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Effects of Foreign Banks Presence on Emerging Economies: Evidence from Tanzania

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Abstract
Foreign banks presence has increased rapidly since 1990 where emerging economies lifted restrictions in their financial systems. Currently the ownership of foreign banks in many developing countries is more than 50%. Academically the positive effects of foreign banks participation are widely accepted in these emerging markets. However unlike studies of foreign investment in real sectors, little has been done to understand the negative effects from foreign banks to domestic banks and society in general. The importance of such understanding is crucial, especially after the break out of the global financial crisis and pandemic Covid 19 which raises certain concerns regarding the market – driven model of these emerging markets. The paper highlights this trend and survey the existing literature in order to explore the effects of foreign banks presence in emerging economies paying particular attention to Tanzania banking sector. It has been observed that; Competition and efficiency, stability and access to credits are among the effects that have been influenced by foreign banks participation. The descriptive results also revealed that foreign banks perform better in term of ROA and ROE than domestic banks in Tanzania during 2017 – 2021, but the performance of foreign banks is unstable and risky as compared to domestic banks.
Keywords: Foreign banks presence, Domestic banks, Emerging Economies, Return on Asset, Return on Equity.
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1. Introduction

Since the mid-1990s, due to a growing trend across countries towards globalization and financial integration, banking sectors in many developing countries have experienced some important transformations. Key among them has been a rapid increase in the degree of foreign bank participation (R. Cull and M. Peria 2007). Despite variation in the degree and scope of their involvement across regions and countries foreign banks presence has grown significantly across the board of emerging economies. Between 1995 and 2002, the average share of banking sector assets held by foreign banks in 104 developing countries rose from 18 percent to 33 percent (R. Cull and M. Peria, 2007). In Sub-Saharan Africa, the increase in foreign bank participation was a fairly widespread phenomenon. Foreign bank participation increased in 22 out of the 30 in African countries (Cull and Peria, 2007). Foreign bank assets account for 42% of the total bank assets in the host countries in 2013 , and the average proportion of foreign banks in host countries increased from 29% in 1995 to 48% in 2013 (Yin 2019). According to Financial Sector Supervision Annual Report of Bank of Tanzania 2021, local and foreign owned commercial banks accounted for 59.9% and 40.1% respectively. Worldwide there are main arguments which support the opening emerging market financial sectors to foreign ownership. They argue, that the presence of foreign bank increases the amount of funding available to domestic projects by facilitating capital inflows, which in turn may increase the stability of available lending to the emerging market by diversifying the capital and funding bases (Huizinga, 2000). Different scholars argue that despite the fact that foreign banks promotes efficiency through enhanced competition and transfer of skills, however in most cases they pose challenges to policy makers in areas of managing liberation pace, upgrading supervision skills, and conducting monetary policy (Claessents, et all, 2001; Li-Gang, 2005). Different factors have been attributed as the major drivers of foreign bank participation. These factors include: banks' desire to service their customers abroad the so called "follow the clients" motive; host specific factors including market opportunities and regulatory barriers; and economic and cultural ties and institutional and regulatory similarities between home and host countries (Clarke et al. (2003);

In terms of the relations between foreign bank presence and financial sector development, patterns differ by host country. Specifically, in middle-income and high income countries, foreign bank presence tends to have an insignificant relationship with credit extended. In low-income countries, however, foreign bank presence is associated with less credit extended. In terms of financial stability, we find that foreign banks generally reduced their domestic credit during 2009 more than domestic banks did. Foreign banks did enhance the stability of domestic financial systems though in countries with majority foreign bank presence since their credit growth declined there less than that of domestic banks.

Previous studies show positive effects of foreign capital entry on bank performance because of competition in the domestic banking sector and efficiency in management. A number of recent papers investigate the impact of foreign entry on bank spreads and other variables (see for example Helhel (2015),Chantapong, S.(2010), Yu et al 2017 , Yin (2019) and Josephat Lotto (2016) . But despite this concentration, little researches have focused on the effect of these foreign bank presence in Tanzania, hence this has left a room for investigation in the country. Therefore the study aimed at establishing the effects that can be brought about by the foreign bank presence in Tanzania.

