Workshop on

“The Costs and Benefits of International Banking”

Eltville, 18 October 2010

Kent Matthews
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Discussion of

“All banks great, small, and global: Loan pricing and foreign competition“

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Comment on All Banks Great, Small and Global

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Foreign bank participation

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- The model considers two routes
- Direct lending – cross border
- Acquisition of a domestic bank
- The first route focuses on the demand side by domestic firms as the menu of choice has increased.
- The second focuses on the supply through efficiency gains to the target bank.

Implications of offshore borrowing

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- Domestic firms concentrate on home search but also makes applications abroad
- To the borrower it should not matter if the bank is domestic or foreign therefore borrowing from a foreign bank occurs only if there is price advantage.
- This route has additional complications not considered such as FX risk and the implications of borrowing in domestic currency from foreign banks for capital flows and the exchange rate.
- Real effects stronger but complicated.

Implications of Takeover

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- Improved efficiency of target bank
- Market power or informational externalities are offset by efficiency gains. Loan rates of acquired bank fall and profit increases.
- But spreads widen as MC of borrowing is lowered and efficiency increases.
- Frictions ensure that current clients of acquired banks benefit but not potential clients from other banks (or new clients)
- Overall average loan rates are unchanged (or lowered slightly) and the real effects are more muted.

The model

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- Heterogeneity of banks based on managerial efficiency differences.
- The model imposes informational frictions on the part of firms and on the costs of sampling loan applications.
- But banks are unencumbered by these frictions. Predator banks know the efficiency of target banks .
- But clients cannot pre-select banks according to known efficiency. They sample randomly.
- Banks do not signal efficiency superiority to clients – no marketing.
- Why don't the inefficient banks go out of business? There is an emerging literature of convergence of efficiency in banking.

Abbey National taken over by Banco Santandar 2004 NIMs

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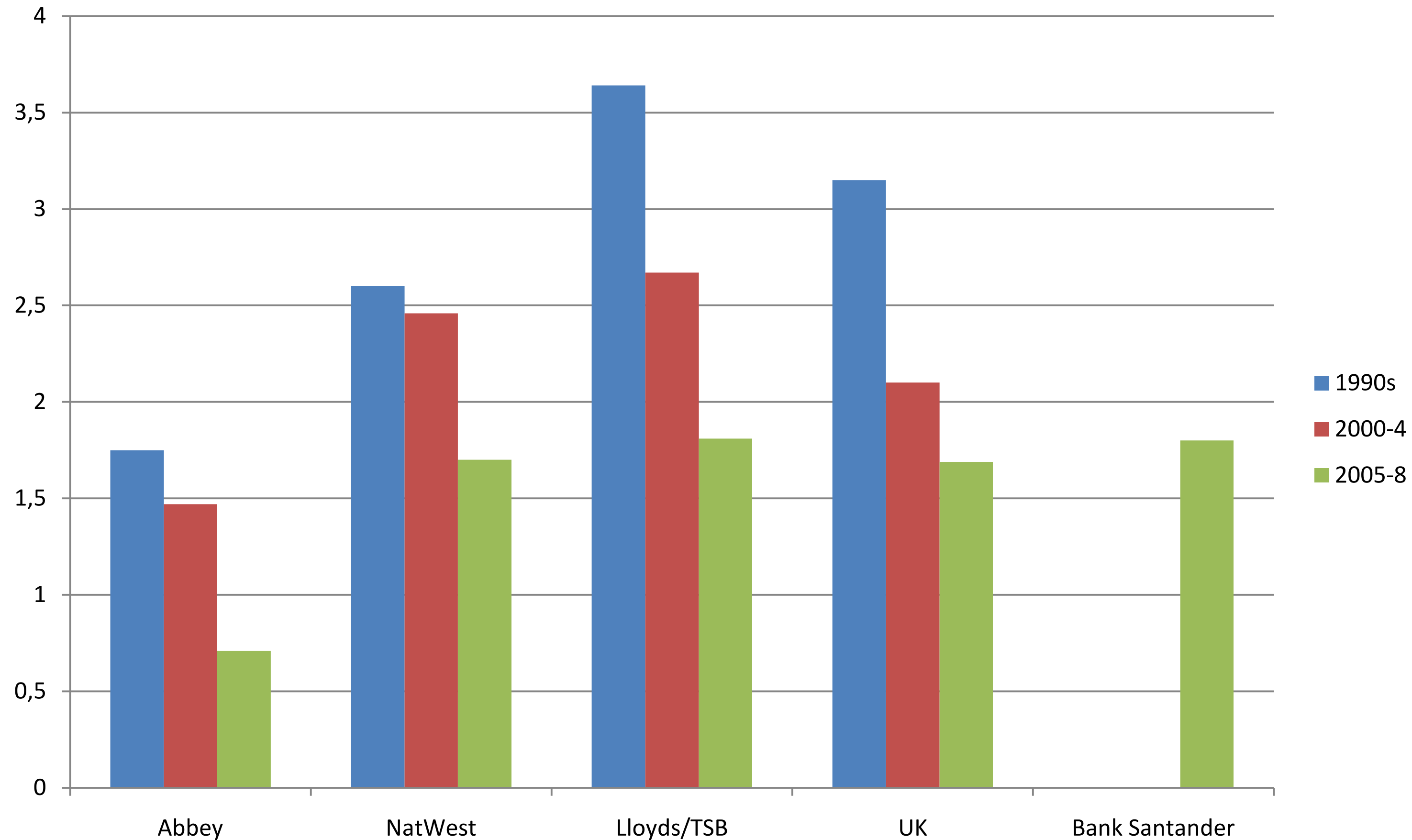

