Impact of Foreign Bank Presence on Domestic Banking Efficiency: An Institutional Perspective from Uzbekistan

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Abstrak *: This study examines the impact of foreign bank presence on domestic banking efficiency through an 18-year longitudinal case study of KDB Bank Uzbekistan between 2006 and 2024. Framed by institutional theory, particularly the Burns and Scapens process model and the concept of institutional isomorphism, the study investigates how foreign bank entry influences competition, operational efficiency, technology diffusion, and organizational change in the Uzbek banking sector. The research adopts a mixed-methods sequential explanatory design that combines financial statement analysis, Data Envelopment Analysis (DEA), Stochastic Frontier Analysis (SFA), difference-in-differences estimation, 22 semi-structured interviews, a survey of 156 banking professionals, and documentary analysis. The findings indicate that foreign bank entry contributed to lower market concentration, improved domestic cost efficiency, wider adoption of digital banking infrastructure, and stronger risk-management practices. In particular, lower cost-to-income ratios among comparable domestic banks indicate an efficiency gain rather than deterioration. The study also shows that spillover effects operated through competition, staff mobility, benchmarking, and regulatory learning. Theoretically, the article extends institutional explanations of banking change in an emerging market setting. Practically, it offers evidence relevant to policymakers designing foreign bank entry strategies that both encourage modernization and protect balanced domestic banking development.*

Kata Kunci *: Foreign Bank Entry; Banking Efficiency; KDB Bank Uzbekistan; Institutional Theory; Uzbekistan*

INTRODUCTION

Financial liberalization since the 1990s has reshaped domestic banking in emerging economies through foreign bank entry, intensifying debates on competition, efficiency, and institutional development. Central Asia, including Uzbekistan, remains underexplored despite major post-Soviet reforms. Uzbekistan's shift from a monobank system and gradual openness is exemplified by KDB Bank Uzbekistan, the first fully licensed foreign bank in 2006, which introduced new products, standards, and technologies, pressuring domestic banks to compete.

The topic remains relevant as reforms continue, state banks retain a key role, and supervision modernizes. Evidence shows that foreign bank effects are heterogeneous and institution-dependent, underscoring the need to assess their long-term influence on banking practices and competition.

This study addresses three gaps: limited short-term focus (5–7 years), underrepresentation of Central Asia, and lack of explanation on how practices transfer from foreign to domestic banks. It applies an institutional theory approach to examine the 18-year impact of KDB Bank Uzbekistan.

This study answers three research questions:

RQ1: How has KDB Bank Uzbekistan's entry influenced competitive dynamics and operational efficiency in the Uzbek banking sector?

RQ2: How have the foreign bank's efficiency spillovers, technology transfer, and knowledge diffusion happened to domestic institutions?

RQ3: What changes have foreign banks made to institutions, and what problems have come up as a result of these changes?

This study applies Old Institutional Economics using Burns and Scapens' (2000) framework to explain how foreign bank entry introduces new routines that gradually become embedded through stages of rule creation, implementation, repetition, and institutionalization. The study contributes in three ways: it clarifies how regulatory, competitive, and mimetic pressures drive institutional change; provides rare long-term evidence from Central Asia linking efficiency with underlying processes; and offers policy insights for managing foreign bank entry and strengthening the domestic banking sector.

RESEARCH METHOD

The Research Design

This study uses a single case study design with embedded units of analysis [6], focusing on KDB Bank Uzbekistan while examining impacts on competition, efficiency, technology diffusion, human capital, and institutional change. It adopts a mixed-methods sequential explanatory approach [7], starting with quantitative efficiency analysis followed by qualitative insights to explain underlying mechanisms. The case is particularly suitable due to its status as the first fully licensed foreign bank in post-Soviet Uzbekistan and its 18-year trajectory (2006–2024), which enables observation of long-term institutional change. Rich data sources and multidimensional impacts further support a comprehensive and theoretically relevant analysis.