2. Literature review

There is an extensive literature, including empirical analyses, examining the effects of foreign bank presence to emerging economies, which is one of the most important aspects of the internationalization of banking services within a financially globalizing world. In some emerging and transition countries, most banks are large, subsidized, bureaucratic institutions that possess few financial skills and provide such low-quality services that they drive potential customers to transact in parallel markets. Since the 2008 financial crisis, especially with the recent trade dispute between the United States and China and the outbreak of the COVID-19 crisis, the debate on globalization has intensified, and the issue of whether bank globalization helps improve bank efficiency has become more prominent for policymaking, multinational banking strategy, as well as academic research. The purpose of this paper is to shed new light on the effects of foreign banks presence on domestic banks from different perspectives with an updated dataset. Specifically, we add to the literature in several aspects like bank performance in term of profitability.

There were countries case studies on the link between foreign banks, financial performance and bank efficiency on developing and emerging economies countries, such as those of Fujii et al. (2014) on India, Mulyaningsih et al. (2015) on Indonesia, and Josephet Lotto (2016) on Tanzania. Other cross-country studies, also focus on developing and emerging economies include the works of Konara et al. (2019) on eight emerging market economies, Williams (2012) on four Latin American countries. The advantage of foreign bank entering developing countries banking sectors have been discussed by many studies. Foreign bank participation brings advanced techniques to the banking business and enhances good governance. Azam and Siiddiqui (2012) examined the effects of foreign bank entry on the domestic banking sector in Pakistan. They concluded that foreign banks are more profitable than all domestic banks regardless of ownership structure. Many studies argue on what foreign banks bring to the host country's financial system. On the effects of bank presence in the time of crisis, Beck et al (2003) find that the likelihood of a crisis and the number of restrictions for foreign entry are positively correlated. In the literature, many results are put forward as benefits of and costs from foreign entry of banks. Foreign banks bring new technology, increase aggregate lending and bring new risk management techniques. In addition to above factors, Bonin et al.(2005) supports the view that, foreign banks bring more benefit than harm to the domestic market.

Studies made against foreign banks entries claimed that foreign banks captured the best customer segment and leave the domestic banks with the remaining risky customer group. However, Montgomery (2003) claims that foreign banks enter the banking sector targeting a specific segment, and thus they will not dominate the whole market. Yin (2019) and Wu et al (2017) both find that foreign banks entry increase bank risk. A series of empirical studies have shown that foreign banks are associated with greater efficiency and competition in a host country banking sector. Foreign banks have been linked to lower net interest margin, profitability, cost ratio and non- interest income for domestic banks in developing countries (Claessens and Lee, 2003, Bayraktar and Wang, 2004). Other empirical studies that compare performance of foreign and domestic banks find that foreign banks have high interest margin and profitability and lower overhead costs in developing countries (Micco, Panizza, and Yanez, 2007). In fact many authors agreed that foreign banks in developing countries are strong competitors and can increase pressure on domestic banks to become more efficient and competitive. Konara et al. (2019) tried to reconcile the discrepancies in the foreign entry–efficiency relationship by investigating the impact of financial sector FDI on different measures of efficiency (i.e., overall technical, pure technical, scale, cost, and revenue efficiencies) with a sample of eight emerging market economies. Their estimates show that foreign bank competition increases overall technical efficiency and scale efficiency, but has no clear impact on the other efficiency measures. Ally Z (2022) investigated efficiency of foreign and domestic banks in Tanzania and found out that foreign banks have exhibited a high efficiency level than domestic banks for all three efficiency scores. Josephat Lotto (2016) evaluated the financial performance of foreign and domestic banks operating in Tanzania and revealed that, both Return on Equity (ROE) and Return on Asset (ROA) of foreign banks are higher than those of the domestic banks.

