Financial Stability Issues - Colombian bank efficiency and the role of market structure

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Colombia’s financial system has undertaken major changes during the last decade, with new regulatory regimes being implemented, as well as a significant expansion of financial services. Nevertheless, the recent literature has yet to analyze this new epoch for banking institutions under an efficiency framework. Taking into account the availability of new information and the methodological advances of recent years, our purpose is to study the evolution of bank efficiency during the past few years, as well as to evaluate the influence of some market structure variables on the latter. We find evidence, both under SFA and Order-m, supporting an increase in efficiency over time. Moreover, relating the latter with market structure variables suggests that there is a positive relationship between market power and efficiency; this occurs due to product differentiation, which allows banks to gain in efficiency provided they don’t set excessive credit prices. Nonetheless, there is an open debate concerning the behavior of banks with the highest market shares, since the negative relation between market concentration and efficiency advocates for a "quiet life formtt, where banks don’t have incentives to fully minimize costs. Additional to these results, we provide evidence of potential impacts that mergers and credit specialization may have on efficiency.

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