+ MODEL
ARTICLE IN PRESS
+ MODEL
Available online at www.sciencedirect.com
Borsa İstanbul Review

Borsa İstanbul Review xx (2014) 1–7
http://www.elsevier.com/journals/borsa-istanbul-review/2214-8450

Relative power and efficiency as a main determinant of banks' profitability in Latin America

Jorge Guillén [a,*], Erick W. Rengifo [b,1], Emre Ozsoz [c,d,2]

[a] *Department of Economics, Escuela Superior de Administracion de Negocios, ESAN Graduate School of Business, Lima, Peru*
[b] *Economics, Fordham University, New York, USA*
[c] *Economics, FIT-SUNY, New York, USA*
[d] *Center for International Policy Studies at Fordham University, USA*

Abstract

Despite the financial sector liberalization and openness that started in the earlier 90's and significant macroeconomic development as well as increasing inflow of capital toward the region, there is not any evidence of the reduction of interest rates as well as banks' profits in Latin America. In this paper we develop a model to estimate the determinants of Latin American banks' profitability and, try to understand the reasons why banks are reluctant to decrease their interest rate spreads even when change in competitiveness in the financial system is improving. By using Data Envelopment Analysis to better exploit the information of several variables at the same time and, by employing a sample of 200 Banks located in Argentina, Bolivia, Brazil, Costa Rica, Ecuador, El Salvador, Mexico, Nicaragua, Paraguay, Peru, Uruguay and Venezuela; we find that banks' profits grew consistently above the normal levels of profits adjusted by risk. Our results show that banks in Latin America have been profiting from their oligopolistic position in detriment of their clients in particular and of their whole economy in general.
Copyright © 2014, Borsa İstanbul Anonim Sirketi. Production and hosting by Elsevier B.V. All rights reserved.

JELS classification: C14; G21; G28

Keywords: Data Envelopment Analysis; Latin American banks; Banks' profitability; Market concentration

1. Introduction

During the 90's most of Latin American economies started to open their economies and to liberalize their financial systems which were mostly controlled by their governments until then (Quispe-Agnoly & McQuerry, 2001). During this period it was observed that the composition of banks' assets within the region changed and that a significant inflow of foreign capital moved toward their banking systems. Capital inflows took the form of foreign direct investments and portfolio inflows.[3] During the 90's the region got an inflow of 180 billions of dollars (Cravino, Lederman, & Ollareaga, 2007). However, banks' competitiveness did not necessarily improve after this period of financial liberalization and capital growth.

In Tables 1and 2 we present information about three of the most representative countries in our sample. The information in these tables corresponds to the years 1990 and 2007; respectively. Table 1 shows that besides the significant participation of foreign capital in the banking system, there is still an evident banking concentration: The top 5 banks of each of the

* Corresponding author. Tel.: +51 1 317 7200; fax: +51 1 345 1328.
E-mail addresses: jguillen@esan.edu.pe (J. Guillén), rengifomina@fordham.edu (E.W. Rengifo), emre_ozsoz@ftnyc.edu (E. Ozsoz).
Peer review under responsibility of Borsa İstanbul Anonim Şirketi.

Production and hosting by Elsevier

[1] Tel.: +1 718 817 4061; fax: +1 718 817 3518.
[2] Tel.: +1 212 217 4929; fax: +1 212 217 4641.

[3] An additional form of capital inflow took the form of remittances.

http://dx.doi.org/10.1016/j.bir.2014.02.003
2214-8450/Copyright © 2014, Borsa İstanbul Anonim Sirketi. Production and hosting by Elsevier B.V. All rights reserved.

Please cite this article in press as: Guillén, J., et al., Relative power and efficiency as a main determinant of banks' profitability in Latin America, Borsa İstanbul Review (2014), http://dx.doi.org/10.1016/j.bir.2014.02.003

Table 1
Banks' deposit concentration in Latin America before liberalization (1990).

Country	Number of banks	Foreign-owned banks (%)	Deposit in top 5 banks (%)	GDP growth (%)
Argentina	105	51	44	−1.338
Brazil	149	n.a.	19	−4.168
Peru	18	41	77	−5.09

This table presents some statistics for a subsample of countries under study. The data presented in this table corresponds to 1990.

Table 2
Banks' deposit concentration in Latin America after liberalization (2007).