3. Methodology

Data collection for this study was done thorough interviews (using both open and closed ended questions) and documentary.. Open ended questions were designed to obtain wide understand of the question at hand, while closed ended questions were designed to provide a particular information. (10) local banks were interviewed concerning the effects of foreign banks participation in Tanzania banking sector. Documentary review involved the review of various documents including: various publications of national or of international bodies and their subsidiary organizations; reports and publications of various associations and organizations connected with intangible cultural heritages; and lastly the reviews of various research reports and publications on the effects of foreign bank participation in general. The reason behind was to select only those respondents that were well informed with the issue of foreign bank participation activities in the banking sector. Some data were taken from general macroeconomic data for the period of 2017 – 2021. The data were analyzed using SPSS software and results were presented in tables, charts/figures.

4. Findings

4.1 Results on Foreign bank participation in Tanzania economy

The first point that the researcher wanted to establish was the extent of foreign bank presence in an economy. In this, the respondents were asked to provide if foreign bank are allowed to participate in the country's financial market. The results in this were as follows; Out of all 10 respondents that were questioned in this, all respondents seem to know the kind of activities that foreign banks engaged for. The question that follows was to establish their overall understanding on the effects that can be brought about by foreign bank participation in an economy. With this part two questions were posed to evaluate benefit and cost of foreign banks participation in Tanzania banking sector. In the benefit side, respondent were asked to evaluate different dimensions as benefits from foreign banks. The analysis shows that three types of benefits are expected to flow into the domestic banking sector. Many respondents choose competition and efficiency, more innovative products and transfer of knowhow as most evaluated benefits as shown in the table 1.1

Table 1.1 foreign bank's entries

Dimensions	5	4	3	2	1	Average
Competition and efficiency	7	2	1			4.6
Risk management	3	2	1			2.6
More innovative products	4	3	1		2	3.5
Transfer of know how	2	4	1	1	1	3.2
Greater access to international market	2	1	2	3	2	2.8
Boost to domestic banking sector	0	1	1	2	5	1.6

The competition and efficiency were ranked higher to their importance at an average of 4.6 followed by creating more innovative product to be the second with an average importance of 3.5. The results are consistent with many studies like Konara et al (2019), (Micco, Panizza, and Yanez, 2007, which suggest that foreign banks could force domestic banks to reduce management cost, increase management efficiency and improve financial services quality to maintain the market share. They can also bring state of art technology and training for domestic bankers and their presence can encourage other foreign firms to invest in the domestic economy. Some respondents agree even at lower level that foreign banks are familiar with sophisticated financial instruments and techniques, and have faster and cheaper access to international capital markets and liquid funds. The performance indicators for central banks in Tanzania confirm that foreign banks are more efficient than domestic banks .In the cost side investors were asked to evaluate some of the commonly discussed concerns country has when it decides to allow foreign bank entry. The question posed to local investors in banking sector and was demanding to evaluate the cost of foreign banks. The analysis shows that factors like cream- skimming behavior, fear of foreign domination and capital flight were among dimensions evaluated at their highest importance as shown in the table 1.2.

Table 1.2 Cost of foreign bank entries

Dimensions	5	4	3	2	1	Average
Lack of local commitment	2	1	3	1	3	2.8
Fear of foreign domination	7	1	2	0	0	4.5
Cream skimming behavior	9	1	0	0	0	4.9
Capital flight	6	2	1	1	0	4.3
Unhealthy competition	0	1	2	2	5	1.9

Cream skimming effect is the most concern to the local bankers as foreign banks serve out special group as their customers and really extend their services to the retail segment of the market and was ranked at highest level to its importance at 4.9 averages. Fear of foreign domination was ranked second at an average of 4.5, which mean that it is also a very important concern of foreign banks into local market. This is also a concern of many studies which explain that, unrestricted entry of foreign banks may result in their dominant positions in domestic market by driving out less resourceful domestic banks. They also fear that local depositors may have more faith in big international banks than in domestic banks. Another dimension which took the respondent mind was capital flight which was evaluated at an average of 4.3 of its importance. Many studies have talk about capital flight in which foreign banks are planned for encouraging an increase in capital flight from less developed countries to more developed ones.

