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Coexistence, cooperation, and competition between banks and non-banking entities

Abstract

Financial stability is essential for the functioning of the economy, and competition between banks is seen as an essential factor for their stability. Reframing the conflict and each party's goals in such a way that they are mutually dependent increases a party's chances of reaching an agreement. This study investigates the relationship between bank size and the institution's stability. Government regulators and anyone else's ability to keep an eye on the entire financial system is jeopardized when large portions of it are left largely unregulated. Price competition (marginal-cost pricing) reduces the market power of a single firm as the number of firms in an industry grows. Since the 1990s, the banking industry, according to previous studies, has been experiencing concentration and competition. Some argue that the lack of technology in small banks may put them at an advantage in terms of customer satisfaction, but this is not necessarily the case.

Keywords: coexistence, competition, cooperation, non-banks, financial sectors
JEL Classification: O3, E4, G1

Introduction

A theory of cooperation and competition developed by Deutsch aims to understand better conflict processes and resolutions, since the majority of conflicts involve a mix of cooperative and competitive motives. In order to understand cooperation/competition, one must understand the type of interdependence between the parties involved. Success for one party may be directly related to the failure of the other. In these circumstances, it is common to have antagonistic, win-lose relationships. It is possible that the parties' aims are mutually reinforcing, and their success or failure will be linked. In these kinds of situations, cooperative relationships based on mutual benefit are common. There are many advantages to working with others, among them the improved ability to communicate and coordinate tasks, a sense of reciprocity, and a willingness to increase one's own authority within the relationship. A lack of trust and confidence in one's ability to communicate and work together is a major hindrance to effective teamwork. As a result, a desire to control and dominate the other develops.

In our understanding of conflict, our practice of conflict management, and our training in conflict resolution, the theory of cooperation and competition has important implications.

A party's chances of reaching an agreement are increased when the conflict and the goals of each party are reframed in such a way that they are mutually dependent. Compliance with cooperative norms by all the parties will aid in this initial reframing and the development of viable solutions. Respect, responsiveness, acceptance of responsibility, and forgiving one self as well as looking for the common ground are all examples of these norms. The foundations of constructive conflict resolution are reciprocity, human equality, shared community, and non-violence. Both sides can agree on this set of values, which makes it a useful tool for bridging divides.

In order to manage conflict effectively, more than just these attitudes and values are required. The first step in resolving a conflict is to build and maintain good working relationships between the parties involved. Cooperative conflict resolution is the first and most important skill to learn in conflict management. A third set of skills is needed: the ability to create efficient processes for solving problems and making decisions in groups.

These theoretical insights have ramifications for practitioner education as well. Both the teaching methods and the learning environment need to be infused with cooperative, constructive problem-solving. Practitioners must have access to a supportive environment in order to maintain a cooperative attitude in the face of unfavourable or hostile conflict.

Literature review

To ensure the proper functioning of the economy, financial stability is essential. Everyone benefits from a well-functioning banking system in an efficient economy. The banking system is responsible for a large portion of economic transactions. Bank competition, bank

size, and regulations are examined in this study, which takes into account the importance of the banking system.

For the stability of banks, competition is seen as an essential factor. In the banking literature, the measurement of competition has remained an important topic. Theoretical and empirical studies of competition have relied on a variety of different metrics over the years. However, the incapability of concentration ratios and the Herfindahl-Hirschman index to capture competition has been a point of contention. The Lerner index and the Boone indicator are considered to be better measures of the competition between banks [Zigraiova, Havranek, 2016].

The question of whether or not increased competition is good or bad for bank stability is one that is still being debated in economics. Theoretically, bank competition should have a negative impact on bank stability, but there are conflicting predictions in the literature. With two competing hypotheses about how competitiveness and stability relate, such authors like Boyd and De Nicolo [2005] and Keeley [1990] propose the hypothesis of competition-stability and the hypothesis of competition-fragility. Research on the relationship has yielded mixed results. Furthermore, these opposing views suggest that competition and stability may have a non-linear relationship.