Efficiency = Overheads/Earning Assets

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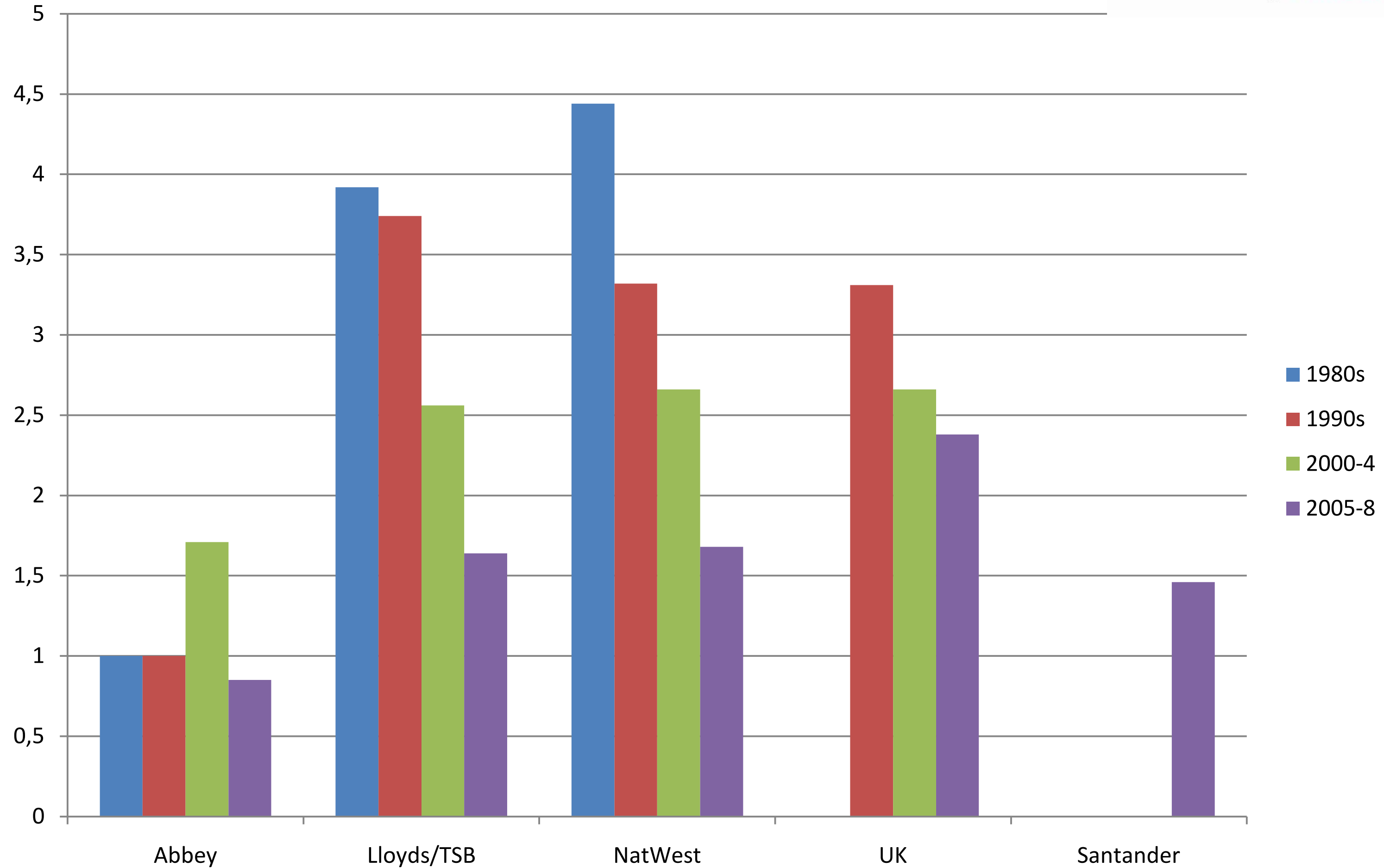

Overall

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- Model – restrictive and artificial
- NIM gap between Abbey and UK before takeover was 0.63
- After takeover was 0.98
- Efficiency gap between acquired bank and the rest before takeover = 0.95
- After takeover = 1.53
- So prediction based on a case study
- – pretty good!