Country	Number of banks	Foreign-owned banks (%)	Deposit in top 5 banks (%)	GDP growth (%)
Argentina	122	31	47	9.179
Brazil	167	54	27	3.160
Peru	22	59	71	6.827

This table presents some statistics for a subsample of countries under study. The data presented in this table corresponds to 2007.

economies presented here captured between 44 and 77% of the overall deposits in the system. This table shows that concentration and market imperfection, i.e. oligopoly, appears to be a typical characteristic in the banking system in this region.[4]

From Tables 1 and 2,[5] we can observe that Brazil and Argentina have the largest number of banks. However and even though both countries have more than 100 banks, their banks' deposit concentration is not only high but also has increased since 1990 from 44% to 47% and from 16% to 27% for Argentina and Brazil, respectively. Peru's concentration has decreased (from 77% to 71%) but it is still one of the highest in the region. Accordingly, the size of the country or the number of banks does not matter and, apparently, there is always a high concentration ratio that has not been wiped out with the financial liberalization and the inflow of capital towards the region.

Banks' concentration in Latin America can be traced back to the early 1900s when the Kemmerer's mission promoted the ongoing concentration in the Latin-American financial system (see Drake, 1989).[6] Kemmerer advised to accelerate bank concentration and at the same time to amplify credit availability. Kemmerer's suggestions made the number of banks in Colombia to decrease from 35 in 1924 to 16 in 1930. However, the number of regional branches multiplied.[7] The same was observed in the other countries that he advised.

Kemmerer's plans seemed to have achieved its goals as the number of credits and deposit soared in the countries he visited. Moreover, similar policies to the ones suggested by Kemmerer were implemented in other Latin American countries that he did not visit.

Kemmerer's basic idea goes along with the tradeoff between bank's efficiency and stability (Northcott, 2004). Banks' efficiency and competitiveness normally implies a large number of banks competing and, by competition, efficiency is achieved. However, efficiency and competitiveness does not assure stability of the system as it has been seen in this region: whenever there was a significant capital outflow, small banks were not able to withstand and most of them closed. According to Kemmerer, the latter situation could be offset by increasing the concentration in the banking sector allowing large banks to be less vulnerable to bankruptcy and runs.[8]

On the other hand, it has been shown in several studies that efficient functioning of the banking sector and financial openness contributes to economic growth and development (Graff, 2003; Kim, Lin, & Suen, 2012; King & Levine, 1993; Levine, 1997). Other empirical studies (i.e. Fernandez (2005)) have proved empirically the existence of bank lending channels especially in Latin America. According to this literature, banks are not only crucial for economic growth but they are also in an industry that in general is more unstable than other ones. This instability could have pernicious consequences in the economy as a whole. For instance as demonstrated by Peltonen et el. (2011) unexpected variation in the cost of capital and the lending rate has a negative effect on investment especially in the Latin American case. Northcott (2004) points out the following reasons that can explain banks' instabilities:

- A bank's balance sheet consists of short-term deposits on the liability side and, long-term assets that are illiquid. This leaves banks vulnerable to runs in the presence of uncertainty and/or sudden stops in capital flows.
- Highly leveraged banks have an incentive to engage in risky behavior. If the gamble works, shareholders benefit; if it does not, the lenders bear the cost. This is a typical agency problem for banks. There is also asymmetrical information because depositors are not well informed of a bank's activities and potential risks.

However, Casu, Girardone, and Molyneux (2013) found different result in the relationship between competition stability and competition-fragility described by Northcott (2004). They found empirically some difficulties associated with competition and risk in banking industry. In this paper we focus on the

[4] Claessen and Laeven (2004) found some interesting results regarding a free entry of foreign banks in and environment of restriction to banks' activity. Contestability is relevant and they claim that there is no evidence of negative relationship between concentration and competitiveness. However, they contrast to the literature of tradeoff between stability-competition (Northcott, 2004).

[5] We have verified the same structure in the remaining countries. The selection of countries follows GDP and outstanding performance during the 90's. Bank concentration turns out to be slightly higher after 1990 as well as foreign participation.

[6] Edwin W. Kemmerer (1875–1945) was an American economist who advised some Latin-American countries, promoting plans to reform the financial system, fiscal and monetary policies. He advised the governments of the Philippines (1904), Mexico (1917), Guatemala (1919), Colombia (1923), Chile (1925), Ecuador (1926) and Peru (1931).

[7] It is important to note that the four foreign banks present in this country at that time became even larger than before.

[8] Ennis (2005) shows the relevance of large banks in the US and how important they are in the financial system. However, it is also noted that the failure of any large bank may collapse the financial system even in a country like US.

Please cite this article in press as: Guillén, J., et al., Relative power and efficiency as a main determinant of banks' profitability in Latin America, Borsa İstanbul Review (2014), http://dx.doi.org/10.1016/j.bir.2014.02.003

Download English Version:

https://daneshyari.com/en/article/7342124

Download Persian Version:

https://daneshyari.com/article/7342124

Daneshyari.com