Emerging market banks are by no means small and are growing fast. However, very little is known about these banks, especially about their cross-border activities. This chapter explores in detail the importance of emerging market banks as foreign investors and discusses how the global financial crisis allows these banks to increase their global (albeit regionally confined) footprint.

Emerging market banks, emerging giants
Although, in the West, many are unfamiliar with emerging market banks, they are by no means small. In fact, the world’s biggest bank in market value is China’s ICBC. The global top 25 currently includes eight emerging market banks. Among these are three other Chinese banks (China Construction Bank, Agricultural Bank of China, and Bank of China), three Brazilian banks (Itau Unibanco, Banco do Brasil, and Banco Bradesco), and one Russian bank (Sberbank). While excess optimism might have inflated these market values, these banks are large with respect to other measures, as well. In terms of assets, all these banks are in the top 75 worldwide, with all four Chinese banks in the top 20. In addition, lower down in the rankings, there is a long list of smaller banks that together add up to quite a lot. In 2010, emerging market banks as a group accounted for roughly 30 percent of global profits, a third of global revenues, and half of tier 1 capital. In 2011, these numbers only increased. For example, Brazil has now overtaken the United Kingdom in terms of profits earned, despite having an asset base that is less than one-fifth as large as that of the UK.

Not only are emerging market banks already substantially large; they are growing fast. In terms of market value, the share of emerging market banks in the industry’s total worldwide almost doubled between 2005 and 2010. While in 2005 all of the world’s 25 largest banks by market capitalization were located in advanced countries, currently eight are from emerging markets. In addition, asset growth has been impressive in many emerging markets. Although China again tops the ranks, other emerging markets have seen impressive increases in bank assets, as well, while maintaining adequate capital ratios and ample deposit funding. Loan growth was strong in many emerging markets in the period leading up to the financial crisis, and many banks in Asia, Africa, and Latin America predict that their loan books will continue to rise with double-digit numbers over the next few years.

Outward bound
With a large part of their populations still unbanked and their economies growing, much of the growth potential of emerging market banks will lie at home. However, there is also growth potential overseas. Although many are not aware of the foreign adventures these banks have undertaken in the past, quite a few emerging market banks are no stranger to setting
up a branch or subsidiary abroad, generating revenue outside their domestic market. Standard Bank of South Africa, for example, generated almost a quarter of its profits from abroad, mainly the rest of Africa. Hungary’s OTP Bank Nyrt expects business in its home market to contract this year amid tough economic conditions, but projects double-digit growth rates in its Russia and Ukraine retail business. So, how active are emerging market banks overseas? How has this changed over time, and what type of countries are these banks targeting?

Over the last two decades, the world has witnessed an unprecedented degree of foreign bank entry. Driven by globalization and increased financial integration, the number of foreign banks almost doubled, from 774 in 1995 to 1,334 in 2009. Although most of this foreign investment is done by banks from advanced countries, banks from emerging markets have been active investors, as well. Figure 1 depicts the entry of foreign banks, highlighting investments by advanced country banks and those by emerging market banks. Of the 1,088 entries that took place between 1995 and 2009, 312 were by emerging market banks. The figure shows that foreign banks from emerging markets have been active investors over the whole sample period. Especially in 1997 (41 percent) and 2006 (38 percent), they were responsible for a large share of the new entries.

Over the period 1995-2009, the share (in terms of numbers) of foreign ownership by emerging market banks has stayed relatively stable, as both advanced country banks and emerging market banks increased their overseas investment (see Figure 2). In 2009 (the last year of our sample period), banks from 60 emerging markets owned 27 percent of the foreign banks in terms of numbers, up from 24 percent in 1995. In terms of assets, however, they owned only 5 percent, so emerging market banks still represent only a small portion of total foreign banking assets. This indicates that, even though quite a few emerging market banks engage in foreign adventures, they tend to focus on small acquisitions, often to service local customers abroad or to offer services to migrants. For example, State Bank of India (SBI) and ICICI Bank, India’s largest privately owned bank, have both undertaken expansions in Asia, Africa, and the Middle East. The reason behind these expansions are to facilitate increasing trade and investment flows between India and other countries, to provide foreign currency denominated loans to the overseas affiliates of Indian companies, and to provide remittance and retail credit services for Indian expatriates.

