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To what extent will the banking industry be globalized? A study of bank nationality and reach in 20 European nations ☆

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Abstract

We model two dimensions of bank globalization – *bank nationality* (a bank from the firm's host nation, its home nation, or a third nation) and *bank reach* (a global, regional, or local bank) using a two-stage nested multinomial logit model. Our data set includes over 2000 foreign affiliates of multinational corporations operating in 20 European nations and over 250 banks that serve them. We find that these firms frequently use host nation banks for cash management services, and that bank reach may be strongly influenced by this choice of bank nationality. Our results suggest limits to the degree of future bank globalization.

JEL classification: G21; G15; G28; G34
Keywords: Bank; Globalization; Europe; Mergers

☆ The opinions expressed here do not necessarily reflect those of the Federal Reserve Board or its staff.

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1. Introduction

Recent years have seen a drastic reduction in global barriers to competition in the financial services industry. Deregulation around the world has permitted consolidation across more distant and more different types of financial institutions. Improvements in information processing, telecommunications, and financial technologies have facilitated greater geographic reach by allowing institutions to manage larger information flows from more locations and to evaluate and manage risks at lower cost without geographic proximity to the customer. Moreover, growth in cross-border activities of non-financial companies has spurred greater demands for institutions that can provide financial services across borders.

Despite these forces, the financial services industry in general, and the commercial banking industry in particular, currently remain far from globalized. While there has been considerable bank consolidation within individual industrialized nations in recent years, cross-border bank mergers and acquisitions (M&As) among these nations have generally been much less frequent (Group of Ten, 2001). In most other nations as well, market shares of foreign-owned banks are generally below 10% (Levine, 1996).

We argue here that the banking industry may never become fully globalized, even after adjusting to the full effects of deregulation, technological progress, and increased cross-border non-financial activity. Some banking services – such as relationship lending to informationally opaque small businesses – may always be provided primarily by small, local institutions operating in the nation in which the services are demanded. Other services, such as syndicated loans to large borrowers, are more likely to be provided by large, global institutions for which the home nations of these institutions are of much less consequence to the demanders of the services. In our view, the better question is not when or if the banking industry will be globalized, but rather *the extent to which* it will be globalized.

To address this question, we examine how more than 2000 foreign affiliates of large multinational corporations choose banks for cash management services in each of 20 European nations. The term *cash management* covers a variety of core banking services, with an emphasis on services that require frequent turnover, including liquidity management, short-term lending, foreign exchange transactions, and assistance with hedging. In effect, cash management refers to virtually all short-term banking needs, and generally requires a physical presence in the nation in which the services are provided.

The provision of cash management services to foreign affiliates of large multinational corporations represents a crucial "middle ground" of financial services that could be provided by (1) small local banks that operate only in the host nation, (2) global banks headquartered in a few financial centers, but with offices in many nations around the world, or (3) institutions between these two extremes. Moreover, because cash management services to foreign affiliates of large multinational corporations represent a significant portion of the potential market for global banks, they may be influential in determining the extent to which the banking industry will become globalized. To our knowledge, there is no prior research on the choice of bank for cash management services by these firms.