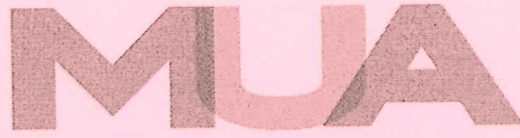


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POST GRADUATE UNIVERSITY EXAMINATIONS
SCHOOL OF MANAGEMENT AND LEADERSHIP
DEGREE OF MASTER OF BUSINESS ADMINISTRATION

BFO 502: INTERNATIONAL BANKING PRACTICES

DATE: 27TH NOVEMBER 2023

DURATION: 3 HOURS

MAXIMUM MARKS: 60

INSTRUCTIONS:

1. Write your registration number on the answer booklet.
2. **DO NOT** write on this question paper.
3. This paper contains **FOUR (4)** questions.
4. Question **ONE** is **compulsory**.
5. Answer any other **TWO** questions.
6. Question **ONE** carries **30 MARKS** and the rest carry **15 MARKS** each.
7. **Write all your answers in the Examination answer booklet provided**

QUESTION ONE

Read the Case Study below carefully and answer the questions that follow:

THE GLOBAL MACROECONOMIC, FINANCIAL AND REGULATORY ENVIRONMENT

The liberalization of international trade and capital markets has gone hand in hand with a dramatic increase in economic integration at the global level. Restrictions to foreign bank entry have been gradually eased by bilateral and regional trade and investment agreements. In particular, the General Agreement on Trade in Services addressed several issues regarding international banking by calling for a higher degree of openness to foreign banks among World Trade Organization members.

The internationalisation of banking activity has followed naturally from, and has itself contributed to, this universal drive towards economic integration across countries. Global integration has opened the way for the international transfer of best practices in banking and for a more efficient use of resources. At the same time, financial integration also facilitates the transmission of shocks across countries. In literature, there is a general consensus on the economic links between developments in the real sector and banks' international activities (Goldberg and Johnson (1990), Moshirian (2001), Focarelli and Pozzolo (2005)).

First, banks have a natural incentive to follow their multinational non-financial customers. Second, globalisation goes hand in hand with an increase in the demand for bond and securities underwriting and M&A advice, which is a pull factor for international investment banks. Third, the increase in the number and size of multinational non-financial enterprises has also created a demand for very large loans, often managed as syndicated loans by pools of global financial institutions (Houston et

al (2007)). Technological advances have reinforced the impact of economic integration on international banking. By improving access to hard information on borrower or collateral characteristics, technology has enhanced the development of economic and statistical models, paving the way for broader access to bank credit, new forms of securities and improvements in risk management. The associated benefits have offset (at least partially) the costs of doing business in locations far from the head office. Over the past 25 years, economic integration went hand in hand with deregulation and a trend towards international harmonisation of banking supervision and market infrastructure. By significantly reducing the costs of foreign operations, deregulation fostered international M&A, greenfield investment and the provision of cross-border financial services (Focarelli and Pozzolo (2005), Buch (2003), Buch and DeLong (2004), Buch and Lipponer (2007), Berger (2007)).

The impact of eliminating cross-border differences in supervisory practices has been seen most clearly in Europe, where international banking picked up significantly after the "single banking licence" was introduced in 1989 (by the Second Banking Directive) and EU member states implemented 27 directives under the Financial Services Action Plan (Kalemli-Ozcan et al (2009b)). Likewise, the creation of an efficient and uniform cross-border wholesale payment system (TARGET) has led to an integration of the euro area for wholesale activities. By contrast, the lack of such a payment system for retail activities has contributed to the fragmentation of retail banking within the euro area.

The profit-maximising strategy behind banks' international activities is affected by, inter alia, economic developments and the regulatory environment in the home country. Thus, it should come as no surprise that literature has identified relationships between domestic economic, financial and regulatory conditions and the size and form of banks' business abroad. Conditions in home countries have helped explain different - both structural and transitory - features of international banking. For example, Schoenmaker and Van Laecke (2007) report evidence of a positive relationship between the degree of internationalisation of large financial institutions and indicators of economic

development and financial sophistication in their countries of incorporation. By extension, these findings suggest that the relatively underdeveloped economic and financial environment in China lies behind the domestic focus of Chinese banks, which rank among the largest banks worldwide. In turn, McGuire and Tarashev (2008) show that shocks originating in home countries can explain short-term swings in cross-border lending by internationally active banks to emerging market economies. A push factor, related to the degree of development of financial systems, has been the increasing competition among banks and between banks and other market players, eg money market funds (Gorton (2010)). This trend, which has accelerated over the last 25 years in mature systems, has put pressure on profit margins at home, encouraging banks to expand their customer bases abroad and stimulating financial innovation.

The trend of international expansion was reinforced by the rise of securitisation, which has expanded banks' financing options by allowing them to match more closely the specific needs of different investors. In some cases, government policies have also acted as a push factor for international banking. This might occur through deregulation that results in increased competition among domestic and foreign financial institutions or through restrictions in the home country, which banks attempt to avoid by redirecting part of their business abroad (Jones (1990)). For example, the regulatory environment and interest rate controls in Japan in the 1980s resulted in domestic banks routing a large portion of their lending to Japanese firms through international financial centres. Earlier, the rise of the eurodollar market in the 1950s stemmed from US government restrictions on interest paid on deposits within the United States and UK government restrictions on sterling lending by UK banks. Likewise, the establishment of subsidiaries abroad prior to 1999 allowed US banks to undertake investment banking activities they could not undertake in the United States. Evidence in support of this view is provided by Miller and Parkhe (1998), who find that restrictions on universal banking in the United States lead to a greater percentage of US subsidiaries (as opposed to branches) in host countries without such restrictions.

Required

- a) Formulate five features of international banking as identified in the above case study **(10 Marks)**
- b) Evaluate five drivers of internationalization of the banking activities as discussed in the case study **(10 Marks)**
- c) "A push factor, related to the degree of development of financial systems, has been the increasing competition among banks and between banks and other market players,". Assess any other five risks sources of risks in international banking as elucidated in the case study. **(10 Marks)**

QUESTION TWO

- a) "The drop in credit demand from both the non-financial corporate sector and households has been a direct manifestation of global recession. The demand for trade credit, for instance, declined dramatically against the backdrop of shrinking world exports and falling commodity prices". Illustrate any five advantages of using letters of credit as international banking instruments **(10 Marks)**
- b) "As international banking evolved over the years, the international dimension of financial stability increased in importance and economic agents gained access to a broader range of financial services". Evaluate the importance of offshore banking centers as international banking offices **(5 Marks)**.

QUESTION THREE

- a) From the perspective of the global system, the internationalization of banking influences cross-border risk-sharing. Enhanced risk-sharing is generally beneficial

for financial stability. Assess the role of the International Monetary Fund in International lending **(5 Marks).**

- b) "The ability to access and manage cross-border risks also determines whether foreign banks alleviate or add to local strains during a crisis". Analyze the role of strategic decision making in international banking **(10 Marks).**

QUESTION FOUR

- a) "Green banking is an emerging area of creating competitive advantages and new business opportunities for private sector banks and expanding the mandate of central banks and supervisors to protect the financial system and manage risks of individual financial institutions". Examine any five challenges in implementation of green banking in Kenya. **(5 Marks)**
- b) "The rapid transmission of shocks across the global financial system through internationally active banks, together with the concurrent macroeconomic problems, has prompted calls for improvements to these banks' business models that will strengthen their risk and liquidity management". Critically assess any five emerging trends in international banking. **(10 Marks)**