What do New Zealand bank customers understand about the risks of dealing with foreign and New Zealand owned retail banks?

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Abstract

This research has sought to develop an in-depth awareness of what New Zealand banking customers understand about the potential risks of dealing with foreign-owned retail banks, relative to those that are New Zealand owned. For the purpose of this study, a mail-out questionnaire was developed in joint collaboration with Xiaojie Zhuang, a Master's research student in the Department of Finance, Banking and Property at Massey University (Palmerston North). Using assistance by way of a Reserve Bank of New Zealand grant, the questionnaire was distributed to 2250 randomly selected persons throughout New Zealand. Overall, the key results showed that most respondents have a reasonable understanding of which institutions are foreign or locally owned. It also found that the most important risks facing banks at present are foreign exchange risk (a bank's inability to hedge its foreign currency exposure) and credit risk, (a bank's inability to provide sound grounds for lending). It found that banking ownership, whether it is foreign or local, does not change the way in which New Zealand banking customers perceive these risks. This study found that the majority of respondents felt that, while foreign-owned banks may reduce market profitability, they do not detract from the stability of the New Zealand financial system.

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Table of Contents

List of Tables

CHAPTER 1

INTRODUCTION

1: Introduction

1.1 Background to the Research

The opening up of financial marketplaces through deregulation, particularly since the 1970s, has been followed by the growth of multinational financial organisations. These developments have given rise to a need to investigate and further understand the implications of foreign banking involvement on the stability of domestic financial marketplaces.

In New Zealand, the issue of foreign bank ownership is particularly significant; with 98% of the total banking system assets being foreign-owned (Mortlock, 2003). Embedded within this level of foreign ownership, is the fact that Australian banks own all of New Zealand's major retail banks and 85% of New Zealand's financial marketplace (Hull, 2002). Although research into the impacts of foreign-owned banks on the New Zealand financial system is very limited, previous results have highlighted a number of important factors.

New Zealand based research by Hull (2002), Evans and Quigley (2002), and Mortlock (2003), showed that because of New Zealand's high level of foreign-bank ownership and interdependency with Australia, the New Zealand financial system could be susceptible to financial contagion spreading from Australia into New Zealand. There is also the major issue that if trouble did arise offshore, funds may be transferred out of New Zealand to support a foreign parent. Or, from an alternative perspective, a lack of financial support by a foreign parent should its New Zealand branch or subsidiary face financial failure. Despite these fears, Hull (2002), Evans and Quigley (2002), and Mortlock (2003), have all acknowledged that a high level of foreign-bank ownership is good for New Zealand, and that foreign-owned banks have enhanced the efficiency of the New Zealand financial system and its ability to manage in a crisis. The key reason behind these improvements is the fact that these foreign-owned firms were able to access international capital markets at a lower cost than the smaller locally-owned banking organisations (To and Tripe, 2002).

From an international perspective, previous research has shown that foreign-owned banks can impact the local financial system in a number of ways; some of which differ from previous New Zealand based findings. Studies by Claessens *et al,* (2001); Crystal *et al,* (2002), Dages *et al,* (2000), and Goldberg *et al,* (2000), showed that during the Argentinean financial crisis, foreign-owned banks provided a stabilising effect on the financial marketplace, by providing more effective risk management practices and better access to foreign capital markets. From a negative perspective, studies by Miller and Parkhe (2002), Rittippant (2004), and Zaheer and Mosakowski (1997), have found that foreign-owned banks incur a number of costs (referred to as the theory 'liability of foreignness') that domestic firms do not, and that as a result, foreign firms have lower cost and profit efficiencies than domestic banking institutions. Research by Peek and Rosengren (1997) into risk dimensions of financial trading rooms in Japan and the United States, found that financial risks can spread from the parent bank's home market into the local markets of its subsidiary branches.

Overall, the results of both the international and New Zealand based studies have demonstrated the need for the Reserve Bank of New Zealand (Reserve Bank)[1] to ensure that the foreign-owned banks that operate in this country act prudently, have sound risk management practices and conduct their business in a manner that reflects the best interests of their New Zealand banking customers; not just those in their home marketplace (Bollard, 2004a; Mortlock, 2003).