Even though, at a global scale, emerging market foreign banks are still small, these banks are becoming more significant in many emerging markets. Figure 3 shows that the importance of emerging market foreign banks increased substantially in a large number of countries since 1995. In 1995, there were 39 countries that had a foreign bank active but no foreign banks owned by a parent from an emerging market. By 2009, this number was down to 24. Similarly, in 1995, there were 20 countries where emerging market banks represented more than 50 percent of the foreign banks active in the country; in 2009, there were 26 countries in this group. In fact, in some countries (Azerbaijan, Kuwait, Malawi, Mongolia, Namibia, Sudan, and Vietnam), all foreign banks are owned by parents from emerging markets. And in some host countries, these banks are large players indeed. For example, the biggest bank in Madagascar is Bank of Africa, headquartered in Mali. Similarly, in Burkina Faso, Bank of Africa and Ecobank, headquartered in Togo, are two of the six foreign banks active, and two of the biggest ones in terms of assets.

Ownership by emerging market banks has expanded not only in terms of host countries, but also in terms of the number of emerging market investors. While in 1995 banks from 45 different emerging markets pursued banking activities in other countries, by 2009, banks from 60 emerging markets did so. While emerging market investors typically come from more developed emerging markets, such as Argentina, Brazil, and South Africa, banks from low- and lower-middle-income countries, such as Kenya, Nicaragua, and Pakistan, are also active as investors. In 2009, 30 percent of emerging market foreign banks were owned by parents located in low- or lower-middle-income countries, up from 21 percent in 1995. In 1995, most emerging market investors belonged to countries in Latin America (33 percent), but by 2009, this focus had shifted towards Eastern Europe (23 percent) and Central Asia and sub-Saharan Africa (23 percent), mostly due to disinvestment by banks from Argentina, Brazil, and Panama and to large-scale investments by banks from Hungary, Nigeria, Russia, and South Africa. Excluding Panama, which is an offshore center, the most active investors as of 2009 are banks from South Africa, Russia, Turkey, and Brazil, owning 31, 29, 21, and 17 foreign banks, respectively.

Table 1 groups countries according to their income level and region and shows a number of interesting facts. First, as expected, the share of emerging market foreign banks is higher in emerging markets than in advanced countries, in terms of both numbers and assets. When the sample of emerging markets is split into middle- and low-income countries, it becomes obvious that emerging market banks are specifically investing in low-income countries. On average, 52 percent of the foreign assets in these countries is owned by a bank headquartered in an emerging market, compared to 33 percent in middle-income countries.
Figure 1: Bank entries from advanced countries and emerging markets, 1995-2009

![Graph showing bank entries from advanced countries and emerging markets, 1995-2009.]

Source: Claessens and Van Horen, 2012.

Note: As the database starts in 1995, the number of foreign banks that exited the market cannot be determined. For a definition of advanced countries and emerging markets, please see the main text.

Figure 2: Number of advanced country and emerging market banks, 1995-2009

![Graph showing the number of advanced country and emerging market banks, 1995-2009.]

Source: Claessens and Van Horen, 2012.

Figure 3: Concentration of emerging market foreign banks, 1995 and 2009

![Bar chart showing the concentration of emerging market foreign banks, 1995 and 2009.]