4.2 Result on the effects of foreign bank's entry on Tanzania bank performance.
The scope of our study focused on the following performance measures: Return on Asset (ROA) and Return on Equity (ROE). To compare the performance between foreign owned banks and domestic owned banks, we use banks with majority foreign ownership to be foreign and majority local ownership to be domestic bank. Table 1.3 presented the variables. Of Return assets and return on equity.

Table 1.3 annual report of Bank of Tanzania (BOT 2021) ROA) and (ROE) of commercial banks in Tanzania

YEAR	Return on Assets (ROA)	Return on Equity (ROE)
2017	**1.2**	**4.7**
2018	**1.0**	**2.9**
2019	**1.9**	**7.1**
2020	**1.9**	**7.6**
2021	**2.8**	**11.5**

Sources: BOT Annual Report 2021

Table 1.4 The average level of ROA, ROE of foreign and domestic banks

YEAR	Domestic Return on Assets (DROA)	Foreign Return on Assets (FROA)	Domestic Return on Equity (DROE)	Foreign Return on Equity (FROE)
2017	**1.4**	**2.9**	**5.2**	**8.2**
2018	**1.2**	**3.1**	**3.8**	**7.1**
2019	**1.7**	**3.7**	**7.8**	**11.2**
2020	**1.6**	**3.9**	**7.5**	**11.5**
2021	**1.9**	**4.1**	**8.2**	**13.2**

The figure above shows that the average performance of foreign banks in term of ROA, ROE is higher than domestic banks.. As it is very difficult to guess any relationship between foreign and domestic banks through data table presented, we try to find their relationship through graph, regression and correlation analysis.

4.3 Descriptive statistics of foreign and domestic banks' ROA and ROE
The purpose of this section is to present statistics which examine the profitability, performance and riskiness of foreign and domestic banks in Tanzania. Table 1.5 represents the mean, standard deviation, minimum and maximum ROA, ROE for foreign and domestic banks during 2017-2021.

Table 1.5 Descriptive Statistic

	DROA	DROE	FROA	FROE
Mean	1.560000	6.50000	3.54000	10.24000
Median	1.600000	7.500000	3.700000	11.20000
Maximum	1.900000	8.200000	4.100000	13.20000
Minimum	1.200000	3.800000	2.900000	7.100000
Std . Dev.	0.270185	1.907878	0.517887	2.514558
Skewness	-0.122440	-0.554213	-0.24688	-0.186860
Kurtosis	1.829705	1.608737	1.396859	1.521577
Jarque- Bera	0.297824	0.659213	0.584916	0.484459
Probability	0.861645	0.719207	0.746427	0.784876
Sum	7.800000	32.50000	17.70000	51.20000
Sum Sq.Dev.	0.292000	14.56000	1.072000	26.29200
Observations	5	5	5	5

In table 1.5, indicated the descriptive statistics. The mean of foreign ROA is greater than domestic ROA, in which FROA is 3.54% where DROA is 1.56%. But their standard deviation seems to be almost low and equal, which mean that both foreign and domestic banks are less risky in term of their return of asset.