Consequently, this study examines the effects of bank competition and stability in both linear and non-linear ways. In discussions about bank regulation and supervision, bank size is another variable of interest that is critical to the stability of a bank. A lot of attention has been paid to this phenomenon since the financial crisis of 2008, when large banks had a devastating effect on countries' economies. Recent research suggests that as a bank's size increases, so does its stability. Prudentiary regulations, including capital requirements, have been tightened in the wake of the global financial crisis. However, in developing countries where economies of scale are at play, a larger bank might be advantageous.

Both the banking regulatory environment and competition policy are critical. With a focus on emerging Asian and European economies, this research also examines how regulation affects bank stability.

In the past, banking regulations have had a stabilizing effect on financial institutions and the economy. A number of banking restrictions were imposed by the Glass-Stegall Act and the establishment of the Federal Deposit Insurance Corporation (FDIC) in 1933. Separation of commercial banking from investment banking was also implemented in the industry.

As well as looking at competition at the bank level, this study examines the competition-stability growth relationship. It also looks at how the global financial crisis and the systemic bank crisis affect growth, and it emphasizes the significance of a stable financial system during this time of crisis. This comparative macroeconomic analysis of Asian and European economies examines the interplay between competition, stability, and growth.

Analytical information

Non-banking financial institutions

The term 'non-banking financial institution' refers to any financial institution that does not have a full banking licence and thus cannot accept deposits from the general public. Additional services provided by non-banking financial institutions (NBFIs) include investing (both collectively and individually), risk-pooling, financial advisory services, brokering, money transfers, and check cashing, to name just a few. Consumer credit can be obtained from NBFIs and licensed banks (along with licensed banks). Non-banking financial institutions include insurance companies, venture capitalists, currency exchanges, some microloan organizations, and pawn shops. To compete with banks, non-banking financial institutions offer services that banks may not be able to provide or specialize in specific industries or demographic groups.

Institutions that pool their risk

Insurance companies and reinsurers insure economic losses resulting from death, illness, property damage or loss, and other risks of loss. They guarantee a specific amount of money in the event of a loss. Life insurance and general insurance are the two most common types of insurance in the insurance sector. A life insurance policy is a long-term commitment, unlike a short-term general insurance policy. All segments of society can benefit from both life and property insurance. Because of the nature of the business, the insurance industry has a high level of information efficiency (companies need to access a plethora of information to assess risk in each individual case).

Depending on arrangements for access to clearing and settlement, end-to-end providers may have direct access to a clearing and settlement network, or use a bank for parts of these processes.

Protecting one's family financially if one dies early is the primary purpose of a life insurance policy. An insurance premium is due at the beginning of each policy term. Due to the fact that mortality risk rises with age, but premiums remain constant, the insured pays too much in the beginning and too little in the latter years. The cash value of the insurance policy is based on the overpayments made in the early years of the agreement.

Market-based and socially based general insurance are two other types of general insurance. Human social insurance policies may cover people whose income is unexpectedly lost due to things like unemployment, illness, and natural disasters. As a result of the unpredictable nature of these risks, the ease with which the insured can conceal relevant information from the insurer, and the presence of moral hazard in this industry, private insurance companies often do not provide social insurance, which is typically provided by the government. In

industrialized Western societies, where social insurance is more widely available, family networks and other organic social support groups are less common.

Privatized property damage and theft insurance is available in the form of market insurance. A single premium payment is required by all general insurance providers. In return for the insurance company's promise to cover the risk, a payment is made. In addition to robbery, fire, structural damage, and other disasters, there are a number of other possibilities that could occur.

