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Market structure and competitive conditions in the Arab GCC banking system

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Abstract

This paper investigates the market structure of Arab GCC banking industry during the years of 1993–2002 using the most frequently applied measures of concentration *k*-bank concentration ratio (CR*k*) and Herfindahl–Hirschman Index (HHI) and evaluates the monopoly power of banks over the ten years period using the '*H*-statistic' by Panzar and Rosse. The results show that Kuwait, Saudi Arabia and UAE have moderately concentrated markets and are moving to less concentrated positions. The measures of concentration also show that Qatar, Bahrain and Oman are highly concentrated markets. The Panzar–Rosse *H*-statistics suggest that banks in Kuwait, Saudi Arabia and the UAE operate under perfect competition; banks in Bahrain and Qatar operate under conditions of monopolistic competition; and we are unable to reject monopolistic competition for the banking market in Oman.

JEL classification: G21; L1; D40

Keywords: GCC countries; Concentration; Market structure; Competition; Panzar–Rosse model; *k*-bank concentration ratio (CR*k*) and Herfindahl–Hirschman Index (HHI)

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1. Introduction

The Gulf Cooperation Council's (GCC)[1] economies share a number of common features. These economies are characterized by large oil producing sectors, dependency on oil exports, stable currencies and stable price levels. Similarities also extend to geography, longstanding cultural and political ties, a common language, high living standards and coordinated policies. These similarities by far outweigh any differences.

The last 30 years have seen significant structural change in the GCC financial markets. In particular, policies of financial liberalization and financial restructuring were implemented with the goal of enhancing competitiveness in the banking sector. These policies beg the following questions: how large are the banking markets in these six countries? What is the structure of the banking market? Is the concentration in these markets increasing or decreasing?

Studies of competitive conditions in the developed economies banking markets are commonplace, there have been relatively few studies conducted for the GCC economies[2] and no empirical work of a specialist nature. This paper investigates the market structure of the GCC banking industry in the decade to 2002 with the aim of evaluating the monopoly power of the banks over this period. The paper aims to test the relationship between the market structure and the competitive conditions of the banks in these six economies using the most frequently applied measures of concentrations; namely the k-bank concentration ratio (CRk) and Herfindahl–Hirschman Index (HHI) to measure concentration, and the H-statistic of the Panzar–Rosse model to measure monopoly power.

The rest of the paper has the following structure: Section 2, provides a background to the banking system in the GCC countries. Section 3, discusses measures of market structure and concentration. Section 4, presents the empirical result for the competitive conditions in these markets. The final section concludes.

2. The GCC banking sector

The banking industry in the GCC countries is relatively young, with the oldest banks dating back to no earlier than the 1950s. Although the majority are privately owned, the role of the public sector remains substantial. Whether through equity participation in several banks or through a number of governments owned specialized credit institutions that provide financing to public and private sector enterprises at subsidized rates, the public sector continues to have a prominent role in the banking industry of the GCC countries. Private sector ownership of financial institutions also tends to be concentrated in a few shareholders; a matter that reduces the threats (and benefits) of the market for corporate control.

Considering the region's massive oil wealth, the combined Tier One capital of the GCC's top 50 banks at \$31.5 billion is relatively small, amounting to 1.7% of the capital of the top 1000 world banks. The capital of all 50 GCC banks is considerably less than that of HSBC (Hong Kong Shanghai Banking Corporation) Holdings at \$35 billion. While GCC banks have been able to receive the highest rating of any bank in the Arab world or the emerging markets, the GCC has not been able to produce large powerhouse institutions that could

[1] The Arab GCC countries are Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates (UAE).

[2] Salem-Ghanem et al. (2002) examines concentration and equates concentration with lack of competitiveness.