Because of the potential ramifications of foreign ownership of banks, and the limited New Zealand material available, it is imperative that more is done to understand the potential impact of foreign-owned banks on the New Zealand financial system. In this research, this has been achieved by examining the way in which New Zealand banking customers perceive the risks and relative implications of dealing with foreign-owned retail banking organisations. As part of this, the researcher also examined the role of the Reserve Bank in monitoring the behaviour of banking

[1] Unless otherwise stated, the term "Reserve Bank" refers to the Reserve Bank of New Zealand.

institutions in New Zealand, and the level of knowledge that banking customers have on the issue of deposit insurance.

This research has therefore attempted to fill a gap in the published body of knowledge on the perceived risks of foreign-bank ownership in New Zealand, and the level of understanding that New Zealand banking customers have about the safety of their banking deposits.

1.2 The Research Problem

1.2.1 Problem Statement

Given the paucity of empirical evidence regarding the perception of foreign bank ownership in New Zealand, this research has sought to contribute to the body of knowledge, by exploring New Zealand banking customers' perception of the risks and relative impacts of foreign-owned retail banks.

1.2.2 Aim of this Research

The aim of the study was to develop an in-depth awareness of what New Zealand banking customers understand about the potential risks of dealing with foreign-owned retail banks, relative to those that are New Zealand owned.

1.2.3 Objectives of this Research

To achieve this aim, this research has the following objectives:

1. To ascertain the extent to which New Zealand banking customers know which banks are foreign and locally owned.

2. To determine the perception of the risks that foreign and locally owned banks face in New Zealand.
3. To ascertain the effect that bank ownership has on the perception of banking related risks.
4. To ascertain what factors affect the perceived risk of a locally or foreign-owned bank.
5. To determine the perceived impact of foreign bank ownership on the stability and profitability of the New Zealand financial system.
6. To determine what New Zealand banking customers know about the issue of Government policy and its involvement within the New Zealand banking system.

1.3 Structure of the Thesis

This thesis is composed of seven chapters. Following this introductory chapter is a background discussion of the New Zealand banking system. The chapter discusses a number of issues, including: what is meant by the term 'bank'; the history, structure, and the regulatory provisions that govern the New Zealand banking system; and the different types of risks that banks face.

Chapter three reviews a range of prior empirical studies relevant to the issues covered in this thesis. The review synthesises and evaluates literature, from an international (generally emerging market) and New Zealand perspective, the costs and implications of foreign banking ownership on domestic banking systems.

Chapter four outlines the methodology used to address and justify the type of research technique included in this research. It also outlines who the participants were, how they were selected, and the reasons behind their selection. The methodology is quantitative and incorporates a mail-out questionnaire to further investigate the issues identified in chapter two. Chapter five reports the findings of the primary research. Chapter six discusses the findings and, where relevant, draws comparisons with previously published research. Chapter seven summarises, and draws conclusions from the key issues discussed in previous chapters. It also identifies issues for further research and discusses some of the limitations of this thesis.

1.4 Limitations

There are a number of limitations to the generalisability of the findings from research undertaken in this thesis. These are as follows:

1. The primary research is geographically limited to New Zealand and findings may not be reflective of what might be found in other countries.
2. The study's focus is aimed specifically at retail banks and does not take into consideration the risks present in wholesale banks.
3. Those that responded to the mail-out questionnaire may have a special interest or knowledge of the topic being researched. This may increase this research's susceptibility to bias.
4. The use of a mail-out questionnaire may increase the response error of the research. This is because the respondent, with no researcher control, may misinterpret a question's instruction and/or meaning, which could lead to an invalid response.
5. As there will be no researcher control during the completion of the questionnaires, there is also the risk that respondents may take the time to find the 'correct' answers, rather than give an honest perception of their own understanding or interpretation of the issue.
6. The sample size of the research may mean that the results will only provide a general indication of what wider behaviours could be.

Despite these limitations, it is expected that the findings will be a valuable addition to the level of knowledge that exists about these issues in New Zealand and will suggest worthwhile directions for further inquiry into the subject being discussed.

1.5 Chapter Summary

This chapter laid the foundations for the thesis by explaining the importance of the topic and why it is worthy of research. It introduced, by means of a brief literature review: New Zealand's interdependent relationship with Australia; the liability of foreignness theory; the implications of foreign bank ownership in emerging nations and New Zealand; and the role the Reserve Bank plays in safeguarding the New Zealand financial system. This chapter also introduced the research problem, the primary aim of the research, and the objectives that have been established to achieve this aim. An outline of the proposed course for the thesis was given which included the proposed research methodology and its anticipated limitations. The thesis now moves on to examine, in chapter two, the New Zealand banking system.