Source: Claessens and Van Horen, 2012.
1.3: Branching Out: The Rise of Emerging Market Banks

Table 1: Foreign bank penetration, aggregates by income level and region, 2009

<table>
<thead>
<tr>
<th>Income level</th>
<th>COUNTRY-BASED</th>
<th></th>
<th>GROUP-BASED</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Foreign bank assets in total bank assets</td>
<td>Share EM foreign bank assets in total foreign assets</td>
<td>Number of foreign banks in total number of banks</td>
<td>Share EM foreign banks in total foreign banks</td>
</tr>
<tr>
<td>Advanced countries</td>
<td>0.23</td>
<td>0.22</td>
<td>0.29</td>
<td>0.17</td>
</tr>
<tr>
<td>Emerging markets</td>
<td>0.48</td>
<td>0.33</td>
<td>0.47</td>
<td>0.38</td>
</tr>
<tr>
<td>Middle-income</td>
<td>0.40</td>
<td>0.33</td>
<td>0.44</td>
<td>0.38</td>
</tr>
<tr>
<td>Low-income</td>
<td>0.65</td>
<td>0.52</td>
<td>0.52</td>
<td>0.48</td>
</tr>
<tr>
<td>Region (emerging markets only)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>East Asia and Pacific</td>
<td>0.19</td>
<td>0.42</td>
<td>0.26</td>
<td>0.46</td>
</tr>
<tr>
<td>Europe and Central Asia</td>
<td>0.62</td>
<td>0.15</td>
<td>0.59</td>
<td>0.30</td>
</tr>
<tr>
<td>Latin America and Caribbean</td>
<td>0.42</td>
<td>0.37</td>
<td>0.44</td>
<td>0.32</td>
</tr>
<tr>
<td>Middle East and North Africa</td>
<td>0.26</td>
<td>0.24</td>
<td>0.27</td>
<td>0.42</td>
</tr>
<tr>
<td>South Asia</td>
<td>0.18</td>
<td>0.30</td>
<td>0.14</td>
<td>0.24</td>
</tr>
<tr>
<td>Sub-Saharan Africa</td>
<td>0.63</td>
<td>0.53</td>
<td>0.58</td>
<td>0.47</td>
</tr>
<tr>
<td>All countries</td>
<td>0.41</td>
<td>0.31</td>
<td>0.43</td>
<td>0.33</td>
</tr>
</tbody>
</table>

Source: Claessens and Van Horen, 2012.

Notes: Figures reported are ratios of number of foreign banks to total number of banks (in 2009) and foreign bank assets to total bank assets (average over 2007-2009) in each country, and the ratios of the number of emerging market foreign banks to total number of foreign banks and emerging market foreign bank assets to total foreign bank assets in each country. Income and region classifications follow World Bank definitions as of 2009. Country-based figures are the simple average of the countries within a group ((1/n)ΣiFBi/(ΣiDBi+FBi) for country i), whereas group-based figures are obtained from iFBi/(ΣiDBi+FBi) for country i within a group. FB and DB represent foreign bank and domestic bank respectively.

Second, strong regional differences exist. While foreign ownership is especially prevalent in Eastern Europe and Central Asia, Latin America, and sub-Saharan Africa, ownership by emerging market banks is significantly higher in the latter region. In sub-Saharan Africa, 53 percent of foreign assets, on average, are owned by emerging market banks, while in Eastern Europe and Central Asia and in Latin America, these numbers are substantially lower—15 and 37 percent, respectively. The difference is even more pronounced when looking at the group-based shares. In sub-Saharan Africa, emerging market banks own 49 percent of foreign banks and 17 percent of foreign assets. In Eastern Europe and Central Asia, these numbers are 21 and 4 percent, respectively, and in Latin America, 25 and 4 percent.

Third, clear differences emerge when comparing the shares calculated on a group basis with those based on simple averages of the individual countries, and especially when looking at asset shares. In most cases, the emerging market share for the group-based measure is lower than the country-based measure, indicating that foreign banks owned by banks from emerging markets are overrepresented in smaller markets. This suggests that advanced country banks are more attracted to larger markets, while emerging market banks tend to invest in the smaller, often poorer, countries, a topic that will be discussed further next.

