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Domestic and multinational determinants of foreign bank profits: The case of Greek banks operating abroad

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Abstract

This paper examines the determinants of profits of Greek banks operating abroad by developing an integrated model that includes a set of determinants informed by the literature on the profitability of both multinational and domestic banks. The basis for our econometric analysis is provided by an unbalanced panel dataset for 19 Greek bank subsidiaries operating in 11 nations, covering the period from 1995 to 2001. The results show that the profitability of the parent bank and the operating experience of its host nation subsidiaries have a robust and positive impact on the profits of Greek banks abroad, whereas subsidiary bank size has a negative effect. Domestic financial factors reflecting stock market developments, bank-specific factors such as liquidity, loan loss provisions or cost efficiency, and market specific factors like concentration or market share in the host nations, are all insignificant in explaining Greek subsidiary banks' profits.

JEL classification: G15; G21

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1. Introduction

Until recently the literature on the investigation of the determinants of foreign bank performance focused mainly on the case of foreign banks operating in the US, or on US banks operating abroad

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(e.g. Cho, 1985; Goldberg and Johnson, 1990; Seth, 1992). Extensions to the case of foreign banks operating in other countries include recent studies by Williams (1996, 1998a, 1998b, 2003) for Australia; Minh To and Tripe (2002) for New Zealand; Ursacki and Vertinsky (1992) for Japan and Korea; and Engwall et al. (2001) for the Nordic countries.

As for the determinants of profitability, Williams (2003) argues that there has been relatively a limited overlap between the set of factors informed by the domestic bank profits literature and those based on the multinational bank profits literature to explain foreign bank profits. Since a multinational bank typically influences participation of a foreign bank in a host market, failure to simultaneously include multinational determinants alongside host country factors will not adequately explain all aspects of a foreign bank's profitability. To overcome this shortcoming, Williams (2003) has proposed the use of an integrated model that combines both sets of factors to examine the determinants of foreign banks' profits in Australia.

The purpose of this paper is to develop such an integrated model to identify the determinants of profits of Greek banks operating abroad. In this context, we adopt the approach of Williams (2003) using a different dataset, although in principle our study differs from Williams (2003) in that we consider outward investment of Greek banks to a number of countries, as opposed to inward investment of foreign banks into a single nation. Furthermore, some of the banks in our sample operate in less developed countries (e.g. Albania, Bulgaria, Macedonia, Romania), which makes our study specifically important in the light of the fact that other studies have found evidence that foreign banks are more at a disadvantage compared to the domestic banks in developed countries (e.g. De Young and Nolle, 1996; Berger et al., 2000; Claessens et al., 2001; Sathye, 2001; Kosmidou et al., 2004), although not so in less developed countries (Claessens et al., 2001). In addition, as Williams (2002) points out, developing nations do not possess a highly sophisticated banking system and therefore the option of providing distant finance, via correspondent banking for example, is not a viable option as it is in developed nations. In fact, owing to the location of many Greek bank subsidiaries, we find that none of the domestic financial factors reflecting stock market developments and liquidity are significant in explaining Greek bank profitability abroad, the latter being determined mainly by multinational factors like parent bank profitability and the experience of Greek bank subsidiaries in host nation markets.

The remainder of this paper is structured as follows. Section 2 discusses the set of determinants used for estimating our integrated model. Section 3 presents some descriptive statistics based on the sample of data obtained. Section 4 outlines the model formulation and discusses the empirical results and, finally, Section 5 presents the concluding remarks.

2. Determinants and variables

This study uses return of assets (ROA) as the dependent variable, calculated as profit before taxes[1] divided by total assets to measure the overall profitability of the bank. As for the potential determinants of bank performance, the literature on multinational banking suggests several ownership-specific and location-specific factors while empirical studies on the profitability of domestic banks identify several internal (bank-specific) and external (market related) factors. In

[1] An initial version of the paper adopted ROA as a measure of profits after tax, but since cross border differences in taxes can be substantial we have re-estimated our model using ROA before taxes, thanks to the suggestion of an anonymous referee.