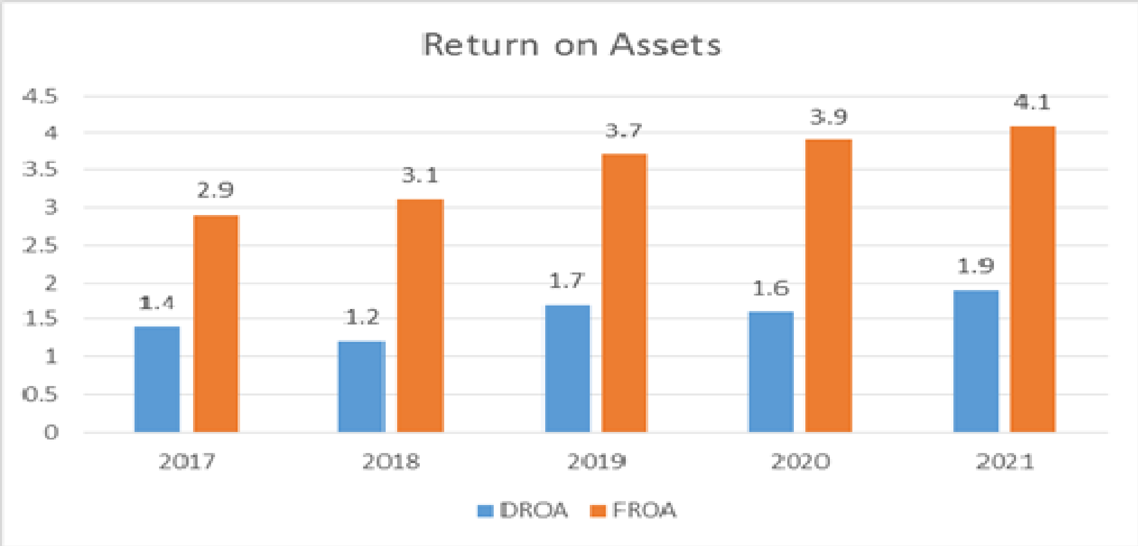

Figure 1.1 Return on assets for domestc and foreign banks

In case of ROE, the average figure of foreign banks over a period of 2017- 2021 is 10.24% compared to domestic banks of 6.5% with a difference in standard deviation .The difference is very significant because the greater foreign ROE with higher standard deviation indicate better with unstable performance of foreign banks compared with domestic banks

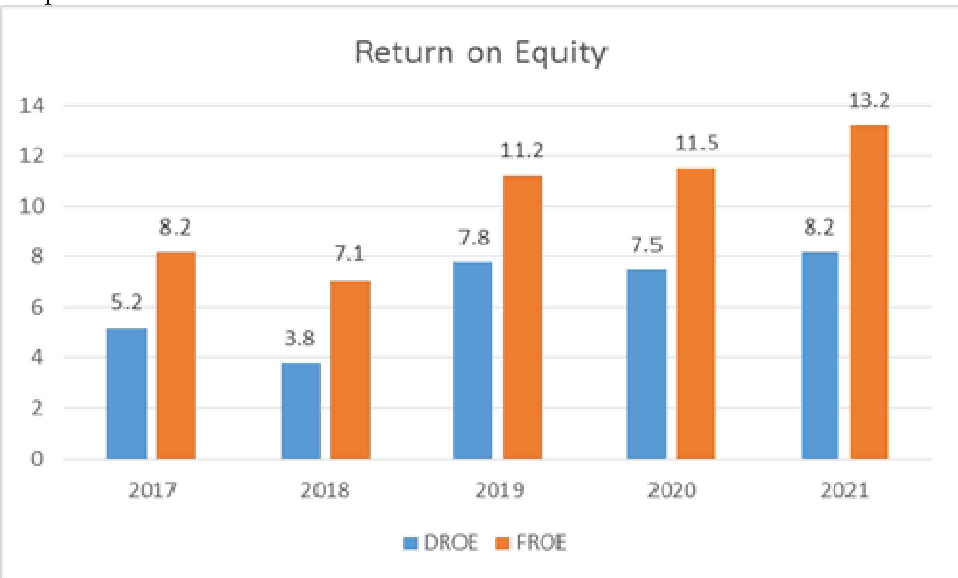

Figure 1.2 Return on equity for domestic and foreign banks

In general, we can summarized that foreign banks performed better than domestic banks in Tanzania during 2017 – 2021, but the performance of foreign banks is unstable and risky as compared to domestic banks. We also did separate regression analysis for ROA and ROE. The regression analysis of ROA is presented in the table 1.6

Table 1.6 ROA Regression analysis

Variables	Coefficient	Std Error	T statistic	Probability
FROE	0.440923	0.016580	26.59418	0.0000

The results indicated that FROA has positive relationship with DROA and statistically significant. This implied that FROA can influence the growth of DROA by 44%. This also may indicate that the presence of FROA can stimulate the growth of DROA. Hence, more foreign banks investment can accelerate the expansion of domestic banks.

