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Consolidation and market structure in emerging market banking systems

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Abstract

This paper examines the evolution of market structure in emerging markets banking systems during the 1990s. While a significant process of bank consolidation has been taking place in these countries, reflected in a sharp decline in the number of banks, this process has not systematically been associated with increased concentration as measured by standard indices. Moreover, econometric estimates based on the Panzar and Rosse (1987) methodology suggest that overall, markets have not become less competitive in a sample of eight European and Latin American countries. Lowering barriers to entry, such as allowing increased participation of foreign banks, appears to have prevented a decline in competitive pressures associated with consolidation.
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1. Introduction

The financial services industry has been subject to dramatic changes over the past decades as a result of advances in information technology, deregulation and

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globalization. This has reduced margins in traditional banking activities, leading banks to merge with other banks as well as with non-bank financial institutions, both at home and abroad. The ongoing process of consolidation has raised a number of positive and normative issues for both mature and emerging banking systems (see, for instance, Group of Ten, 2001; International Monetary Fund, 2001); one important question is whether consolidation has reduced competition. In this paper, we review the main characteristics of the consolidation process in the major emerging market banking systems and we study its impact in the market structure of the industry.

The forces driving the consolidation process are similar in both mature and emerging markets, but the latter show some distinguishing features. First, while cross-border mergers and acquisitions are the exception in the mature markets, they account for a large share of the consolidation activity in emerging markets. Second, while consolidation in the mature markets has served to eliminate excess capacity more efficiently than bankruptcy or other means of exit, in emerging markets consolidation has often been a way of dealing with problems stemming from financial crises. Third, the authorities played a major role in the consolidation process in emerging markets, whereas the role of markets forces was more dominant in the mature markets.

While a number of studies have examined the effects of bank consolidation on competitive conditions in mature markets, hardly any systematic research has been carried out for emerging economies. We attempt to fill this gap. First, we discuss the main forces shaping bank consolidation in major emerging markets and describe the patterns of consolidation and concentration using traditional indicators of market structure. Then, we employ the method developed by Panzar and Rosse (1987) to assess changes in the competitive structure in these markets following the consolidation process of the second half of the 1990s. This approach, which is based on the relationship between revenue and marginal costs, has typically been applied to cross-sectional data from developed countries.[2] By contrast, the panel data approach followed here allows for assessing changes in market structure over time, in addition to providing more reliable estimates.

We find that while the number of banks has fallen in all the emerging markets covered in this study during the period 1994–2000, this decline has not systematically resulted in an increase in concentration. In central Europe, for instance, a reduction of the number of banks has been associated with lower concentration—as measured by the share in total deposits of the largest banks and by Hirshman–Herfindahl (HH) indices—since the large, former state-owned savings banks have been losing market share to the more dynamic medium-sized banks. In most of the Asian crises countries, government-led restructuring processes have led to a drop in the number of banks, but the degree of concentration also fell—with the exception of Malaysia. The process of bank consolidation is more advanced in Latin America, as a result of the earlier occurrence of crises and foreign bank entry; in this region,

[2] Two exceptions are Bikker and Groeneveld (2000) and De Bandt and Davis (2000), who examine the competitive conditions in European markets using data from various countries.

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