Contractual savings and loan organizations

Through contractual savings institutions, individuals can invest in collective investment vehicles in a fiduciary rather than principal role (also known as institutional investors). Collective investment vehicles are used by individuals and businesses to invest in a variety of equity, debt, and derivatives. Individuals own the CIV as a whole, not just the investments it has made. Contractual savings institutions include mutual funds and private pension plans. Mutual funds can be open-end or closed-end. Open-end funds create new investments by allowing anyone to buy additional shares at any time. If investors want to get rid of their shares, they can sell them back to the open-end fund at their net asset value. A predetermined number of shares is issued by closed-end funds in an IPO. Investors can reap the benefits of the value they have accrued through the sale of their shares on the stock market.

The types of investments made by mutual funds can be used to categorise them. To illustrate the concept of a low-risk, high-return investment strategy, consider tax-exempt securities. Investments in specific industries or across borders may be the focus of a hedge fund. If you are looking for a way to keep your money safe until you retire, a pension fund may be the best option for your investment. Tax breaks for pension funds have encouraged workers to save a portion of their current income for the time when they will no longer be a source of income for the economy (retirement income).

Various other types of financial institutions not affiliated with non-banks and banks

Market makers, which are broker-dealer institutions, provide both buy and sell price quotes. To name just a few, these types of assets include stocks, bonds, derivatives, and foreign currencies. To make up for the loss of inventory that occurs when a customer orders, market makers either sell their inventory or purchase more. The difference between the selling and buying quotes, known as the bid-offer spread, is how the market maker earns his or her living. All assets held by market makers have increased liquidity.

Sectoral financiers are financiers who specialize in a particular industry. In contrast, real estate financiers lend money to people who want to buy a house, whereas equipment leasing companies lend money to people who want to buy equipment. Leasing companies have two

distinct advantages over other specialized sectoral financiers. Due to a collateral agreement, they have some protection from default by owning the leased goods. Tax rates are lower for businesses that lease equipment.

Among the other financial service providers are brokers (securities and mortgage), management consultants, and financial advisors. There is a fee for their offerings. The improved accuracy of financial service providers' data is a huge benefit to investors. Brokers, on the other hand, facilitate the sale of existing assets by acting as a middleman.

The financial sector's role

For both individuals and businesses, NBFIs provide an additional avenue for obtaining financial services. These services, for example, allow them to compete with banks. Financial services provided by non-banking financial institutions differ from those offered by traditional banks in that they cater to a more diverse range of customers. Individual NBFIs can specialize in a specific industry to gain an advantage over their competitors. By unbundling, targeting, and specializing, NBFIs encourage competition in the financial services industry and help consumers make informed decisions.

Having a diversified financial system, non-banking financial institutions can help prevent and recover from financial shocks. Other financial institutions offer a variety of ways to turn an economy's savings into investment, serving as a fallback option in the event that the primary intermediation method does not work.

On the other hand, non-banking financial institutions can exacerbate the vulnerability of the financial system in countries with lax regulatory frameworks All NBFIs are not part of the shadow banking system, but those that are subject to lax regulation are. NBFIs such as hedge funds and structured investment vehicles were largely ignored by regulators prior to the recent global financial crisis in terms of NBFI oversight. If a large portion of the financial system is held by NBFIs that are largely unsupervised by government regulators and anyone else, the stability of the entire financial system can be threatened. Due to NBFI regulation weaknesses, credit bubbles and asset overpricing can lead to asset price crashes and loan defaults.

Supervisory and financial institution integration

Banking, securities, and insurance have all become increasingly intertwined in recent years, and this trend is expected to continue in the future. There has been a notable shift in financial regulation over the last two decades from the traditional approach of regulating financial institutions separately by sector (with supervisors for banks, securities markets, and insurance companies), to a more cross-sectoral approach [see, for instance, Čihák, Podpiera 2008]. A major shift in global supervision and regulation has been brought about as a result.

