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Foreign bank ownership and household credit ☆

Thorsten Beck [a,b,c], Martin Brown [d,*]

[a] Cass Business School, City University London, United Kingdom
[b] CentER and EBC, Tilburg University, The Netherlands
[c] CEPR, United Kingdom
[d] University of St. Gallen, Switzerland

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ABSTRACT

Theoretical and empirical work on banking emphasizes the role of banks in overcoming information asymmetries and agency problems between borrowers and lenders. This paper investigates the importance of bank ownership in determining the sorts of customers that a bank serves, and consequently, the sorts of information problems a bank lender chooses to address. Using survey data for over 16,500 households from 19 emerging economies in Central and Eastern Europe in 2010 this paper is the first to document that information asymmetries in the retail credit market lead foreign banks to cherry-pick financially transparent clients in similar ways as documented previously for enterprise credit. First, a higher market share of foreign banks in a country is associated with a larger gap in credit use between households with and without formal employment. Second, among mortgage borrowers, clients of foreign banks are more likely to be formally employed, are more likely to have personal assets, and are richer than clients of domestic banks. Third, consistent with these results, retail lending techniques of foreign banks rely more on financial information and collateral than those of domestic banks.

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* Corresponding author.
E-mail addresses: TBeck@city.ac.uk (T. Beck), martin.brown@unisg.ch (M. Brown).

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1. Introduction

To what extent financial institutions can overcome information asymmetries in lending is critical for access to credit in both developed and developing countries. In this context, the relationship between foreign ownership of banks and access to credit in emerging markets has been intensively discussed. From a theoretical viewpoint it has been conjectured that foreign banks may "cherry pick" those clients to which they can lend on a transactional basis implying that financially opaque clients may have relatively less access to credit in countries with foreign dominated banking sectors. Worse still, by cream-skimming the credit market, foreign-owned banks may make it unprofitable for their competitors to lend, implying an absolute decrease in credit access for clients which rely on relationship banking. Empirically, the relationship between foreign bank ownership and cherry-picking in the credit market has focused exclusively on corporate and small business credit. In this paper we expand that analysis to the fastest growing segment of credit market in most emerging markets: household credit.

Over the past decades, household credit has gained increasing importance across the developed and developing world, with its share in total bank lending passing 40% in many Central and Eastern European countries in 2007 (Beck et al., 2012a,b). It is therefore important to understand how the ownership structure of the banking sector may impact access to credit across different households. If, due to different organizational processes and a lack of local knowledge, foreign banks focus their lending on large and audited firms rather than small sole-proprietorships, the same banks may focus their retail lending on households with formal income sources and marketable collateral as opposed to households with informal income sources and illiquid assets.

The banking sectors of emerging markets and developing countries are increasingly dominated by foreign-owned institutions. Between 1995 and 2009 the share of foreign-owned banks among the total number of banks increased from 18% to 36% across all emerging markets and from 24% to 46% in developing countries (Claessens and Van Horen, 2012). Foreign banks are especially dominant in Emerging Europe where they account for more than 60% of total bank assets in 15 countries. In this paper we examine how foreign ownership of the banking sector affects access to credit for households in this region.

This paper uses household survey data from 19 countries in Emerging Europe (including Russia and Turkey) taken from the EBRD's Life in Transition Survey (LITS) database to assess how cross-country variation in bank ownership affects the composition of households which use credit. Specifically, we first examine whether in countries with a higher market share of foreign banks the use of mortgage loans and credit cards is tilted towards high-income households, formally employed households, and households with pledgeable assets (i.e. a car). Second we examine whether the most creditworthy clients (from an objective viewpoint) are more likely to have outstanding loans with foreign as opposed to domestic banks. We corroborate our findings with a comparison of lending techniques for 345 banks in our sample region, employing data from the 2012 Bank Environment and Performance Survey (BEPS) of the EBRD. This survey data allows us to establish whether foreign and domestic banks use different lending procedures, which are consistent with their different client profiles.

The countries of Emerging Europe are an almost ideal sample to study the relationship between bank ownership and household credit. After the fall of communism, these countries had to transform their state-owned, mono-banking systems into two-tier market-based financial systems.[1] Countries, however, chose different financial sector reform paths.[2] Some countries opted for domestic privately-owned banking systems through privatization or the entry of new domestic players. Others opted for foreign bank entry early on, be it through privatization or by encouraging greenfield entry (Claeys and Hainz, 2007). These different strategies were mostly driven by different macroeconomic policy programs and less if at all by concerns about access to household credit. Existing evidence suggests that foreign bank entry has been associated with a strong increase in lending to households in the region (Brown

[1] The state-bank systems before the transition had quite extensive networks with large shares of the population having savings accounts. However, besides the notable exceptions of Czechoslovakia, Bulgaria and Hungary with high levels of financial intermediation there was little cross-country variation before the on-set of the transition process.

[2] See Bonin and Wachtel (2003) for a survey of financial sector reforms in the transition economies.