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DOES COMPETITION MAKE BANKS RISKIER IN DUAL BANKING SYSTEM?

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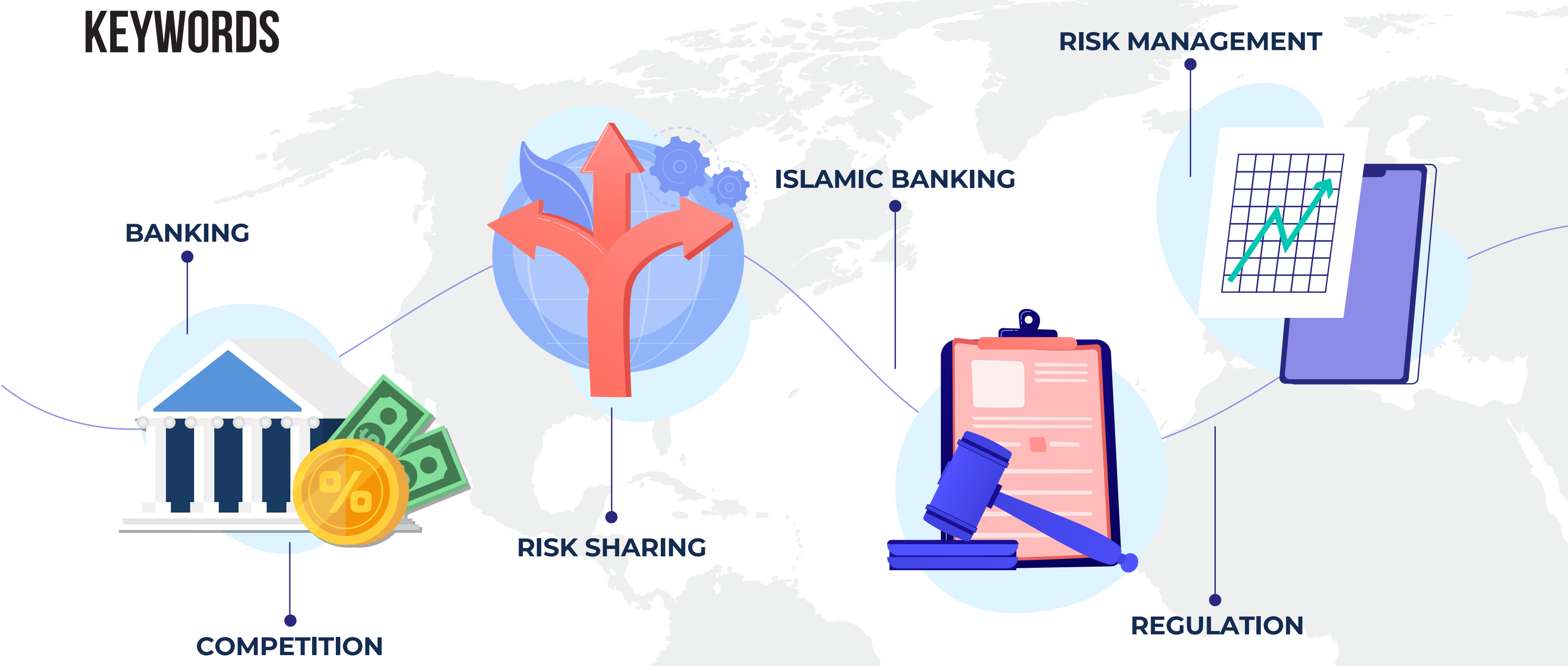
KEYWORDS



INTRODUCTION

- "Excessive competition among banks could threaten the solvency of particular institutions and, at an aggregate level, hamper the stability of the entire banking system" (Saurina, Jimenez, & Lopez, 2007).
- The effect of competition in banking-sector is one of the key determinants that impact on bank risk-taking.

"Competition-fragility view" vs. **"Competition-stability view"**

"Competition-fragility view": assumes that banks in excessive competition banking systems are less concentrated and have less market power which will erode the character values of the banks (Allen & Gale, 2004).

"Competition-stability view": suggests that the risk-taking behaviour of banks and competition within the sector have a negative correlation (Boyd & De Nicolo, 2005; Boyd, De Nicolo, & Al Jalal, 2009).

- The emergence of Islamic banking system as an alternative banking system has added another dimension to the competition theory within the dual banking system.
- Despite the reality that Islamic banks grow rapidly in today's economy, there is little systematic and regular analysis and studies on the topic of the impact competition have on bank-risk taking among Islamic banks.
- This topic still remains ambiguous in theory and empirically under investigations even though there are relatively large amounts of literature in conventional banks.

METHODOLOGY

Lerner index is defined as the difference between price and marginal cost, divided by price.

Used the Lerner index to reveal the level of market power when assessing monopoly pricing power.

Lerner index = 0 indicates perfect competition in a market; Lerner index = 1 indicates monopoly in a market.

Lerner index is an "opposite measure of competition where a high Lerner index implies lower competition" (Forssback & Shehzad 2011).

DATA AND SAMPLE

- This paper uses the framework to evaluate the correlation between competition and risk by basing on the works proposed by (Alam, 2014; Berger, Klapper, & Turk-Ariss, 2009; Forssback & Shehzad, 2011; Saurina et al., 2007).

Sample

- Consists of 1664 banks: 472 are Islamic banks2, 1192 are conventional banks
- Data has been taken from the Bankscope database
- Time-period of data: 2006-2016
- Banks in 10 countries which is mainly located in Gulf Cooperation Council (GCC) and South East Asia (SEA): Bahrain, Bangladesh, Indonesia, KSA, Kuwait, Malaysia, Pakistan, Qatar, Turkey and UAE

CONCLUSION AND IMPLICATIONS

- The results suggest that bank competition have a negative association for Islamic banks risk-taking behaviour in contrast with the positive association for conventional banks.
- The findings confirm the reasoning that Islamic banks have a strong incentive to engage in market segments where the degree of competition is low in order to achieve higher rates of return.
- This paper has significant implications for policymakers including central banks and other international agencies operating in countries where dual-banking system coexist.
- This study will enable:
  - i) Researchers and relevant organizations – to understand the market power of each type of banks and how the varying degrees of market power could impact banks' risk-taking behaviour of the two-types of banks
  - ii) Policymakers – to implement a policy such as licensing of new Islamic and conventional banks

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