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Research Article

Is there a liability of foreignness in global banking? An empirical test of banks' X-efficiency

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Abstract

When a company operates outside of its home country, it may suffer a 'liability of foreignness.' Does this a priori theoretical expectation hold in the global banking industry? Banks increasingly compete outside of their home countries, and operating environments often differ sharply across countries, both in terms of financial markets and credit risk. In this paper, we report the results of an empirical test of the liability of foreignness in the global banking industry, using Fitch–IBCA BankScope data for the period 1989–96. Our findings strongly support the liability of foreignness hypothesis. Further, the data show some evidence that the X-efficiency of a foreign-owned bank is strongly influenced by the competitiveness of its home country and the host country in which it operates. Lastly, we find that in some environments U.S.-owned banks are more X-efficient than other foreign-owned banks in some environments, but less X-efficient in others. Copyright © 2002 John Wiley & Sons, Ltd.

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