Table 1.7 ROE Regression analysis

Variables	Coefficient	Std Error	T statistic	Probability
FROE	0.639525	0.021711	29.45587	0.0000

The table 1.7 revealed that FROE has a positive relationship with DROE and statistically significant which implies that FROE can influence the growth of DROE by 64%. Therefore, more foreign banks presence can accelerate the expansion of domestic banks. As seen in Figire 1.3 indicated that the normality test result showed that the data were residually normally distributed.

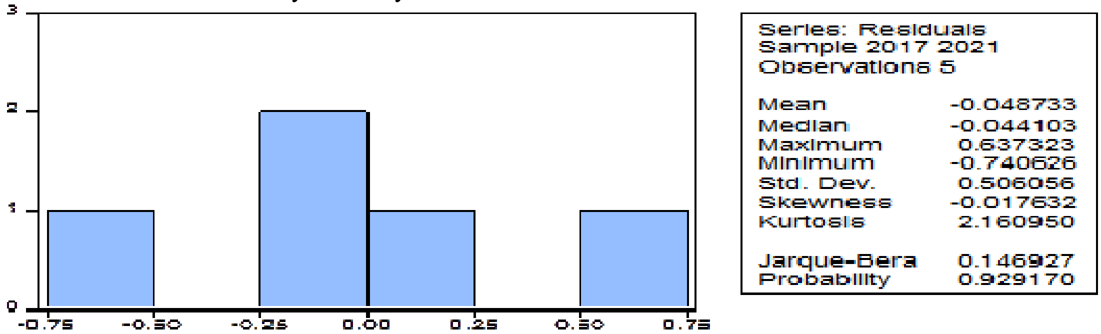

Figure 1.3 Normality Test

The result indicated that there were no serial correlation as table 1.8 depicted.

Table 1.8 serial correlation

F-statistics	0.546052	Prob. F (2,) 0.6848
Obs R-Square	1.728467	Prob. Chi-Square(2) 0.4214

Stability test

In Figure 1.4 revealed that of stability test over CUSUM showing the recursive residual test have accepted the stability test at 5% level of significance, since the blue line of both CUSUM was located within two red line, meaning that the mode is stable.

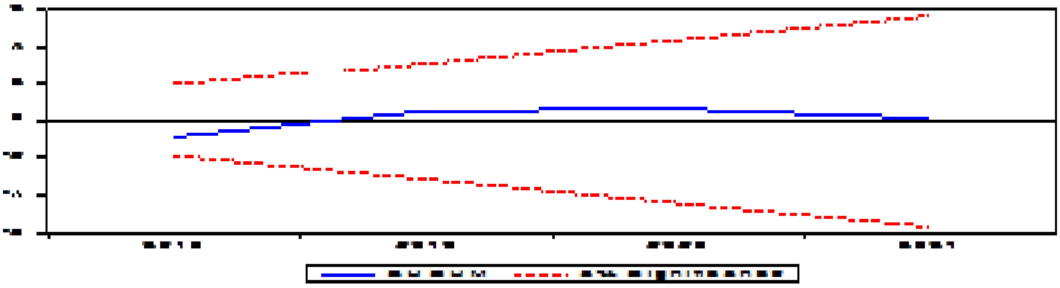

Figure 1.4 Stability Test

5. Conclusion

The overall understanding on the effects that can be brought about by foreign bank participation in banking sector was established. Many respondents choose competition and efficiency, more innovative products and transfer of knowhow as most evaluated benefits. In the cost side the analysis shows that factors like cream-skimming behavior, fear of foreign domination and capital flight were among variables evaluated at their highest importance. The low level of institutional quality in developing countries encouraged the researcher to examine the important aspects of institution so that suitable policies can be drawn.

A part from questionnaire survey research introduced the methods for measuring the performance of banks, reviewed some literature on performance comparison between foreign and domestic banks, and commented on the various viewpoints about the effect of foreign bank investment. The study was particularly intended to show how ROA and ROE were affected due to the entry of foreign banks. Regressive analysis of foreign banks suggested that greater foreign entry is positively significant associated with ROA and ROE.

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