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# ROLE OF COMPETITION BETWEEN COMMERCIAL BANKS

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**Abstract**

Competition in the banking sector is crucial for fostering innovation, reducing costs, improving service quality, and ensuring financial stability. However, many markets are dominated by a few large institutions, which can stifle innovation and limit customer choice. This research explores key strategies for increasing competition between banks, focusing on regulatory reforms, technological integration, and market diversification.

**Key words**

Bank competition, regulatory reforms, fintech integration, market diversification, digital banking.

**Methodology:** Traditional methods of economic analysis, such as comparison, grouping, as well as analysis and synthesis methods, are used in this article.

**Literature Review:** Early work by Bain (1951) and Mason (1939) in industrial organization focused on the relationship between market structure and performance. The Structure-Conduct-Performance (SCP) model suggested that higher concentration (fewer competitors) leads to less competition, which could result in higher prices and reduced consumer welfare. However, this model has limitations in explaining the complexities of banking markets where regulatory frameworks play a significant role.

More recent theoretical models, such as the Quiet Life Hypothesis (Berger et al., 1993), argue that bank profitability and competition are not solely determined by market concentration. Instead, they can also be influenced by factors like product differentiation, regulatory policies, and market entry barriers. Additionally, models of contestable markets (Baumol et al., 1982) suggest that competition is not only about the number of banks but also the ease with which new entrants can enter and exit the market.

Several studies have examined the impact of market concentration on competition. For instance, Claessen and Leaven (2004) found that market concentration in developing countries correlates with reduced competition and less favorable outcomes for consumers, such as higher interest rates on loans. However, they also found that regulation can sometimes offset these negative effects.

A number of studies have investigated the relationship between competition and profitability. For example, Carletti and Hartmann (2003) found that greater competition leads to reduced profitability in banking, especially in oligopolistic markets, while other studies (e.g., Beck, Demirgüç-Kunt, and Levine, 2006) have shown that excessive competition could harm long-term bank stability by promoting riskier lending practices.

**Introduction:** The banking sector is a cornerstone of any economy, facilitating transactions, investments, and savings. However, in many countries, a small number of large banks dominate the market, which limits consumer choices and reduces the incentive for banks to innovate or offer better services. Enhancing competition within this sector can drive economic growth by fostering a more dynamic and customer-centered environment.

The main objective of this research is to identify effective ways to increase competition between banks. It will focus on the following areas:

- Regulatory reforms that encourage new market entrants.
- The role of financial technology (fintech) in driving competition.
- Market diversification and customer empowerment.

To effectively increase competition, a comprehensive strategy is required - one that addresses both the structure of the market and the regulatory framework. This includes fostering new entrants, reducing barriers to market entry, ensuring regulatory fairness, and encouraging technological innovation. Additionally, policymakers must consider the evolving role of fintech companies and the increasing convergence between traditional banks and technology firms, which could further intensify competition and transform the industry. Here given some Key Strategies for Increasing Competition.

➢ One of the most effective ways to increase competition is through **regulatory reforms.** Governments and central banks can lower the barriers for new banks to enter the market by simplifying the licensing process and reducing capital requirements for smaller, niche players. For example, in the UK, the introduction of "challenger banks" has significantly increased competition by allowing smaller, digitally-focused banks to operate under a more flexible regulatory regime.

➢ Secondly, **encouraging fintech and digital banking.** Technological advancements are revolutionizing the banking sector. Fintech companies are offering a wide range of services, from peer-to-peer lending to digital wallets, that challenge traditional banking models. Encouraging partnerships between banks and fintechs or supporting fintech innovation through favorable regulations can lead to a more competitive environment. Open banking initiatives, which require banks to share customer data with third parties (with consent), can also empower customers to access better financial products.

➢ Thirdly, **market diversification.** Diversifying the market by encouraging the development of alternative financial institutions, such as credit unions, cooperatives, and digital-only banks, can help reduce the concentration of power among a few large institutions. These smaller institutions often specialize in niche markets, offering tailored products and services that larger banks may overlook.

➢ **Promoting customer empowerment** is the one of the most crucial point. Increasing competition requires more than just regulatory and technological changes; it also requires educating and empowering consumers. Governments and financial institutions should invest in financial literacy programs to help consumers understand the range of services available to them and make informed decisions. This creates demand for better, more competitive banking products.

**Analysis and results:** Non-performing loans (NPLs) are a critical measure of a bank's asset quality and financial health. High NPL levels can create significant challenges for individual banks and the broader banking system, such as reduced profitability, impaired capital, and increased risk exposure. Conversely, a decrease in NPL levels can have positive effects on a bank's balance sheet, ultimately leading to a more competitive environment between banks.

While high levels of non-performing loans (NPLs) are generally a sign of trouble within the banking sector, they can indirectly foster greater competition. NPLs drive banks to innovate in risk management, improve pricing strategies, and adapt to customer needs more effectively. In an environment of rising NPLs, banks are compelled to compete on service quality, operational efficiency, and risk management, pushing the industry toward healthier competition and market discipline. However, this competitive dynamic depends on the overall regulatory environment, the capacity of banks to absorb shocks, and the willingness of institutions to adopt more customer-centric strategies.