Data Collection

Data were collected using four triangulated methods. First, financial analysis covered KDB Bank Uzbekistan (2006–2024) and 15 peer banks using reports from

banks, the Central Bank, World Bank, and IMF. Second, 22 semi-structured interviews (bank executives, regulators, and experts) provided insights on sector conditions, responses to KDB's entry, and institutional change. Third, a survey of 156 banking professionals (52% response rate) measured perceptions of competition, technology, and foreign bank impact. Fourth, document analysis of regulations, bank materials, and public reports was used to validate findings and provide context.

Quantitative Analysis Techniques

This study applies multiple quantitative methods: DEA to measure efficiency (using inputs such as deposits, equity, costs, and staff, and outputs like loans and income), SFA for robustness, DID to compare banks with different exposure to KDB Bank Uzbekistan, and the Malmquist index to track productivity over time. Qualitative data were thematically analyzed to explain the mechanisms behind these results.

Formal Model Specification

DEA model: Efficiency is estimated by minimizing theta subject to linear production constraints under variable returns to scale, where theta <= 1 represents the proportional input contraction needed for a bank to become efficient relative to the frontier.

min theta, subject to -y_i + Y lambda >= 0; theta x_i - X lambda >= 0; e' lambda = 1; lambda >= 0.

Difference-in-Differences Model:

Efficiency_it = alpha + beta1 Treatment_i + beta2 Post_t + beta3 (Treatment_i × Post_t) + gamma Controls_it + mu_i + tau_t + epsilon_it.

In this specification, beta3 captures the estimated effect of foreign-bank entry on domestic-bank efficiency. Treatment_i identifies banks with stronger exposure to the contested corporate segment, while Post_t denotes the post-entry period. Controls include bank size, capitalization, loan quality, and macroeconomic conditions where data availability is allowed.

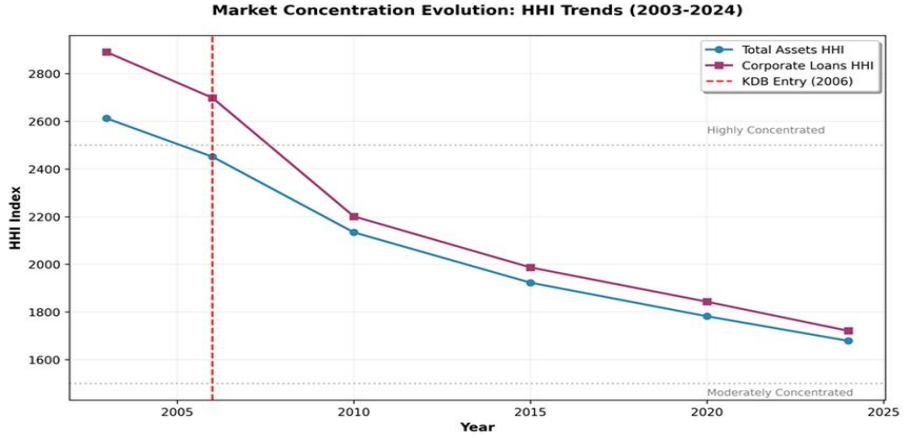

Figure 1. Market Concentration Evolution

Source: Central Bank of Uzbekistan; Author calculations

Strategy for Entering the Market and Business Model

The Korea Development Bank, established in 1954, expanded internationally in the 2000s and entered Uzbekistan due to Korean business presence, bilateral cooperation, and opportunities in underserved corporate banking. It chose a greenfield entry to fully apply its systems, focusing on corporate banking, trade finance, and

project financing with a premium, service-driven strategy. Its subsidiary, KDB Bank Uzbekistan, introduced advanced technologies such as the Temenos T24 system, Basel II–based risk management, and early online corporate banking, creating spillover effects through clients, labor mobility, vendors, and regulators.

KDB's performance evolved in three phases: initial setup (2006–2008), rapid growth (2009–2015), and steady consolidation (2016–2024). It achieved strong efficiency, profitability, and asset quality, consistently outperforming industry averages. By 2024, it held around 14% of banking assets and 11.3% of corporate lending, with a focused branch network and a dominant position in corporate and trade finance.