Globally, the ‘sectoral’ and ‘twin peak’ models (prudence and business conduct) are the most popular, but there are others as well like banks, insurance, and securities (all types of supervision under one roof). According to the World Bank’s Bank Regulation and Supervision Survey, a major shift in banking regulation and supervision over the past decade has been toward a two- or integrated-pillar model (with the twin peak model gaining traction in the early 2000s). Furthermore, a study conducted by Melecky and Podpiera [2012] found that countries with higher economic development tend to integrate their supervisory structures, small open economies tend to opt for more integrated supervisory structures, and financial deepening makes countries integrate supervisory structures progressively further over the past 10 years.

Cross-country regressions using data from a wide range of developing and developed economies provide some evidence in favour of the twin peak model and in opposition to the sectoral model. However, the global financial crisis largely bypassed many countries, such as Australia and Canada, while the United States (a jurisdiction that employs sector-based approaches to regulation) was at the epicenter. The financial crisis was a two-way street, not just a one-way street. A major European bank failure, the Fortis failure in the Netherlands, is an example of the twin peaks model. As a result, it is too early to draw conclusions, and it is notoriously difficult to isolate the effects of supervisory architecture from those of other influences.

Competition in banking

Any economy relies on a well-run banking system. One way banks help the economy grow is by providing a way for individuals and businesses to store and exchange financial assets, as well as by issuing credit cards to customers. Competition in banking could have similar benefits to those in other industries. Improving allocative, productive, and dynamic efficiency (e.g. by encouraging innovation) can lead to stronger economic growth. This is the ultimate goal of the system.

To determine the competitiveness of a market, one must ask a simple question: How much control do businesses have over the market? An examination of the theoretical and empirical literature on this topic in relation to the banking sector is the focus of this article.

There is a long-held belief that more competition means more price competition, and less competition means less price competition. We can infer this from an old-school industrial organization argument, which holds that pricing, profits, and market power are all directly related to market structure – market concentration. Thus, as the number of companies increases, prices become more competitive (marginal-cost pricing), reducing the amount of market power that a single firm can exercise.

The focus of the literature is on establishing a link between market structure and market power because pricing behaviour is difficult to observe. Indicators for concentration, seller count, and entry conditions are just a few of the structural variables. Profits and costs are used to calculate market power.

There is a large body of literature that applies this paradigm to a single industry over time, despite the fact that traditional studies using this approach are based on cross-industry data. Most of the initial literature on bank profitability (or prices) and concentration used data from the United States to examine this relationship. Concentration and loan prices were often found in these early studies [e.g., Hannan, 1991]. According to a recent study based on panel data, countries with well-functioning legal systems, open entry, and the presence of foreign banks can significantly reduce the negative effects of concentration.

Traditional methods have a number of drawbacks. Accounting data on profits and costs, for example, may not accurately reflect economic gains and market power from a measurement standpoint. It is also necessary to have an accurate definition of the market in order to measure a structural variable such as concentration. The definition of the market must include all substitutes and all suppliers of substitutes. A market without uniform products, like banking, makes it difficult to assess this in practice. It is not just banks that supply substitute products; other financial and non-financial companies do it as well.

According to previous studies, the banking industry has been experiencing concentration and competition since the 1990s. Since the structure–conduct–performance (SCP) theory hypothesis asserts that market saturation and bank competition and concentration negatively affect banks' structure, conduct, and performance from a social perspective, this hypothesis can be used to explain such competition. Researchers use a simple concentration measure known as the n-firm concentration ratio (CRn) or the Herfindahl-Hirschman Index to test the SCP hypothesis (HHI). Both the HHI and CRn are exogenously inverse indicators of competition intensity. All banks, regardless of size or type, are given the same treatment under this measure of competition. The SCP was studied in the 1990s using bank profitability and prices as an endogenous measure of the SCP in the United States, but these studies are restricted to or focused on the local American financial sector.

