Issue No. 20

AUTHOR OR EDITOR

Sandra Rozo Dairo Estrada

AUTHORS AND/OR EDITORS

Rozo, Sandra

As Freixas and Rochet (1997) mention, in perfect competition the optimal choice for banks is determined by the point where intermediation margins are equal to operating costs. In this scenario, market equilibrium is not affected by a bank’s actions. In contrast, when a bank has market power, it can affect prices, which will lead to higher lending rates and lower deposit rates. In this way, part of the consumer surplus is passed to the banks and efficiency is lost through a reduction in the volume transacted on the market. Therefore, regulations to limit the creation, spread and use of market power are entirely justified.

Nevertheless, the only guides to implementing such regulations in an ideal way are the empirical studies of competition that describe the characteristics of the relevant market, which is why they are so important.

In Colombia, existing empirical literature on the study of competitive conditions in the banking system has, by tradition, followed one of two tendencies. The focus is either on price or volume to explain the way banks behave, ignoring the possibility that banks might consider other types of strategic variables, or the market structure is invariably analyzed from a national standpoint, without asking if the conclusions for the domestic market are applicable on a regional scale.

This summary outlines a competition oligopoly model where banks use other variables, besides price, to compete on the market. Specifically, the relevance of geographic variables, such as the number of branch offices, is analyzed to explain the strategic behavior of banks in Colombia. A two-stage model is suggested in this scenario, where banks select the optimal interest rate with which they will compete throughout the country during the first period. In the second period, given that interest rate, they select the optimal number of branch offices to be opened in each region.

The proposed model is intended to evaluate the extent of competition in Colombia's regions and departments. More specifically, the working hypothesis suggests that the aggregated measures used traditionally to examine market power in Colombia leave aside certain regional and departmental features. This can lead to erroneous conclusions. In other words, analyzing the market structure in a more disaggregated way can produce more precise results, thereby making it possible to identify the regions where anti-competitive pressures might occur that cannot be detected at the aggregate level