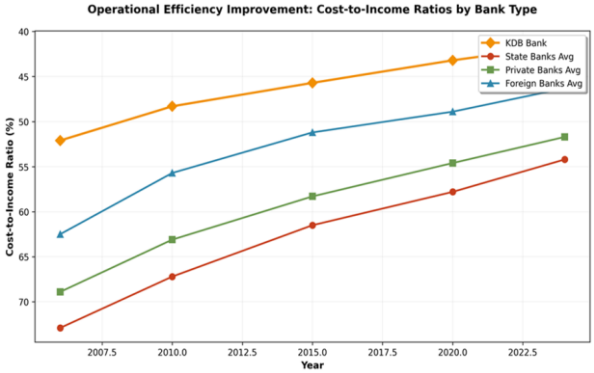

Figure 2. Operational Efficiency Evolution by Bank Type
Note: Lower cost-to-income ratios indicate higher efficiency
Source: Bank annual reports; Author calculations

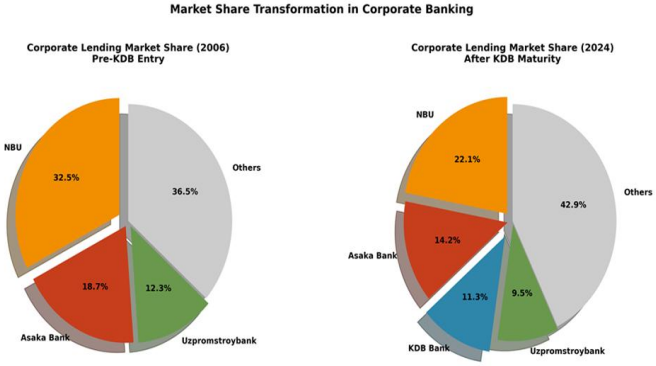

Figure 3. Market Share Transformation in Corporate Banking
Source: Central Bank of Uzbekistan; Author calculations

How it Affects Competition in the Market

The entry of KDB Bank Uzbekistan significantly intensified competition in Uzbekistan's corporate banking sector. Market concentration declined sharply, with the HHI for total assets falling from 2,451 (2006) to 1,679 (2024) and corporate lending from 2,698 to 1,721, shifting the market from highly to moderately concentrated. State banks (NBU, Asaka, Uzpromstroybank) lost 17.7 percentage points of market share, while KDB gained 11.3%, indicating real competitive redistribution. Pricing pressure increased, as sector net interest margins dropped from 6.7% to 4.2%, with the largest declines among state banks; regression results confirm significant additional margin compression (−0.72, $p<0.01$) for banks directly competing with KDB. Survey data support these findings: 81% of respondents reported stronger competition, with higher agreement among corporate-focused banks, alongside improved service quality (82%) and domestic bank responses (83%). Interviews reinforce that KDB's speed,

professionalism, and service quality—not pricing—were key drivers of competitive pressure.

Consequences of Efficiency Spillover

The evidence strongly supports the efficiency hypothesis (H1), indicating that KDB generated measurable pressure for domestic banks to improve operations. The cost-to-income ratio declined from 71.4% in 2006 to 52.1% in 2024, which signifies higher - not lower - efficiency. The difference-in-differences estimate of -0.087 ($p < 0.01$) indicates that banks more exposed to the contested corporate segment improved efficiency by an additional 8.7% relative to the control group. DEA and SFA results point in the same direction, strengthening the robustness of the conclusion.

