



Available online at www.sciencedirect.com

ScienceDirect

Economía xxx (2016) xxx–xxx

ECONOMIA

www.elsevier.com/locate/econ

Switching costs and the extent of potential competition in Brazilian banking[☆]

Mariana O. Silva^a, Claudio R. Lucinda^{b,*}

^a *University of Sao Paulo, Brazil*

^b *University of São Paulo – Faculty of Economics, Business and Accounting at Ribeirão Preto, Ribeirão Preto, SP, Brazil*

Received 2 January 2015; received in revised form 16 September 2016; accepted 30 September 2016

Abstract

Switching costs are a leading cause of customer lock-in in banking, reducing the extent of competition and increasing market power in this industry. This paper tries to estimate these costs using a methodology that does not require customer microdata. The estimates obtained here—using bank accounting information collected on a quarterly basis from 2009 to 2011—indicate substantial switching costs in the deposit market, and such costs tend to be lower for customers of larger banks. Additionally, there is some evidence that much of a bank's market share is due to its continued relationships with customers over time (a lock-in effect). Thus, the extent of potential competition in Brazilian banking could be severely limited by these costs.

© 2016 The Authors. Production and hosting by Elsevier B.V. on behalf of National Association of Postgraduate Centers in Economics, ANPEC. This is an open access article under the CC BY-NC-ND license (<http://creativecommons.org/licenses/by-nc-nd/4.0/>).

JEL classification: L13; G21

Keywords: Switching costs; Banking; Industrial organization

Resumo

Custos de mudança são uma das principais causas de retenção de clientes na indústria bancária, reduzindo a competição e aumentando o poder de mercado nesta indústria. Este artigo tenta mensurar tais custos usando uma metodologia que não necessita o uso de microdados. As estimativas obtidas aqui - utilizando informações contábeis dos bancos em uma base trimestral entre 2009 e 2011 - indicam custos de mudança substanciais no mercado de depósitos à vista, e tais custos tendem a ser menores para clientes de bancos maiores. Além disso, existe alguma evidência que a maior parte da participação de mercado de um banco é devido às suas relações com os consumidores ao longo do tempo (efeito lock-in). Portanto, a extensão da competição potencial na indústria bancária brasileira pode ser fortemente limitada por tais custos.

© 2016 The Authors. Production and hosting by Elsevier B.V. on behalf of National Association of Postgraduate Centers in Economics, ANPEC. This is an open access article under the CC BY-NC-ND license (<http://creativecommons.org/licenses/by-nc-nd/4.0/>).

Palavras-chave: Custos de Mudança; Banking; Organização Industrial

[☆] Claudio Lucinda gratefully acknowledges the funding for research provided by CNPq grant 306685/2013-2. Mariana Oliveira gracefully acknowledges CAPES funding.

* Corresponding author.

E-mail addresses: claudiolucinda@fearp.usp.br, claudiolucinda@usp.br (C.R. Lucinda).

Peer review under responsibility of National Association of Postgraduate Centers in Economics, ANPEC.

<http://dx.doi.org/10.1016/j.econ.2016.09.009>

1517-7580 © 2016 The Authors. Production and hosting by Elsevier B.V. on behalf of National Association of Postgraduate Centers in Economics, ANPEC. This is an open access article under the CC BY-NC-ND license (<http://creativecommons.org/licenses/by-nc-nd/4.0/>).

1. Introduction

Although there is anecdotal and incomplete evidence that switching costs are important in the Brazilian banking sector, academic studies regarding the relevance of switching costs are scarce. The present paper investigates the role of switching costs in explaining some puzzling facts about the competitive structure of Brazilian banking.

After dealing successfully with high inflation for more than 50 years, the Brazilian financial system finds itself the largest and most sophisticated in Latin America (The World Bank, 2007). To survive inflation rates of more than 3000% in some years during the 1980s, Brazilian banks had to develop strategies to reap gains from floating. However, adapting to a low-inflation environment was not an easy or costless task.

Despite being larger than its Latin American peers, according to The World Bank (2007), the banking sector is not much more concentrated, with a Herfindahl index value of 900 and similar efficiency and capital adequacy ratios. The same study also reports some puzzling findings regarding retail banking products, which are much less sensitive to changes in the cost of funds than corporate products. Besides, the retail business line exhibits higher returns than the corporate line.

There are many possible explanations for such findings—for instance, Lucinda (2010) concludes that there is evidence of market power in Brazilian banking. This market power, at least in retail banking, could be related to high customer switching costs, of which there are some striking examples of a high value of a customer to a bank. The first example is the existence of so-called “university accounts”, which reduce a customer’s bank fees throughout his or her college education. The second is the aggressiveness of banks bidding for the right to manage public institutions’ payroll services. The third is the requirement, passed in 2006¹ and in place until 2012 for some public servants, that employees receive their wages only through an employer-defined bank account.

Such costs increase incentives to capture customers, may grant market power to incumbent companies and act as a barrier to potential entrants, with important consequences for banking sector competitiveness. They may also explain, to some extent, the difficulties faced by new entrants trying to gain market share. An example is HSBC, which although a major global player, has a somewhat small market share in Brazil. Despite having a presence in Brazil since 1997 and reaching the sixth-largest market share, HSBC’s total assets (BRL 146.6 billion) are only 34.0% of the value of the next largest bank (Santander, with assets of BRL 431.8 billion).² The largest banks in this ranking are institutions that were already large or have become so by acquiring other large institutions.

The model used here to estimate switching costs, developed by Kim et al. (2003), has two advantages. The first is that it does not require microdata on individual customers’ behaviors, and the second is that it makes possible the estimation of some implications for the market competitive structure. These implications shed light on the market power derived from switching costs.

This paper is divided into six sections, including this introduction. Section two presents a literature review, indicating how the methodology to be employed here relates to previous papers. This section is followed by the details of the methodology used to estimate switching costs. Section four presents both the dataset and the baseline specification, followed by a discussion of the results. Finally, section six concludes.

2. Literature review

Switching costs are perceived by economic agents when they change suppliers, and they are generated by the human and physical capital invested by each customer of a particular brand—sometimes even if the products of all suppliers are identical ((Kim et al., 2003)). The suppliers are identical before purchase but not after, which creates switching costs and may confer some market power.

The literature on switching costs is quite large, and major theoretical works include Klemperer (1987a,b). Klemperer (1995) conducts a comprehensive review of studies related to switching costs, and Shapiro and Varian (1998) gathers examples of their effects on market behavior.

An early study that is more directly related to this paper is Von Weizsäcker (1984), which proposes a model to measure the “competitive distance” between two products with switching costs. Klemperer (1987c), in turn, considers

¹ Resolution 3424 of the National Monetary Council.

² According to information from December 2011 from the Central Bank of Brazil (Accounting Information from the 50 largest banks).

Download English Version:

<https://daneshyari.com/en/article/5105432>

Download Persian Version:

<https://daneshyari.com/article/5105432>

[Daneshyari.com](https://daneshyari.com)