

Assessment of The Degree of Competition in the Banking Industry

The efficiency of the Korean banking industry has improved, thanks to the restructuring implemented since the Asian Financial Crisis. However, market concentration has increased, as the number of banks has decreased. Consequently, concerns have emerged over reduced competition. Reduced competition may lead to a decline in the surplus of financial consumers, including households and corporations, and weakening of the impact of monetary policy through the interest rate channel. Hence, an assessment on the degree of existing competition is needed. In addition, the issue of easing regulations on the establishment of new banks has come up since the launch of the new government. This is a matter that calls for thoroughgoing discussion. In order to address it, an analysis on competition in the banking industry first needs to be conducted

This paper assesses competition within the domestic banking industry from a multi-faceted perspective, using an econometric model on the basis of the revenue-cost functions of banks. First, an assessment based on the Panzar-Rosse model reveals that the banking industry as a whole may be a strategic oligopoly and it is unclear whether each bank group is a strategic oligopolist or not. The results run counter to most existing research results showing that the domestic banking industry is a perfectly competitive market or a monopolistically competitive market. This seems to be because this study rules out scope for overemphasizing of the degree of competition within the banking industry by reflecting Bikker's argument (2006).

Next, it is found that competition in the bank lending market has weakened significantly since 2003, according to the results of estimation with the use of the Boone index. Moreover, given that the period when the lending market showed a reduction of competition coincides with a sluggish phase of the corporate bond market which is a rival of the banking sector, it is assumed that the depressed corporate bond market weakened banks' competition among themselves for lending.

Meanwhile, in contrast to the analysis results showing that banking

industry competition has been gradually weakening, some indicators including net interest margin suggest even fiercer competition among banks for market share. Assuming that this phenomenon may have resulted from the herd-like behavior of the Korean banking industry, herd behavior in the lending market is also estimated in this paper with the use of the LSV index. According to the results, given recent stronger herd behavior in the lending market, banks' competition for market share in specific sectors can be interpreted as more intense competition across the entire banking sector.

If the Korean banking industry continues to show only a low degree of competition, this could have a negative impact on the efficiency and stability of the financial system. In this regard, policy efforts, such as continuous monitoring, need to be made to create a sound environment for competition within the banking industry. In addition, the scope of competition policy should be extended to include the corporate bond market, together with the lending market, in order to strengthen competition in the banking industry effectively.