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Bank lending, crises, and changing ownership structure in Central and Eastern European countries

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ABSTRACT

We examine the interactions of bank lending dynamics, ownership structures, and crisis phenomena in the banking systems of Central and Eastern European (CEE) countries. Using a panel dataset of more than 400 banks for the period from 1994–2010, we show that the impact of ownership structure on a bank's lending activities in CEE countries was conditional upon the type of crisis, namely, whether it was a host, home, global, or simultaneous crisis. In contrast, our evidence indicates that bank-specific characteristics, such as deposit growth and profitability ratios, are significant determinants of credit growth during both normal economic times and crisis periods, regardless of the crisis type. Moreover, we provide indirect evidence of the benefits of banking sector diversification dependent upon the criterion of parent banks' country of origin.

1. Introduction

Since the early 1990s, Central and Eastern European (CEE) countries have experienced significant and extensive economic changes. After the six-year period of the Second World War and 45 years of Communist rule, countries were forced to rebuild democratic political structures, societies, and the institutions of a market-oriented economy. One of the main challenges was to create a stable and efficient banking system as a prerequisite for stable economic growth; however, it quickly became clear that this would not be an easy task. In several cases, post-transition recessions led to bad loans and inadequate capital positions, systematic banking crises, and an urgent need to both recapitalize and restructure banks. Corporate governance problems in state-controlled banks became obvious, and support increased for at least partial privatization and openness to foreign capital. Ownership changes in CEE countries were also fostered by the preparation for EU accession and full membership. Bonin and Schnabel (2011) note that the banking sectors in CEE post-transition economies became primarily foreign investor-controlled rather than predominantly government-owned. All of these dramatic transformations occurred within a chaotic environment marked by political instability, economic downturns, and occasional social unrest. Therefore, the last 25 years have been difficult for CEE countries and their citizens. However, the

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conditions in CEE countries created unprecedented opportunities for researchers because, in the described setting, the strengths and weaknesses of institutional arrangements and governmental and regulatory policies were exposed. This paper exploits one research possibility linked to CEE countries' restless modern economic history. Namely, we attempt to establish how bank ownership interacts with various types of banking crises (home, host, simultaneous and global) in shaping loan supply.

Changes in banks' ownership structures and different banks' origins may influence their lending behaviors, particularly during financial crises. However, existing research has primarily concentrated on foreign banks' credit supply because of their prominent role in the CEE region during domestic crises (de Haas and van Lelyveld, 2006) and, more recently, during the global financial crisis (Cull and Martínez Pería, 2013). Our study attempts to combine empirical designs employed by de Haas and van Lelyveld (2006) and Cull and Martínez Pería (2013) to analyze the lending behavior of foreign-owned and domestically controlled banks during different types of crises.

Historically, foreign bank entry has been considered a positive development for CEE countries because earlier empirical evidence suggested that foreign bank entry brings greater efficiency in the banking sector (Bonin et al., 2005; Drakos, 2003; Fries and Taci, 2005). Foreign bank entry was associated with better access to credit and lower credit costs. Unite and Sullivan (2003) for Asia and Martinez Peria and Mody (2004) for Latin America, document that foreign banks offer lower spreads and lower costs than domestic banks. In a cross-country study, Clarke et al. (2006) show that enterprises in countries with high levels of foreign bank participation rank interest rates and access to long-term loans as weaker constraints of their operations and growth than enterprises in countries with a more modest foreign bank presence. De Haas and van Lelyveld (2006) find that foreign bank subsidiaries of financially strong parent banks did not reduce lending during a crisis but his positive stability effect was driven by greenfield foreign banks. In CEE countries, however, domestic banks reduce lending during domestic banking crises. The authors associate this phenomenon with the internal capital markets of multinational parent banks that provide subsidiaries with capital and liquidity and enable them to continue lending during a crisis in CEE countries. Therefore, the assumption has been that foreign ownership in the banking sector encouraged efficiency and stability in the financial system in CEE countries.

However, several recent papers indicate that foreign-owned banks may have reduced credit availability in CEE countries during the global crisis of 2008. Cull and Martínez Pería (2013) show that foreign bank total loan growth decreased to a greater extent than that of domestic private banks. De Haas and van Lelyveld (2014), using worldwide data, find that parent banks were not significant sources of strength for their subsidiaries during the global crisis. The authors report that, consequently, the slowdown in foreign bank subsidiaries' credit growth was almost three times that of the slowdown for domestic banks during the period 2008–2009. In contrast to our study, de Haas and van Lelyveld (2014) do not distinguish between private and state-owned domestic banks. Simultaneously, despite their diminished economic role, government-owned banks, which are often influenced by political pressure, could partially compensate for the decrease in lending by foreign-owned banks that began in 2008. Cull and Martínez Pería (2013) document that the credit growth of government-owned banks exceeded that of domestic and foreign-owned banks in Latin America during the 2008–2009 crisis. However, the authors did not find evidence that government-owned banks in Eastern Europe stepped up their lending compared to privately-owned banks. Conversely, De Haas et al. (2014), using a larger dataset, find weak evidence that government-owned banks reduced credit growth in CEE emerging economies to a lesser extent than privately-owned banks in 2009. According to the authors, some governments used state-owned banks to smooth aggregate lending when privately-owned banks began to deleverage. In their study, however, De Haas et al. (2014) concentrate mainly on the level of government support and participation in the Vienna Initiative (VI) and its impact on the credit supply of foreign bank subsidiaries during the crisis. The authors do not provide additional evidence on the lending behaviors of government-owned banks in CEE countries during the financial crisis of 2008.

This study compares all foreign-owned banks, private domestic, and government-owned banks to assess the impact of ownership on lending in CEE countries during different crisis periods. To determine whether foreign- and domestic-owned banks in CEE countries react differently to domestic, home country, simultaneous and global banking crises, we use a unique database of foreign-owned and private domestic and government-owned banks from 11 CEE countries. Our main finding is that the impact of ownership structure on bank lending activities in CEE countries is conditional upon the type of crisis phenomena. Namely, when we do not control for crisis occurrence, the ownership dummies are insignificant, and only the selected fundamentals of banks licensed in the CEE countries determine loan growth. However, we confirm that foreign-owned banks stabilize lending during episodes of banking crises in CEE (i.e., host crises). In contrast, prior to 2008, when a CEE country was hit by a banking crisis, state-owned banks reduced their lending dynamics. This statistically robust regularity was overturned during the recent crisis, during which lending by state-owned entities in the region accelerated. These results are, to a certain extent, consistent with Cull and Martínez Pería (2013), who reported an increase in government-owned bank lending in Latin America during the crisis yet they did not find similar evidence for Eastern European countries. However, our study uses a significantly larger sample of countries and banks, including state-owned banks, than the study of Cull and Martínez Pería (2013). This fact and may explain the differences in the results. Moreover, our results corroborate the finding by de Haas et al. (2014) that some governments may have used state-owned banks to smooth aggregate lending during the crisis. The last research outcome should be considered with caution because the share of government-owned banks in the sectors was small during the recent crisis, and those banks do not constitute a homogenous group in CEE countries. As expected, from the parent companies' perspective, home economic woes negatively influenced the lending propensity of foreign banks operating in CEE countries.

Although de Haas and van Lelyveld (2006, 2014) report that the credit growth of foreign banks in CEE countries is associated with their parent banks' financial position, we do not find compelling evidence that the parent banks' financial performance and situation are directly related to their lending behaviors in CEE countries during normal economic times. However, parent bank fundamentals increased in significance during crisis periods. Interestingly, the direction of parent banks' fundamentals impact seems to depend