

The Economic Effects of Foreign Bank Presence: Evidence from the Philippines

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This study examines the economic effects of the liberalization of foreign bank entry in the Philippines from 1990 to 2006. The empirical findings provide strong evidence on the dominance of competition effects from foreign bank presence which lead to the reduction in the profitability and overhead costs of domestic commercial banks. These findings, which reveal that both the actual market penetration and mere presence of foreign banks seem to exert competitive pressure to domestic banks, imply that foreign banks may serve as an effective competitive force, reducing the excess profits earned by domestic banks and compelling domestic banks to update their production technologies and techniques to improve their cost efficiency.

Consistent with the findings in the literature, as competition increases significantly, domestic banks cease to earn excessive profits, suggesting that the increase in foreign bank presence compels domestic banks to give up their sheltered “quiet life”. As a result, this could have pushed domestic banks to pay more attention to their cost efficiency by incorporating the superior techniques and practices of foreign banks. From a policy perspective, the findings on competition effects of foreign banks in the domestic banking system justify the liberalization of foreign bank entry in the Philippines. The main findings demonstrate that the goal of banking liberalization in transforming domestic banks to be more competitive and efficient works considerably well in the case of the Philippines. As expected, the Asian financial crisis posed additional pressure to domestic banks’ performance, as this condition may have derailed the momentum of financial liberalization. Aside from the policy of easing the entry of foreign banks, general market conditions can have significant impact on the performance of domestic banks. Therefore, a sustained improvement in the efficiency of domestic commercial banks requires not only liberalizing the entry of foreign banks, but also on continued strengthening of domestic prudential regulation and supervision on the commercial banking system.

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