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Foreign bank penetration of newly opened markets in the Nordic countries

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Abstract

The opening to foreign banks in the Nordic countries provides us with an opportunity to study the evolution of the foreign bank sector in situations where the sector had a definite start date. Despite low survival rates for individual foreign banks, on balance the foreign bank sector gained market share (in terms of the assets of the banking system) over time. Our results for the role of time, links to the home market and problems facing domestic competitors were strongly in accordance with expectations in the cases of Denmark, mixed or indeterminate for Finland and Norway, and strongly opposite in the case of Sweden. Lastly, our results are broadly consistent with the Stiglitz–Weiss argument that the foreign banks bought entry by accepting worse lending risks. © 2001 Elsevier Science B.V. All rights reserved.

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1. Introduction

In 1971 Denmark deregulated its domestic banking markets and the entry of foreign banks. Only one foreign bank entered initially and the number of foreign banks grew slowly over time. Finland opened next (1978) but no foreign banks entered until four years later when further deregulation made entry attractive. Norway (1984) and Sweden (1985) opened more than a decade after Denmark and a number of banks all entered at once. Today, after falling from its peaks, the number of foreign banks and their share of each country's banking system assets are recovering. In Finland, Norway and Sweden, especially when acquisitions of domestic banks are involved, the number and market share represent a new peak.

The opportunities for the foreign banks did not develop slowly with the evolution of an economy or a technology but suddenly (though with forewarning) when governments removed their barriers. In all four countries, opening to foreign banks accompanied a more general deregulation that resulted in competitive turbulence. The authorities welcomed the foreign banks for the competition and new capabilities they brought to the domestic market. However, the authorities were also concerned about the effect of the entrants on monetary policy, credit control and the soundness of the existing domestic banks.

The foreign entrants were particularly able to take advantage of the openings. They were offshoots of their parent banks: large, internationally well-known organizations. As such the entrants were not subject to many of the hurdles facing totally new firms. However, they were still subject to the liability of foreignness and the need to establish relationships with clients.

Our objective is to examine the determinants of the evolution of the foreigners' market share of the assets of the banking system as a whole, not the survival and success of individual banks. In Section 2 we discuss the limited literature on the evolution of the market share of foreign banks, which is slim but does suggest hypotheses amenable to testing. In Section 3 we formulate three hypotheses regarding the determinants of the foreign bank sector's share of the assets of the banking system. We relate the foreign banks' market share in each of the four countries to a time trend, to each host country's trade balance, and to the banking system's loan loss experience. The first variable captures learning and selection. The second proxies for access to business related to the foreign banks' access to their home markets. The last captures the effect of a possible crisis-induced lack of competitiveness of the host-country banks. In Section 4 we discuss the data and methodology. In Section 5 we present the results of testing our model. In Section 6 we conclude the paper by comparing and contrasting the experiences of the foreign bank sector in the four environments, by pointing out some limitations of the analysis, and by discussing some current developments that are changing the face of the Nordic banking scene. In an appendix available from the corresponding author we discuss the regulatory and economic environment that the foreign banks faced in the Nordic countries at entry and after. We also present the basic data on the development of the foreign bank sector in Denmark, Finland, Norway and Sweden that we use in our analysis.

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