Differences that count

Banks engage in foreign investment for several reasons. First, foreign investment provides a possibility for risk diversification. Second, entering new markets can increase the bank’s client base. Third, by following their international customers in order to provide them with financial services, banks can exploit informational advantages derived from long-term bank-client relationships. Indeed, a number of studies have shown that foreign direct investment in banking is correlated with economic integration, as measured by trade and FDI flows between the home country of the parent and the host country in which it is investing, and with proximity, measured along several dimensions. Fourth, foreign banks tend to be attracted to countries where expected profits are higher, owing to higher expected economic growth and the existence of local bank inefficiencies.

How do entry decisions of foreign banks from emerging markets compare to those of advanced countries? The characteristics of emerging market bank investment described above suggest that emerging market banks tend to invest in different countries than advanced country banks do. Research confirms this. Van Horen (2007) shows that foreign bank entry by both emerging market and advanced country banks is driven by economic integration, common language, and proximity. However, controlling for these factors, banks from emerging markets are more likely to invest in small,
developing countries with weak institutions, where advanced country banks are reluctant to go. This result suggests that emerging market banks have a competitive advantage in dealing with countries with a weak institutional climate.

Indeed, when we have a closer look at the countries in which emerging market banks tend to invest, two facts clearly stand out. First, there exists a high negative correlation between (log of) GDP and GDP per capita of the host country and the share of emerging market banks in foreign bank assets (Figure 4). In the first case, the correlation equals -0.45, and in the second case, it equals -0.37. This shows that emerging market foreign banks are especially attracted to smaller and poorer countries.

Second, while advanced country banks tend to set up shop both within and outside their own geographical region, the vast majority of emerging market banks tend to stay close to home. Table 2 splits countries into four broad geographical regions that cut across income groups (America, Asia, Europe, and Middle East and Africa). It shows that, while quite a few banks from advanced countries are venturing outside their own region (reflecting past colonial linkages or a desire to operate globally), over 80 percent of investments from emerging market banks are within their own region. Among emerging market banks, there are also clear regional differences. While almost all emerging market banks from the Americas and Europe invest within their own region, emerging market banks from Asia have also built a substantial presence outside their region. This is partly the result of Asian banks’ tendency to establish a presence in countries with large migrant populations.

When we look at developments over time, banks from advanced countries have actually become less regional and more global, possibly due to advances in telecommunication and other technologies and to economies of scale in the provision of some financial services. Banks from emerging markets, on the other hand, have become more regional, possibly because they have a stronger competitive advantage in countries physically and institutionally closer as compared with banks from advanced countries.13

Weathering the financial storm
Not being a stranger to foreign investments, the question arises how emerging markets will respond to changes brought on by the turbulence in the global financial markets. With the global financial crisis almost seamlessly merging into the Eurozone debt crisis, the global financial system is still trying to adjust to the new rules of the game. While some banks are faced with major restructurings (either voluntary or imposed by governments), virtually all banks will have to make adjustments in order to comply with Basel III and other, country-specific, regulatory measures. The changes

Table 2: Number and share of foreign banks from home to host regions, 2009

<table>
<thead>
<tr>
<th>HOME REGION</th>
<th>AMERICA</th>
<th>ASIA</th>
<th>EUROPE</th>
<th>MEA</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td>Share</td>
<td>Number</td>
<td>Share</td>
<td>Number</td>
</tr>
<tr>
<td>AMERICA</td>
<td>72</td>
<td>0.44</td>
<td>25</td>
<td>0.15</td>
<td>54</td>
</tr>
<tr>
<td>ASIA</td>
<td>13</td>
<td>0.22</td>
<td>37</td>
<td>0.62</td>
<td>10</td>
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<tr>
<td>EUROPE</td>
<td>121</td>
<td>0.17</td>
<td>53</td>
<td>0.07</td>
<td>450</td>
</tr>
<tr>
<td>MEA</td>
<td>2</td>
<td>0.09</td>
<td>4</td>
<td>0.17</td>
<td>7</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>HOME REGION</th>
<th>AMERICA</th>
<th>ASIA</th>
<th>EUROPE</th>
<th>MEA</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td>Share</td>
<td>Number</td>
<td>Share</td>
<td>Number</td>
</tr>
<tr>
<td>AMERICA</td>
<td>55</td>
<td>0.96</td>
<td>0</td>
<td>0.00</td>
<td>2</td>
</tr>
<tr>
<td>ASIA</td>
<td>9</td>
<td>0.12</td>
<td>49</td>
<td>0.67</td>
<td>8</td>
</tr>
<tr>
<td>EUROPE</td>
<td>0</td>
<td>0.00</td>
<td>7</td>
<td>0.09</td>
<td>72</td>
</tr>
<tr>
<td>MEA</td>
<td>2</td>
<td>0.01</td>
<td>8</td>
<td>0.05</td>
<td>26</td>
</tr>
</tbody>
</table>