Exogenous studies are now being conducted on the aforementioned elements as a result of changes in the research environment. In comparison to earlier, more simplistic approaches, current research has made significant strides. New models of banking competition are being tested and generalizations are being made beyond the SCP hypothesis in today's research. A number of studies have discovered flaws in the traditional methods of calculating competition, such as the HHI and CRn, and have called for the adoption of more sophisticated approaches that take into account a variety of factors, including the size and type of banking institutions. Quality of service, efficiency, and risk are recommended as indicators of banking competition and concentration in research methods. Expanding the scope of their research from just the United States to include other US banking markets and other countries is a primary goal for researchers.

Many studies have shown that economic growth is a result of financial development, but the strength of the legal framework as well as the institutional characteristics of an economy play a significant role in financial development [Levine, 2003]. At both the microeconomic and macroeconomic levels, this dependence of financial development on legal framework and

institutional characteristics can be seen. In some studies, such as that of Beck et al. [2004], researchers have even noticed that economies with a strong legal framework have a sustainable financial development. As a result of this financial development and growth, both domestic and international direct investment is encouraged.

After further research, it is found that banking competition is affected by the size of banks. Furthermore, it has been discovered that small banks, which are referred to as 'community banks', may enjoy more advantages than larger banks. As a result of their increased flexibility in providing retail banking services relative to wholesale banking, these small banks are better suited for serving the needs of the general public [DeYoung et al., 2004].

Increasing competition in the banking industry may be shaped, in part, by technological advancements. Large financial institutions can afford to invest more in cutting-edge technology, which has the potential to improve customer service and the efficiency of banking operations. Some argue that the lack of technology in small banks may put them at an advantage in terms of customer satisfaction, but this is not necessarily the case [Berger et al., 2005]. According to Stein [2002], small banks have more agency problems than large banks, because information cannot be softly transmitted among all levels of management.

An additional study reveals that the majority of banks attempted to protect the value of their franchise in highly concentrated markets by keeping their risks low, due to the fact that this had an adverse effect on the bank's overall quality and level of service [Keeley, 1990]. Many banks in concentrated US banking markets tended to invest a relatively small amount in construction and land development projects as a way of keeping their risk levels low. Such low profitability led to cost challenges for these banks, so they tried to cover their costs by slashing services, as they had fewer funds due to low profitability. As a result, they were unable to provide the same level of service to their customers [Bergstresser, 2001]. Banks typically gained a competitive advantage through geographical expansions as well as acquisitions, according to the majority of the studies. It is because banks benefit from increased focus while also having their risks spread across a wider range of assets. Returns earned in a high-risk portfolio outweigh or cancel out the losses they have suffered elsewhere in their investment portfolio. A combination of high and low risk, according to the studies [Akhavein, Hughes, 1997; Hughes et al., 1996], improves the overall return and profitability of such banks [Akhavein et al., 1997; Hughes et al., 1996]. According to the findings of these studies, the bank's portfolio diversification strategy determines its expected returns and performance.

In the future, a large number of studies have also looked into the impact of bank concentration and competition in non-financial industries that either run parallel to or seek financial assistance from the banking industry. When competition is restricted, new firms, jobs, and growth are all hampered, while market exit is also made more difficult [Beck et al., 2003; Berger et al., 2004b; Cetorelli, Rajan, 2003; Cetorelli, Strahan, 2002], according to some studies. Many studies have found positive correlations between bank concentration and growth and lending to borrowers as their lending options for borrowers are limited [Bonaccorsi di Patti, Dell'Ariccia, 2004].

According to the findings of this study, formal competition policies increase economic growth. To ensure long-term economic growth, specific policies must be implemented. As a result, the stability of the banking sector will improve, which in turn will lead to real economic growth. Financial innovation must be encouraged because effective risk management improves the allocation of resources in an economy, which further enhances banking stability through new product development. To maintain the stability of the financial system, new domestic and foreign entrants must face entry barriers. Acquisitions by foreign banks in Europe must also be scrutinized more closely. As a result, banks in Europe and Asia stand to gain the most by tightening competition policies.

