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Bank competition in Russia: An examination at different levels of aggregation

Diego Anzoategui [a], María Soledad Martínez Pería [b,*], Martin Melecky [c,d]

[a] *New York University, NY, USA*
[b] *Finance and Private Sector Development Research Group of The World Bank, USA*
[c] *Finance and Private Sector Development Department of the Eastern Europe and Central Asia Region, The World Bank, Washington, DC, USA*
[d] *The Technical University of Ostrava, Czech Republic*

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ABSTRACT

We analyze bank competition in Russia at different levels of aggregation. First, we compute a country-level measure of competition and compare it to that for similar-sized economies. Second, we contrast competition across different groups of banks in Russia. Third, we analyze bank competition across Russian regions. We find that banks in Russia are less competitive than those in Brazil, but more so than those in China and India. Large and state-owned banks exert more market power than others. Finally, competition is stronger in regions where there is less bank concentration, greater presence of banks, and greater financial and/or economic development.
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1. Introduction

The Russian banking sector consists of 1080 banks.[1] This number is large both in absolute terms and even when compared to the number of banking institutions in similar-sized economies such as Brazil (163), China (370), and India (169).[2] However, the Russian banking authorities recently increased minimum capital requirements and the number of banks is expected to decline as a result. As of February 2009, new banks need to comply with a minimum capital requirement of 180 million rubles (approximately US$6 million) in order to start operating and existing banks have to meet this requirement by January, 2012. Recently, the Central Bank of Russia (CBR) predicted that approximately 200 banks

* Corresponding author at: The World Bank, 1818 H St., N.W. MSN 3-307, Washington, DC 20433, USA. Tel.: +1 202 458 7341.
E-mail address: mmartinezperia@worldbank.org (M.S.M. Pería).

[1] Number of banks is as of late 2009.

[2] The numbers for Russia as well as those for Brazil, China, and India do not reflect the importance of non-bank institutions such as credit cooperatives that also offer financial services in these countries.

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would not be able to comply with this new limit. Furthermore, the Russian Finance Minister has publicly expressed a desire to take capital requirements to 1 billion rubles (US$ 33 million) within six years, a policy which if implemented will likely further reduce the number of banks in the system.[3] In light of the recent and future changes in minimum capital regulation, it is relevant to understand to what extent the banking sector in Russia is competitive to ascertain the potential impact of these reforms on bank competition. Furthermore, another change in the Russian banking sector that might have implications for competition is the privatization of government-owned banks that is currently under discussion.

Analyzing the extent of competition within the banking sector is also relevant because the banking literature has shown that there are detrimental effects associated with lack of bank competition. In particular, studies have found that lack of competition in the banking sector can result in higher prices for financial products and reduced access to finance, especially for smaller firms (see Beck et al., 2004; Cetorelli and Strahan, 2006, among others). Also, some studies have found that lack of bank competition can lead to less entry and growth of younger firms and also delayed exit of older firms (Cetorelli, 2003). Furthermore, though there is significant debate on the implications of competition for banking sector stability, new evidence suggests that lack of competition can lead to fragility, especially if certain banks become too big to fail (see Beck et al., 2006; Carletti et al., 2007; Koskela and Stenbacka, 2000; Schaeck and Cihak, 2008 among others).

Using bank-level data for the period 2002–2008, this paper examines the extent of competition in the Russian banking sector. Because the Russian banking sector is fragmented -it has a large number of diverse institutions spread out over a vast territory-, it is important to analyze competition at different levels of aggregation (in particular, across groups of banks and geo-political regional divisions within the country). First, to provide some context for the more disaggregated analysis, we contrast banking sector competition in Russia to that observed in comparable emerging economies, namely: Brazil, China, and India. Second, because various types of banks operate within the Russian banking sector, we compare measures of competition for different groups of banks. In particular, we conduct tests to examine differences between the top 20 banks (in terms of assets) vis-à-vis smaller banks, government-owned banks vis-à-vis privately-owned institutions, foreign banks vis-à-vis domestic banks, and business-oriented vis-à-vis consumer-oriented banks. Finally, considering the vastness and heterogeneity of the Russian territory, it is hard to think of the country as one integrated market where all banks compete against each other. Hence, in the last part of the paper, we examine competition across regions within Russia.

Though we motivate the analysis of competition in Russia by discussing recent and planned reforms in the banking sector, it is important to highlight that this paper does not offer an evaluation of the consequences of these on-going policy changes. Rather the main purpose of this paper is to assess in a rigorous and comprehensive manner the recent state of competition in the Russian banking sector to provide a benchmark for future analyses of these policies.

We assess the extent of competition in the Russian banking sector using the Lerner index, a non-structural measure that captures the markup banks charge their customers by calculating the difference between price and marginal costs, expressed as a percentage of the price.[4] Higher values of the Lerner index imply lower levels of bank competition. We prefer this non-structural index of competition rather than using measures of concentration in the banking sector as proxies for competition, because concentrated systems can remain competitive if the threat of entry and exit exists (i.e., if the sector is contestable). Furthermore, studies such as Cetorelli (1999) and Claessens and Laeven (2004) argue that concentration and performance ratios are unreliable measures of competition. Finally, we use the Lerner index instead of the alternative, also non-structural, Panzar and Rosse (1987) H-statistic, because the latter assumes the market is in long-run equilibrium and is intended to characterize competition over long periods of time.[5]

[3] http://www.mn.ru/business/20100721/187941655.html.

[4] There are several studies that assess banking competition using the Lerner index, some of them are: Angelini and Cetorelli (2003), Fernandez de Guevara et al. (2005, 2007), Berger et al. (2008) and Carbó et al. (2009), Fungáčová et al. (2010) and Weill (2011).

[5] Panzar and Rosse (1987) show that the sum of the elasticities of a firm's revenue with respect to the firm's input prices - the so-called H-statistic – can also be used to identify the extent of competition in a market. Under perfect competition, they show the H-statistic should be equal to one. By contrast, the H-statistic will be zero or negative if the firm operates as a monopoly. If the banking sector is characterized by monopolistic competition, the H-statistic will lie between zero and one.

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