# Discussion:
# *Concentration in Asia's Cross-Border Banking: Determinants and Impacts (Lapid, A.K., R. Mercado, and P. Rosenkranz)*


Jun Bernabe

Office of Systemic Risk Management

Bangko Sentral ng Pilipinas

# Implicit assumption that high concentration is to be eliminated…

"High concentration can expose the region to financial risk and policy spillovers … and can lead to less efficient cross-border financial intermediation"

## Comments:

A. Inherent properties of the Herfindahl-Hirschman Index (HHI)
B. Tug-of-war between "concentration-fragility" and "competition-stability"
C. Powerful role of appropriate institutional framework

# A. The HHI

- Measures a firm's absolute size relative to the whole industry using (1) number of firms, and (2) variance in market share distribution
- HHI captures size sensitivities rather than market dynamics
- Provides snapshot of "before" and "after" images of market structure; not necessarily dynamics resulting from economies of scale and scope
- Economies of scale and scope should receive consideration when policymakers consider vulnerability assessment using concentration.

# Alternative market power measures

| Measure | Theoretical Range | Value at perfect competition | Direction indicating increasing intensity of competition | Concept underpinning perfect competition outcome |
|---|---|---|---|---|
| Lerner index | 0 to 1 | 0 | ↓ | Economic profits driven towards zero |
| Boone indicator[2] | -∞ to 0 | -∞ | ↓ | Output reallocated to more efficient firms |

Notes:
[1] The H-statistic can take on negative values for a pure monopoly but for practical purposes is bound between 0 and 1
[2] Under perfect competition, the elasticity of profit to costs is negative infinity as any increase in costs drives firms to exit the market. In practice, estimates of the Boone indicator will be negative, with values approaching zero as competition intensity decreases.

Source: Ramon and Straughan, 2016, p. 4

- Boone indicator (Boone, 2008)
  - measures the extent to which more efficient banks see assets expand vs less efficient as competition heats up
- Lerner index (Lerner,1934, White 2020)
  - measures banks' margins, and where margins are large, there is greater market power (i.e. less competition)

## Various competition measures for banking sector

**Table 2.1: Recent estimates of competition measures**

| Study | Region | # UK Banks[1] | Period under study | Measures[2] | Periodicity of estimates |
|---|---|---|---|---|---|
| Berger et al (2009) | World | 43 | 2007 | HHI, L | Average for period |
| Bikker et al (2012) | World | 73 | 1994–2004 | PRH | Average for period |
| Carbó et al (2009) | EU | 58 | 1995–2001 | HHI, L, PRH | Average for period |
| Casu and Girardone(2006)[3] | EU | 63 | 1997–2003 | CR, PRH | Average for period |
| Casu and Girardone(2009) | EU | 73 | 2000–2005 | L | Annual |
| Claessens and Laeven(2004) | World | 106 | 1994–2001 | PRH | Average for period |
| Coccorese(2014) | World | 116 | 1994–2012 | L | Annual |
| Fernández de Guevara et al (2007) | EU | 45 | 1993–2000 | L | Annual |
| Goddard and Wilson (2009) | G7 | 166 | 2001–2007 | PRH | Average for period |
| Logan(2004) | UK | 357 | 1989–2003 | CR, HHI | Annual |
| Matthews et al (2007) | UK | 11 | 1980–2004 | PRH, L | Average for sub-periods |
| Schaeck and Cihák (2010) | EU | – | 1995–2005 | B | Annual |
| Schaeck and Cihák (2012) | EU | 43 | 1999–2005 | PRH | Average for period |
| Schaeck and Cihák (2014) | EU | 43 | 1995–2005 | B | Annual |
| Schaeck et al (2009) | World | – | 1998–2005 | PRH | Average for period |
| Weill (2013) | EU | 56 | 2002–2008 | L, PRH | Annual |
| van Leuvensteijn et al (2011) | EU + G2 | 140 | 1992–2004 | B | Annual |

Source: Authors

Notes:
[1] Total number of UK banks reported in the study
[2] Measure(s) of competition used in the study. CR = concentration ratios; HHI = Herfindahl-Hirschman Index; L = Lerner index; PRH = Panzar-Rosse H-statistic; B = Boone indicator
[3] Casu and Girardone (2006) contains a similar table for earlier studies of competition in the banking sector

Source: Ramon and Straughan, 2016, p. 4

# B. Concentration-fragility versus competition-stability

- Does greater competition, increase risk-taking among banks endangering financial sector stability? BUT does a more concentrated banking system exacerbate fragility since less competition leads to greater concentration and increased market power (thus, TBTF)?
- Both concentration-fragility and competition-stability stand but one dominates the other depending on current competition intensity → seemingly, a tug of war between the competing hypotheses ensues
- Key take away: NOT a tug of war between "concentration-fragility" and "competition-stability" but a division of labor
- Relationship between market structure and stability may have evolved vs traditionally seen in literature. Why?
  - banks may be competitive even in high concentration markets as technology facilitates availability of 'hard' (quantifiable, verifiable) information on borrowers; and
  - even when the relationship between market structure and stability holds, its properties are country-specific and "optimal" market structure depends on institutional framework → not simple to have a specific degree of bank concentration as a universal policy objective

# C. Appropriate institutional framework minimizes trade-offs

- Bespoke policies in systemic risk management: important to focus on improving country specific institutional framework
  - Example: Increased competition can engender stability – but fragility costs of competition are avoided only with policy promoting good governance in banks, appropriate policy interventions (Corbae and Levine, 2018)

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