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(Special Issue Editorial)

Abstract

Purpose: The purpose of this special issue is to gain a deeper understanding of banking regulatory practices in emerging markets in the light of the financial crisis of 2007-08. The crisis necessitated countries to adopt macro-prudential policies in the current environment of globalized capital flows. The interconnectedness of financial institutions occurs not only across the world but also across a plethora of financial markets.

Design/Methodology/Approach: The papers in this volume have a focused approach that addresses issues relating to the banking sector. The papers explore diverse issues such as the link between increased competition and the performance efficiency, application of macro prudential norms in credit growth and its relation thereof with the ownership pattern of banks, co-ordination between regulations and compensation in the event of bank failure and risk based regulation. All the papers are country specific and they take in India, Hong Kong and Nigeria.

Findings: The papers offer rich insights in to the different approaches to regulatory practices and are nuanced to specific countries. They will contribute to a better understanding of the various issues and will be of great use to academics for further research and for practitioners in new policy initiatives in the area of banking reform and regulation.

Originality/Value: All the papers are original contributions and it is our view that they will lead to better calibrations of policies so that crises can be better managed or averted altogether.

Keywords: Emerging markets, Banking regulations, Financial markets laws, Global financial crisis, Policy development

Paper type: General review

We are honored to be the guest editors of this special issue of '*Banking and Financial Regulation in Emerging Markets*'. In light of the economic deregulation and financial policy amendments, there is a great deal of capital-flows and interconnected financial activities between the developed and developing countries. As such, banking operations have become very complex and some financial institutions through their sheer reach, across geographies and markets have become 'too big to fail'. For example, Valdez (2003, pp. 25-26) suggest that international banking involves a variety of activities such as deposits/loans to countries but also covers cross-border operations, trade finance, foreign exchange, corresponding banking, international payment services and so on. In view of that, macro prudential norms have become essential and while most central bankers agree on this in principle, the actual practice among different countries exhibits some diversity.

The global financial system has faced several crises like the Asian financial crisis (1997), dot-com bubble (1997-2000), and the recent sub-prime crisis (2007-09) that have led governments and regulators to take preventive actions in ensuring financial markets stability (Paulet, 2011; Reddy *et al.,* 2014). In particular, Paulet (2011) suggest that "regulation is a necessary but not sufficient condition to ensure the efficiency of banking and financial markets; therefore these institutions should be refocused on the collection and distribution of long term lending and retail activities". Likewise, Mullineux (2006) also describes that banks require good regulation that should be aimed at limiting the excessive risk taking, and attention to conflicts of interest and competition issues, especially given the clear information advantage of banks over their retail customers (p. 381). Overall, regulatory systems and corporate governance practices must be widespread and well-balanced (Petitjean, 2013). In a recent study, Barth *et al.* (2013) survey the bank regulatory and supervisory policies in 180 economies during 1999-2011 and infer that "there has not been a convergence in bank regulatory regimes over the past decade despite the worst global financial crisis since the Great Depression". More importantly, the market for mergers and acquisitions in banking and financial sector has sharply increased around the crisis, especially in emerging markets (Reddy *et al.,* 2011, 2013).

Conversely, de Mendonça *et al.* (2012) suggest that the regulation and transparency of the Brazilian financial and banking system could be progressed through an optimal balance between governmental regulation and market discipline. Furthermore, apart from the crisis a given economy should monitor and control unethical actions, like insider trading, money laundering, white-collar crimes and other undesirable practices. However, emerging countries should realize that simply adopting western practices in local environment might not produce better economic results due to several institutional issues. For instance, Guo *et al.* (2013) mention that some corporate governance mechanisms associated with developed countries have no significant impact on firm performance in China because of the strong governmental influence on state-owned enterprises.

With this backdrop, the special issue welcomed scholars to submit their research work on the aforementioned themes. Following the double blind review system, we have accepted four articles out of 22 submissions. We believe that the selected papers published in this special issue constitute a representative sample of what is welcome and we hope readers will enjoy reading them. Thus, papers offer rich insights in to the different angles of regulatory practices and are nuanced to specific countries. They will contribute to a better understanding of the various issues and will be of great use to academics for further research and for practitioners in their new policy initiatives in the area of banking reform and regulation.

Saibal Ghosh contributes a paper titled '*Credit growth and macro prudential regulation: Is ownership important?*' The paper examines the impact of macro prudential policies (MPPs) on credit growth. It uses quarterly data on Indian commercial banks for the period 2002:1 to 2012:1 that subsumes the imposition of MPPs. It suggests that MPPs targeted on provisions are relatively more effective in limiting credit expansion. Given the predominantly bank-based nature of the financial system, macro prudential policy measures have been focused primarily towards banks so that the possible contagion from serious disruption is well contained.

Eva Kan and Mahmood Bagheri contribute a paper entitled '*Banking crises and Hong Kong: Coordination between regulatory measures and compensation schemes (bailout, deposit insurance and insolvency laws).*' The paper will fill a gap in the literature regarding bank failures, particularly the recent financial crisis affecting financial centres such as Hong Kong. The current literature puts emphasis on one important aspect of the problem by taking into account the overall picture in both legal and non legal mechanisms. It not only links the *ex-ante* preventive regulatory measures to the macroeconomic consideration for the prevention of future banking crises, but also identifies a number of *ex-post* compensation schemes, followed by examination of the level of coordination between them. It argues that unless there is coordination between these two paradigms, financial crises are inevitable. Given the globalised nature of financial markets and the domestic nature of regulatory laws and compensation schemes, it suggests that there is a necessity of more coordination between national authorities to prevent future banking crises.

Kenneth Ajibo contributes a paper titled '*Risk-based regulation: The future of Nigerian banking industry*.' The paper posits that the future of Nigerian banking industry lies in a risk-based framework in line with global best practices and international standards in banks. It aims to determine how adopting a risk-based framework as a regulatory governance model can improve the investment landscape in the sub-sector. While drawing attention to the frequent distress and failures in the banking sub-sector, relying solely on recapitalisation strategy and obtaining information from rating agencies in order to determine the health of banks in Nigeria is highly insignificant. This is more so when the rating institutions are embroiled in accountability deficits and are being regulated in developed economies. It is argued that this risk-based regulatory paradigm when implemented will further boost the nation's investment profile and reposition the continent's largest economy as the investment destination centre in the sub-Saharan Africa.

Rakesh Arrawatia, Arun Misra and Varun Dawar contribute a paper titled '*Bank competition and efficiency: Empirical evidence from Indian market*.' The relationship between competition and efficiency, though important, has not been explored for the Indian banking system. By offering insights into this relationship, the paper provides a new perspective to the structure-performance relationship. The Lerner index is measured for the period 1996 through 2011 and a data envelopment analysis technique is applied to provide insights into efficiency levels in the banking sector. It shows that over the period, there has been an improvement in competitive levels in the Indian banking sector. Based on granger causality tests, it suggests that increase in competitive levels can positively affect efficiency in the banking sector. It also provides regulators and policy makers with new insights into important strategic decision parameters.

Nominated Paper from this Special Issue to the Journal Annual Awards

Title: Credit growth and macroprudential regulation: Is ownership important?

Author: *Saibal Ghosh, Reserve Bank of India, Mumbai, India*

Nominated Reviewer from this Special Issue to the Journal Annual Awards

Vipul Singh, Assistant Professor, Institute of Management Technology, Nagpur, India

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