned are victims of a shortage of financing. This situation is all the more critical in that the relative rarity of credit has made the cost of financing extremely expensive. Lending rates and bank intermediation spreads are significantly higher than those encountered in other emerging nations. There are however some notable differences within the region itself. The countries which have the lowest real rates are those that succeed in obtaining the soundest macroeconomic fundamentals (modest levels of public debt, low inflation, current deficit contained) and/or that possess more efficient banking sectors and/or have the least systemic credit risks (Peltier, 2005). Such is the case of Mexico, where in 2004 the real lending rate was 2.5%, and in Chile (4.0%). Conversely, the highest lending rates were to be found in countries where the fundamentals are the most fragile (high public debt, persistent inflation), and/or banks have the highest operating costs and/or the high credit risks are the result of an unstable macrofinancial environment. Brazil and Peru, where in 2004 the average real lending rate was as high as 48.5% and 10.8% respectively, come in this category.

There are several reasons for this volume and cost-driven restriction of credit. The structural weakness of savings rates[8] penalises bank resources. This deficiency comes from the low rate of household savings, which in turn has several causes: disparities in income and wealth, distrust of the currency, reminiscent of the periods of hyperinflation, the young population, the low level of banking services available, a very narrow middle-class category. In addition, issues of government securities to finance internal and external debt servicing absorbed part of the loanable capital, taking it away from investment in private sector driven projects, as well as contributing to pushing interest rates up (Salama, 2006).

[8] In 2005, savings rates as a proportion of GDP stood at 40.6% in the Middle East, 38.3% in Asia, 23.5% in Africa, 22.0% in Latin America and 18.8% in Central and Eastern Europe (IMF, 2006)

Figure 5 – Bank credit to the private sector in 2004 (as a % of GDP)



Source : IMF (2006)

Are foreign banks partly responsible for the credit restriction which is penalising Latin America? From this point of view, the experience of Mexico which is the country with the largest number of foreign banks is particularly telling. Table 11 shows that the market share held by foreign banks jumped from 11% to 83% between 1997 and 2004. Whereas, over the same period, bank lending to companies and households decreased by more than 8%. Bank lending to the private sector, which still represented 25% of GDP in 1997, only represented 14% in 2004. Haber and Musacchio (2005) show that the fall in lending was mainly due to the consequences of the 1994-1995 crisis which weakened bank balance sheets, as they began to adopt a more rigorous stance towards risk management. The very large proportion of total banking assets held by foreign banks inevitably leads us to conclude that they had a role to play in the restriction of credit. Initially they did contribute to bank recapitalisation by subscribing to State-issued bonds in order to discharge the banking sector's non-performing loans. This subscription to risk-free, high yielding investments contributed in part to the improvement in bank profitability. As soon as government bond yields began to decrease, the foreign banks, which in the interim had acquired local banks, preferred raising their charges rather than increasing their loan exposure to households and companies in order to maintain their profitability.

Table 11 – Bank credit in Mexico

Years	Market share of foreign banks (as a %)	Bank credit to companies and households (in billions of pesos [1])	Bank credit to companies and households (as a % of bank assets)	Total bank claims on private sector (as a % of GDP)
1997	11	761	50	25
1998	20	750	44	23
1999	19	607	37	19
2000	57	590	36	17
2001	54	555	33	15
2002	82	560	33	17
2003	82	586	31	15
2004	83	699	34	14

[1] Deflated to 2004
Source: Haber et Musacchio (2005)

B - Foreign banks and the fragility of the local banking systems

The expansion of foreign banks in Latin America has prompted numerous criticisms, the most virulent being those regarding their role in undermining the banking systems. They are accused of positioning themselves on the most profitable markets or segments, particularly the large corporations and the upmarket household sectors. In so doing, they were responsible for the lower profitability levels incurred by local banks which had to manage a higher risk customer portfolio. Likewise, compared to large corporations, it became increasingly difficult for small and medium-sized companies to raise financing from foreign financial institutions, the largest of which base their lending on a standardised and global risk-management approach. Certainly, these banks increasingly make use of decision-making aids such as scoring and expert systems in order to reduce the cost of risk treatment and to increase the security of operations.

