

MARKET POWER IN THE RUSSIAN BANKING INDUSTRY

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ABSTRACT. The aim of this paper is to analyze bank competition in Russia by measuring the market power of Russian banks and its determinants over the period 2001-2006 with the Lerner index. We find that bank competition has only slightly improved during the period studied. The mean Lerner index for Russian banks is of the same magnitude as those observed in developed countries, which suggests that the Russian banking industry is not plagued by weak competition. Furthermore, we find no greater market power for state-controlled banks nor less market power for foreign-owned banks. Finally, our analysis of the determinants of market power enables the identification of several factors that influence competition, including market concentration and risk as well as the nonlinear influence of size.

JEL Classification: G21; P34.

Keywords: Market Power; Bank Competition; Russia.

RÉSUMÉ. L'objectif de l'article est d'analyser la concurrence bancaire en Russie en mesurant le pouvoir de marché des banques russes et ses déterminants sur la période 2001-2006 avec l'indice de Lerner. Nous trouvons que la concurrence bancaire ne s'est que légèrement améliorée sur la période étudiée. L'indice de Lerner moyen pour les banques russes est du même ordre de grandeur que ceux observés dans les pays développés, ce qui suggère que le secteur bancaire russe ne souffre pas d'une concurrence faible. Par ailleurs, nous n'observons pas de pouvoir de marché plus élevé pour les banques publiques, ni de pouvoir de marché pour les banques étrangères. Enfin, notre analyse des déterminants du pouvoir de marché permet l'identification de plusieurs facteurs qui influencent la concurrence, notamment la concentration et le risque ainsi que l'influence non-linéaire de la taille.

Classification *JEL* : G21 ; P34.

Mots-clefs : Pouvoir de marché ; concurrence bancaire ; Russie.

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1. INTRODUCTION

In the wake of major structural changes in banking industries around the globe, the impact of bank competition on economic growth has generated increasing interest in the literature of recent years. Since banks play a key role in the financing of the economy, changes in bank competition are supposed to exert an impact on access to bank finance in the form of lower loan rates or relaxing of financing constraints (Cetorelli and Gambera, 2001; Carbo-Valverde, Rodriguez-Fernandez and Udell, 2009). Such developments would suggest a positive impact of bank competition on economic growth (Claessens and Laeven, 2005).

Bank competition is even more important for economic growth in emerging countries. First, these countries are characterized by low ratios of credit to GDP, which may be a result of the financing obstacles created by subdued banking competition. Second, bank lending is the leading source of external finance in these countries, owing notably to underdeveloped capital markets. In spite of this, earlier studies investigating the level and the determinants of bank competition focus instead on developed countries (e.g. Fernandez de Guevara, Maudos and Perez, 2005).

Russia is a very interesting example of such an emerging market. Bank lending is stunningly low, with a ratio of domestic credit to GDP of 25.7% in 2005, compared with a world average of 55.8% (EBRD, 2006). At the same time, bank lending represents the largest source of external finance for companies.⁴ This picture has not changed despite impressive economic and banking-sector growth in recent years, including a doubling of the ratio of banking sector assets to GDP.

Our aim in this paper is to analyze bank competition in Russia in the recent years by measuring the market power of Russian banks over the period 2001-2006. We utilize a rich panel dataset from the financial information agency Interfax and the Central Bank of Russia, which provides quarterly data for all Russian banks. In line with recent studies on bank competition (Fernandez de Guevara, Maudos and Perez, 2005; Solis and Maudos, 2008; Berger, Klapper and Turk-Ariss, 2009; Carbo-Valverde *et al.*, 2009), bank competition is measured by the Lerner index. This measure of market power directly infers a bank's conduct and then informs on the actual behavior of the bank.

First, we measure the level and the evolution of the market power of Russian banks during the period of study. We assess the level of market power of banks in Russia and compare it with other countries. We also investigate whether strong economic growth influenced banking competition in recent years.

Second, we investigate whether market power depends on ownership. Russian banking is characterized by the coexistence of three different types of banks: state-controlled banks, domestic private banks, foreign-owned banks. We analyze whether the privatization of

4. The 2009 OECD report on Russia also stresses the importance of bank lending by mentioning that "Russia has seen the rapid evolution of securities markets and other non-bank financial activity, especially in the past 8 years or so, but banking still accounts for almost all financial intermediation" (OECD, 2009, p.122).

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