

# Chapter 11

## Connection Between Bank Competition and Bank Performance in India in Light of the Reserve Bank of India's Complaint

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### **ABSTRACT**

*The Reserve Bank of India suspected a cartel among 15 banks in fixing interest rates on deposits of the savings bank accounts over a period from 2011-12 to 2012-13 and lodged a complaint with the Competition Commission of India. The latter could not find any motive of the banks to collude and hence ruled out the complaint. The authors collected data on the banks' activities and performances on the said periods and examined in this chapter whether the commission was right in ruling out the complaint. The results of the analyses in this work lead to the conclusion that the commission was right in ruling out the complaint, but there are certain limitations and policy prescriptions that cropped out of this work, which should be conveyed to policy makers and researchers.*

DOI: 10.4018/978-1-7998-5083-0.ch011

## **NEED FOR THE RESEARCH ON THE CONNECTION BETWEEN BANK COMPETITION AND BANK PERFORMANCE**

In the Budget 2020 the Government of India proposed to infuse INR 70000 crore in addition to already infused 3.5 crore capital to the public sector undertaking (PSU) banks in India after the recovery of over 4 trillion INR of bad loans in the last 4 years through Insolvency and Bankruptcy code (IBC). The overall bad loans of Indian scheduled commercial banks peaked reportedly to 10.36 trillion as of March 2018. This decision came against the backdrop of slowdown of economic growth and chronic non-performing loan or asset (NPA) problems facing the PSU banks. The slowdown of economic growth costs India the downgrade of sovereign rating from stable to negative assigned by Moody's. The banking system plays a major role in financing economic growth as lender to the business. Performances of the banks in playing this role need to be backed by adequate strength in the form of a strong capital to asset ratio. But being rivals of each other in the same industry, they need to strive to keep up performance in order to compete well with each other. In Moody's sovereign rating methodology, capital to asset ratio is an indicator of the strength of the banking system to face an event risk like loan default. The PSU banks are either lacking that health or need to maintain more than the prescribed capital adequacy ratio in order to take risk in lending as suspected by the academia. So is the need for capital infusion by the Union Government. There is a room to suspect presence of collusion in lieu of competition if all of them are suffering from bad health. This can be deemed as the price of a banking crisis and the consequent output loss that could occur in absence of capital infusion. The infusion is to be financed by the recapitalization bonds that the government would issue to some banks against the excess deposits generated out of demonetization and those banks later can sell these bonds in the market for raising further resources. The performance of a bank may be measured by the indicators like return on equity, i.e. net income by shareholder's equity. A part of net income may be provisioned toward credit risk capital in the case of inadequacy of capital. The inadequacy of capital reflects on the government's decision to infuse capital. This also reflects the PSU banks' susceptibility to event risk in terms of Moody's. Researchers take it to be an indicator of the banks' capital cushion size to manage expected or unexpected losses and excessively low levels of this ratio points to potential defaults and can be a forerunner of a banking crisis. Thus, it is clear that the PSU banks are not performing well. So, the PSU banks' individual credit ratings may be affected adversely. The individual bank credit ratings need to be indicative of individual strength of banks, after the effect of government or other guarantees has been taken into account. Credit rating is a rule of thumb indicator of banks' condition and likely to influence their future capital requirement. So, there is a need to investigate into the connection between bank performance and their competition against the backdrop of downgrade of sovereign rating. India's effort to seek changes in international financial governance through BRICS is in the process of shaping global economic policies and promoting financial stability which should have influenced positively the performances of the banks, but is thwarted by the geopolitical factors like political interferences (Shi, 2004; Sengupta and Vardhan, 2019) and bureaucracy in the BRICS (Indrakanti and Sridevi, 2019).

### **CHAPTER SUMMARY**

In 2015 the Indian regulator Reserve Bank of India suspected fifteen banks including the largest public sector player State Bank of India and the largest private sector player ICICI Bank to have colluded in

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