In a study covering Argentina, Chile, Colombia and Peru, Clark et al. (2003) emphasize how small foreign banks lend less to small companies than the small local banks. Meanwhile the same authors note that in Chile and Colombia, large foreign banks lend more to small companies than the large local banks. In Argentina and Chile, they observe that the amount of lending to small companies by large foreign banks is increasing at a faster rate than lending by similar size national banks.

Furthermore, the major part of foreign banks' assets devoted to public sector financing requirements together with the strong dollarization of their balance sheets give them considerable exposure to sovereign and foreign exchange risks. Peltier (2005) states that the average level of dollarization in Latin America stood at 37% of deposits in 2003 compared to 25% in 1991 and at 40% for loans. In order to protect themselves against exchange risks and to reduce their foreign currency positions, the banks lend in dollars by drawing on dollar deposits, including lending to companies that are not outward-facing. They are all the more willing to do this insofar as borrowers prefer loan commitments in foreign currency because they attract lower interest rates than local currency lending. The only drawback is the fact that the banks transfer part of their foreign exchange risk exposure to non-financial agents, thereby increasing their credit risk, as the financial health of their borrowers is jeopardised. In addition, in the event of a currency depreciation, those banks which have highly dollarized balance sheets are exposed to risks of insolvency caused by an increase in default rates, as well as to risks of illiquidity resulting from the rush on deposits in the event of a movement of panic as could be provoked by some external crisis.

Similarly, the cross-border acquisitions realised by large international banking groups have encouraged the concentration of local banking networks. Mexico, for example, has been the scene of several large-scale operations. In 2000, BBVA acquired Bancomer for $1.75 billion. Its competitor, SCH bought Serfin in 2001 for $1.56 billion. In 2001, Citigroup purchased Banamex for $12.55 billion. HSBC spent $1.14 billion to take over the finance group Bital. It is a fact that these reorganisations reinforce the oligopolistic structure of the banking systems, hence increasing the market power of the large foreign banks compared to local competitors. This intensification of banking concentration keeps intermediation spreads high, in turn increasing borrowers' financing costs. Furthermore, the need to maximise equity profitability imposed by shareholders of the parent company constitutes a continual pressure to improve the financial profitability of the whole group.

This concentration also poses numerous challenges for the regulators. They exercise their controlling authority at a national level and experience difficulties in controlling multinational banks whose strategic command post is abroad and whose openness is sometimes lacking. The systemic risk caused by the size of the international banks could incite the supervisory authorities in the host countries to intervene more frequently than in the past, on the basis of the "too big to fail" doctrine (Plihon et al., 2006). As these authors point out, applying this principle leads to excessive risks being taken (moral hazard) inasmuch as it might be the rest of the community which would have to suffer the consequences of these banks' strategies, and not the multinational banks themselves.

Conclusion

The expansion of foreign banks in Latin America highlights the role played by the multinational banks and by the emerging economies in the financial globalization process. While financial liberalisation has intensified the opening and interconnection of the financial markets, the inflows and outflows of capital, it has also brought with it an increased internationalisation of the major banks, particularly in the direction of emerging and transition economies.

Compared with the multinational corporations that bring their capital, their technologies and their methods of governance, the multinational banks possess specific assets which they transfer abroad. In Latin America, the international banks have, in certain aspects, helped strengthen financial stability by disseminating new risk-management methods, by introducing new control procedures and reinforcing the solidity of the asset base within the banking systems. Conversely, their preference for liquid assets and public-sector securities and their aversion to counter-party risk have limited their allocation of credit to the private sector. How can investment projects and consumption be financed if the credit offer is restricted and expensive? This situation is all the more detrimental to the financing of Latin America's development in that the capital markets, given their shallowness, are principally the reserve of the high-standing corporate operators.

As we have observed, foreign banks can be the originators of new sources of financial fragility such as the exposure to foreign exchange risks, increasing market power and perpetuating high intermediation spreads. Yet, the creation of a banking oligopoly under foreign control, as in Mexico, makes it more complicated for the supervisory authorities to take preventive management action against the systemic risk. Would the parent companies of the multinational banks always fulfil their role as lenders of last resort towards their subsidiaries or branches if another Latin American banking crisis were to erupt ?

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