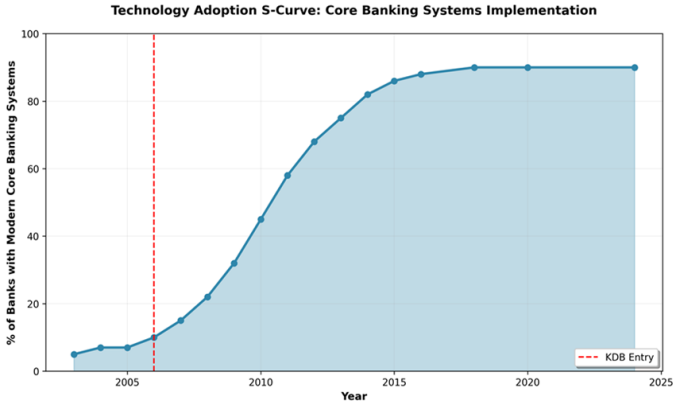

Figure 4. Technology Adoption S-Curve

Source: Bank annual reports; Central Bank surveys; Author calculations

The Transfer of Technology and the Spread of Knowledge

Technology diffusion followed a clear S-curve after the entry of KDB Bank Uzbekistan: core banking adoption rose from 7% (2006) to 90% (2024), with rapid uptake 3–7 years post-entry, consistent with delayed imitation. Innovations such as online corporate banking (introduced by KDB in 2009) and Basel II–based risk systems spread through mimetic behavior, later reinforced by regulation. Knowledge transfer was driven by labor mobility (77 staff moved from KDB to domestic banks), vendor spillovers (e.g., Temenos, FICO, SAS, McKinsey expanding from KDB to local banks), and professionalization. Certification growth (CFA, FRM, CPA/ACCA) and rising training investment reflect normative isomorphism, as domestic banks upgraded skills and standards to match foreign competitors.

How to Change Businesses

Evidence shows all three isomorphic mechanisms operate simultaneously. Coercive isomorphism emerged through regulatory changes influenced by KDB Bank Uzbekistan, including governance reforms (2007), AML/KYC improvements (2008), Basel II roadmap (2010), IFRS adoption (2012), risk-based supervision (2015), and Basel III alignment (2019). Mimetic isomorphism appears in strategic convergence, with references to “international standards,” “risk management,” “technology,” and “Basel compliance” rising sharply (e.g., international standards: 12% to 85%). Normative isomorphism is reflected in professionalization via training, certifications, labor mobility, and knowledge-sharing forums. Survey results confirm this shift, with 76% noting increased professionalism, 81% higher standards from foreign banks, and 69% improved career development post-2006.

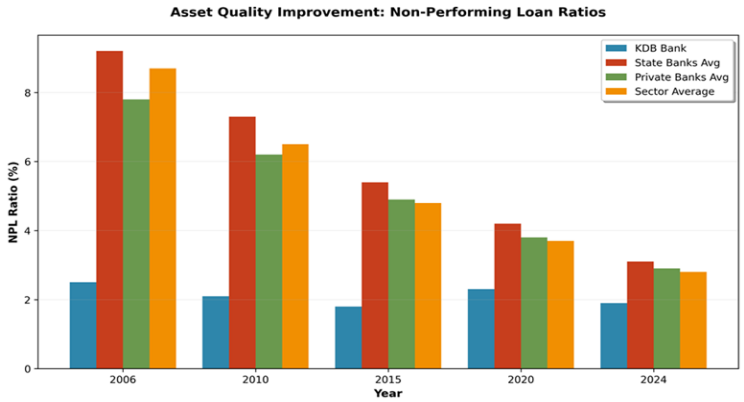

Figure 5. Asset Quality Improvement
Note: Lower NPL ratios indicate better asset quality and risk management
Source: Central Bank of Uzbekistan; Bank annual reports