Summary

It is common for conflicts to be motivated by a mix of cooperation and competition. Having a strong social network is essential to developing and maintaining a cooperative mindset. A party's chances of reaching an agreement are increased when the conflict and the goals of each party are reframed in such a way that they are mutually dependent. Competition between banks is seen as an important factor in ensuring the stability of the economy's financial sector. In economics, there is still a discussion about whether or not increased competition is good or bad for the stability of banks.

The size of a bank is an important consideration in discussions about banking regulation and supervision. When economies of scale are at play, a larger bank may be advantageous in developing countries. This study investigates the relationship between bank size and the institution's stability. The impact of regulations on bank stability is also examined, with a focus on developing Asian and European economies. This paper examines the impact of the global financial crisis and the systemic bank crisis on future economic growth and development.

Protecting one's family financially if one dies early is the primary purpose of a life insurance policy. Human social insurance policies may cover people whose income is unexpectedly lost due to things like unemployment, illness, and natural disasters. Market insurance, a form of privatized property and theft insurance, covers damage and theft to property. By joining contractual savings and loan organizations, individuals can take on a fiduciary role rather than a principal role in investing in collective vehicles. In an IPO, investors can buy open-end mutual fund shares and then sell them back for their net asset value.

Real estate financiers provide financing for prospective home buyers, while leasing companies provide equipment. Hedge funds, on the other hand, focus on speculative trading, a specific industry, or cross-border investments. If you are looking for a way to keep your money safe until you retire, a pension fund may be the best option for your investment. Non-banking financial institutions (NBFIs) offer a wide variety of financial products and services tailored to the needs of specific groups. By unbundling, targeting, and specializing, NBFIs encourage competition in the financial services industry and help consumers make informed decisions.

Government regulators and anyone else's ability to keep an eye on the entire financial system is jeopardized when large portions of it are left largely unregulated.

Although the global financial crisis affected many countries, the United States was the focal point. Cross-country regressions using data from developing and developed economies show evidence for the twin peak model and against the sectoral model. The ultimate goal of a well-run banking system is to increase economic growth by improving allocative, productive, and dynamic efficiency (e.g. by encouraging innovation). Price competition (marginal-cost pricing) reduces the market power of a single firm as the number of firms in an industry grows. Since the 1990s, the banking industry, according to previous studies, has been experiencing concentration and competition. The CRn or the Herfindahl-Hirschman Index (HHI) is used to test the hypothesis by analyzing the concentration of n-firms. In the banking industry, technological advancements may play a role in shaping competition. Customers and banking operations could benefit from cutting-edge technology investments made by large financial institutions. As a result of the numerous studies that have found flaws in traditional methods of competition calculation like the HHI or CRn, more sophisticated approaches are now being recommended. However, the lack of technology in small banks does not necessarily give them an advantage over their larger counterparts in terms of customer service. There are more agency issues in a small bank because information cannot be softly transmitted to all levels of management [Stein, 2002]. Expansions into new regions and acquisitions give banks a leg up on their competitors. High-risk and low-risk investments, according to studies, increase a bank‘s overall return and profitability. Increased barriers to entry into a market and the creation of new firms, jobs, and growth are all consequences of limiting competition. European and Asian banks stand to gain the most from tightening competition policies, for obvious reasons.

A book-based measure of bank stability is used in this study. The market-based stability measures could be the focus of future research. Quantile regression estimator can be used to examine the impact of bank type and the proportion of local to foreign banks in the banking sector on bank-level data. Bank competition and economic growth may be influenced by other factors that are not examined in this research. In addition, the majority of countries have seen positive results when it comes to the crisis variable. For this reason, further research may consider a country-by-country analysis. Individual regulatory factors and bank stability are examined as part of this study. The use of a single aggregate factor may be considered in future studies (or index). Emerging and developed countries can be distinguished in the research.

Bank mergers and acquisitions are an important topic to keep in mind, as one of the reasons financial institutions make acquisitions is to limit competition with other large financial institutions.

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