Source: Claessens and Van Horen, 2012.
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 America and the Caribbean. Asia includes all countries in Central, East, and South Asia and the Pacific countries, including Japan, Australia, and New Zealand. Europe includes all Western and Eastern European countries. MEA includes all countries in the Middle East and North and sub-Saharan Africa.
invoked by the crisis, however, have a very different impact on advanced country banks than on emerging market banks, and therefore the crisis will likely have a lasting effect on the role the latter group will play in the global financial system.

Although emerging market banks have also been affected by the crisis, several factors make it easier for these banks to weather the storm. First, loan-to-deposit ratios in general are very low, due to the net saving position of these countries. This has sheltered emerging market banking systems to a large extent from the collapse of the interbank market and reduced the need for substantial deleveraging. Thus, these banks can continue lending, using a stable and often growing source of deposit funding. Second, most emerging market banks already have high capital ratios, ranging from 17 percent, on average, in Latin America to 13 percent in Asia, which limits pressures for balance sheet adjustments. In addition, the new capital rules under Basel III are likely to be much less painful for these banks, as they typically have less risky assets and their investment banking business tends to be small.

Equally important, emerging market banks face a very different situation in their domestic market from their advanced country peers. First, the fact that a large part of the population in the emerging world is still unbanked provides ample growth opportunities in these markets. This stands in sharp contrast to the conditions advanced country banks face at home, where, due to overall economic weakness and ongoing deleveraging among firms and households, expected credit growth is low. Indeed, currently the top 25 countries for return on capital are all emerging markets, with the exception of Australia and Canada (two commodity-driven economies). Second, the macroeconomic outlook in emerging markets is much better than that of advanced countries. Not faced with major sovereign debt problems and/or large current account deficits, most emerging markets are on pretty solid footing. Even though they will not be isolated from the problems in Europe and the United States, their dependence on the West has diminished in recent years.

So, as compared with many advanced country banks, emerging market banks tend to have much more favorable funding positions and outlooks. This fact, combined with high profits that can provide a buffer to absorb potential losses, puts these banks in a good position to extend their global reach by seizing opportunities that might come along when advanced country banks in need to consolidate, either forced or voluntary, sell-off some of their domestic or foreign subsidiaries.

However, a number of factors might prevent this from happening. First, with still a large part of the population unbanked, most emerging market banks face pressures at home to increase lending, which reduces funds available for foreign expansion. Second, an important share of excess deposits is stuck in sleepy state banks that have shown very limited interest in expanding abroad. Third, many emerging market banks have only limited provisions set aside, especially as compared with advanced country banks, and therefore face pressures to increase their bad-debt reserves. Finally, regulators might oppose foreign adventures as the use of domestic deposits to finance a subsidiary overseas exposes banks to foreign exchange and counterparty risk.

Recent examples, however, indicate that at least some emerging market banks are seizing opportunities and starting new foreign adventures. Russia’s Sberbank bought in 2011 the Central and Eastern European subsidiaries of Austria’s Volksbank and is now acquiring DenizBank in Turkey, owned...
by Belgium’s rescued Dexia. 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. More acquisitions of these types seem likely, suggesting that, in the coming years, emerging market banks will grow not only in their domestic markets but also abroad.

