Bank competition and efficiency: empirical evidence from Indian market

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Abstract:

Purpose

The study investigates the relationship between competition and efficiency. Using bank-level data for Indian banks, relationship between competition and efficiency is examined by applying Granger Causality test for the period 1996 to 2011.

Design/methodology/approach

Lerner Index, a measure of market power is applied for estimation of competition. Data Envelopment analysis technique is applied for measuring efficiency in the Indian banking system along with a Granger Causality test to look at the relationship between competition and efficiency.

Findings

Results show an increasing trend for competition for the period 1996 to 2004 and after that, there is fall in competitive levels. Granger causality tests show that competition positively effects efficiency and vice-versa.

Practical implications
This study gives insight into the relationship between competition and efficiency, thus providing an alternative view to the Structure-Conduct-Performance paradigm. An efficient banking system can positively impact the growth of an economy and hence, competition and efficiency are important decision parameters for regulators and could help them in decision making and policy formulation.

Originality/value

This study has covered more than 90% of the banking assets for looking at competition and efficiency in the banking sector. Policy makers can try to improve competitive levels in banking so as to improve efficiency in the banking sector which can further help in developing the investment-savings cycle.

Key Word :
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