RESULTS AND DISCUSSION

Summary of the Key Findings

This study demonstrates that the entry of KDB Bank Uzbekistan improved domestic banking efficiency and competition (supporting H1 and H2) through interrelated channels, including reduced market concentration, efficiency gains, and widespread digital adoption. Qualitative evidence shows these changes were driven by imitation, workforce development, technological upgrading, and regulatory alignment, confirming foreign banks as catalysts of institutional modernization in supportive regulatory contexts. The findings extend institutional theory by showing foreign banks act as institutional entrepreneurs, reshaping systems rather than merely adapting, and by mapping a staged process of change—early disruption (2006–2010), diffusion (2011–2018), and institutionalisation (2019–2024). They also highlight that transformation requires simultaneous ecosystem development (regulation, technology, governance, human capital) and demonstrate how micro-level practices scale to sector-wide norms. Using Burns and Scapens (2000) [3], the study empirically traces institutional change across encoding, enactment, reproduction, and institutionalisation over 18 years. It further shows that isomorphic mechanisms operate sequentially yet interactively—mimetic first, followed by normative, then coercive—indicating informal change can precede formal regulation. Finally, the study identifies key transmission mechanisms behind efficiency gains: competitive pressure (~45%), technology spillovers, human capital development, and regulatory upgrading, offering clear policy-relevant insights.

Issues and Limitations

While KDB Bank Uzbekistan generated clear efficiency and modernization gains, its focus on high-quality corporate clients (73% AAA–A vs. 28–32% in domestic banks) raised concerns about market segmentation; however, improved domestic NPL ratios suggest adaptation through better risk management rather than riskier lending. Regulators acknowledged this dynamic, noting competition pushed banks to enhance efficiency or pricing strategies. Still, findings are limited by the single-case design, Uzbekistan's unique transition context, KDB's corporate-focused model, and methodological constraints such as imperfect causal isolation and potential survey bias. Policy implications emphasize balancing openness with strategy by prioritizing foreign banks that bring technological and managerial capabilities, encouraging value-added

entry (e.g., technology transfer, training), and leveraging foreign presence for regulatory learning while maintaining a level playing field. Effective outcomes also depend on sequencing—aligning foreign entry with regulatory upgrades, digital infrastructure, and domestic capacity—and addressing distributional effects by ensuring broader access (e.g., SME finance) and local capability development.

Foreign Bank Entry Policy Considerations

The experience of KDB Bank Uzbekistan shows that successful foreign bank entry depends on strong institutions, coordinated policies, and gradual implementation. Evidence favors selective rather than fully open entry, prioritizing banks with long-term commitment, relevant expertise, and technology transfer capacity. Uzbekistan's gradual approach allowed domestic banks to adapt while maintaining stability, especially when combined with regulatory upgrades that ensured a level playing field. Spillover benefits depend on domestic absorptive capacity, supported by training, technical assistance, and institutional readiness. Impacts also vary by market segment, suggesting targeted entry policies for underserved areas. Full ownership structures tend to generate stronger spillovers, though they require careful oversight to manage stability risks. Policymakers must balance competition with safeguards against market abuse, facilitate technology diffusion through knowledge-sharing mechanisms, and align foreign entry with broader social goals such as SME financing and inclusion. Long-term monitoring, adaptive regulation, regional coordination, and transitional support for domestic banks are essential to maximize benefits while minimizing risks.

CONCLUSION

This research investigates the influence of foreign bank entry on the development of the domestic banking sector in Uzbekistan via a longitudinal case study of KDB Bank Uzbekistan from 2006 to 2024. The evidence shows that having foreign banks in the market led to less market concentration, more competition, lower costs for businesses in the country, faster spread of technology, and slow changes in the way things are done in the sector. By combining financial analysis with institutional interpretation, the article shows that foreign banks can act not only as market participants but also as institutional catalysts in transition economies. For policymakers, the findings suggest that foreign bank entry is most beneficial when it is accompanied by capable supervision, domestic capability-building, and a regulatory framework that encourages knowledge spillovers rather than passive dependency.

Future research can build on this study in a number of ways. First, doing comparative studies in Central Asian countries would help figure out which results are unique to Uzbekistan and which are part of larger trends in the region. Second, bank-level panel studies that use more detailed supervisory data could help us understand better how different types of banks, like state-owned, private, and niche institutions, are affected in different ways. Third, future work may examine how foreign bank presence interacts with digitalization, ESG-oriented banking reforms, and changing prudential standards in emerging markets. These extensions would deepen understanding of when foreign-bank-driven modernization is sustainable and inclusive.

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