This increase in their global footprint, however, most likely will remain regionally confined. First, with a fully developed banking system, sovereign debt problems, and low expected economic growth, profits are unlikely to be reaped in advanced countries (most notably Western Europe), making investment in other emerging markets more likely. Second, while many emerging markets have (potential) high returns on capital, they are not easy markets in which to operate. For example, return on capital in Pakistan was 36 percent in 2011, but the country is fraught with political and operational risk, which has kept the banking sector small. Emerging market banks experienced in investing in smaller and poorer countries seem to have a competitive advantage exactly in those markets, and therefore have a better chance of generating profits in these markets. Third, regulatory crackdowns in advanced countries, caused by some cross-border bank failures, might make it hard for emerging market banks to set up a branch or subsidiary in these countries. Fourth, an increasing number of emerging market companies are establishing a presence overseas, mainly in other emerging markets, providing emerging market banks with another reason to extend their foreign network regionally, instead of globally, in order to service their domestic customers abroad.

Summarizing, due to sheer size, almost undoubtedly emerging market banks will soon become important players in the world’s financial system. Most of their muscle will be needed at home to support the credit growth demanded by their populations and politicians. However, with advanced country banks trying to adjust to the new rules of the game, it is likely that more disinvestment, both domestically and abroad, will take place in the near future. Banks from emerging markets, being in a much better financial position, are the most likely buyers, increasing their relative importance as foreign investors. Therefore, the global financial system is likely to witness a shift towards greater dominance by emerging market banks, especially within their own geographical regions.

The views expressed in this chapter are those of the author only and do not necessarily reflect the views of the De Nederlandsche Bank, the European System of Central Banks or their Boards.

Notes
1. For the purpose of this paper, emerging market banks are banks owned by parent companies located in countries that are not high-income countries as classified by the World Bank in 2000. The emerging markets group therefore also includes low-income countries. Current OECD countries such as Hungary, the Czech Republic, Poland, Slovakia, and Korea are included in the emerging markets group. Slovenia, which already was a high-income country in 2000, is included in the advanced countries group.
3. Fast loan growth obviously can create risks, as well. For example, in Central and Eastern Europe, loans grew twice as fast as GDP between 2000 and 2007, but when banks ran out of funding as a result of the global financial crisis, bad debt mounted quickly and loan growth collapsed.
4. All data in this chapter come from the bank ownership database constructed by Claessens and Van Horen. For a description of the database, see Claessens and Van Horen 2012. The banks included in the database are listed in Bankscope, and therefore representative offices and small branches that do not have individual annual reports are not included in the data. A foreign bank is defined as having at least 50 percent of its shares owned by foreigners. Countries that are offshore centers are excluded from this analysis.
5. Foreign banks owned by institutional investors such as the European Bank for Reconstruction and Development (EBRD) or the International Finance Corporation (IFC) are categorized as advanced country banks. Foreign banks owned by banks headquartered in offshore centers are included in the sample, with the bank included in the emerging market or advanced country group depending on the income level of the offshore center. For example, foreign banks owned by banks headquartered in Panama are included in the emerging market group.
6. The difference between the increase in foreign banks between 1995 and 2009 and the number of new entries over the same period is accounted for by 329 foreign banks exiting and 199 M&As of foreign-owned banks by other foreign banks.
7. The lack of balance sheet information for the vast majority of banks prior to 2004 in Bankscope (our source of information for balance sheet information) prevents us from showing time trends in terms of assets.
8 World Bank 2006, p. 118.

9 See, for example, Grosse and Goldberg 1991, Brealey and Kaplanis 1996.


12 America includes the United States, Canada, and the countries in Latin America and the Caribbean. Asia includes all countries in Central, East, and South Asia and the Pacific countries including Japan, Australia, and New Zealand. Europe includes all Western and Eastern European countries. Middle East and Africa includes all countries in the Middle East and in North and sub-Saharan Africa.

13 See Claessens and Van Horen 2008.

References