The information from the given table, showing the NPLs (non-performing loans) of commercial banks in Uzbekistan, has significant implications for competition between these banks. Banks with higher NPL ratios face several challenges that can affect their ability to compete effectively in the market.

The table below provides a snapshot of the credit portfolios, non-performing loans (NPLs), and the share of NPLs in total loans for selected commercial banks in Uzbekistan as of September 1, 2024. This data highlights the health of these banks' loan portfolios and their ability to manage loan defaults:

**Analysis of problem loans of commercial banks**[7]

Information as of September 1, 2024

*billion soums*

| № | The name of commercial ks | Credit portfolio | Non-performing ıs (NPLs) | share of NPLs in l loans |
|---|---|---|---|---|
| 1 | National bank of Uzbekistan | 104 651 | 3 435 | 3,3% |
| 2 | Industrial-construction bank Jzbekistan | 62 326 | 2 150 | 3,4% |
| 3 | Agrobank | 59 422 | 1 933 | 3,3% |
| 4 | Asaka bank | 37 461 | 1 784 | 4,8% |
| 5 | People's bank | 28 452 | 1 492 | 5,2% |

Overall NPL Levels represent a significant portion of the credit portfolios of these banks, though the share of NPLs in total loans ranges between 3.3% and 5.2% across different banks. The highest NPL share is observed in People's bank (5.2%), followed by Asaka bank (4.8%). These banks might face higher risks in loan recoverability compared to others. The largest credit portfolio is held by National bank of Uzbekistan with a credit portfolio of 104,651 billion UZS, followed by Industrial-construction bank of Uzbekistan (62,326 billion UZS). Despite the higher total credit portfolio, National bank of Uzbekistan has a relatively low NPL ratio (3.3%), suggesting effective risk management in comparison to its portfolio size. People's bank has the highest share of NPLs in its portfolio (5.2%), which may signal potential challenges in credit quality and loan recoveries, despite having a smaller credit portfolio compared to others. Asaka bank also has a relatively high NPL ratio at 4.8%, which warrants close attention to its loan management and asset quality.

Banks with lower NPL ratios are likely to be in a stronger competitive position, as they can maintain healthier balance sheets and offer more competitive lending terms. Banks like National bank of Uzbekistan and Agrobank, with

[7] Author's development based on information from the official website of the Central Bank

relatively low NPL ratios, might be more aggressive in pricing and service offerings compared to banks with higher NPL ratios like People's bank and Asaka bank. Regulators may need to closely monitor the performance of banks with higher NPL shares (e.g., People's bank and Asaka bank) to ensure that they maintain adequate capital buffers and do not face liquidity challenges. Banks with higher NPL ratios should focus on improving their credit risk management practices, loan collection mechanisms, and loan restructuring options to reduce default rates and improve asset quality.

Banks with higher NPL ratios are likely to attract more regulatory scrutiny, as a high level of bad loans could indicate systemic issues within the bank. They might face stricter oversight and higher capital reserve requirements, which can restrict their ability to grow and compete. Increased regulatory burdens and higher capital requirements could lead these banks to reduce lending or raise loan prices, thus making them less competitive compared to banks with stronger financial health. Banks with lower NPLs are less likely to face such scrutiny and may find it easier to comply with regulatory requirements without having to maintain large capital reserves. This gives them more room to operate flexibly and to offer competitive products. Banks with fewer regulatory constraints can focus more on growth, investment in innovation, and expanding their market share, while competitors with high NPLs may be constrained.

Banks with low NPL ratios have the financial strength to expand their market share by offering more attractive terms, providing more credit to businesses and consumers, and investing in new technologies or customer-centric services. This allows them to increase their competitive positioning. These banks are likely to grow their customer base and become key players in the market, pushing out less competitive banks. Banks with high NPL ratios may face challenges in customer acquisition as they limit the availability of credit or charge higher rates. Existing customers might leave for more attractive options, and new customers may hesitate to borrow from banks with higher risk profiles. These banks may see stagnation or even a decline in their market share, making them less competitive in the long run.

There are a number of problems in creating healthy competition between commercial banks in our country. We propose the following as these problems and their solutions (Table 2).

**Table 2**

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**Problems of development of competition between commercial banks in the Republic of Uzbekistan and their solutions** [8]

| № | Problems | Proposed solutions |
|---|---|---|
| 1 | The dominant ion of state-owned s | expanding the participation of the private sector: competition can icreased by creating favorable conditions for the development of ite banks and reducing the participation of the state. Government ntive programs should be implemented for private banks to ce taxes, simplify licensing processes and develop their activities. Privatization of state banks: Privatization of some state banks introduction of competitive market mechanisms can increase cet competitiveness. |
| 2 | Differences in the of technological lopment between s | Partnership with fintech companies: Banks can introduce digital ces by partnering with fintech companies. It helps to offer more enient, faster and cheaper financial services for customers. Increase investments for technological modernization: Banks ld invest more in digital technologies and IT infrastructure. ugh this, they can achieve the expansion of remote services to omers, the development of mobile applications and online ces. |
| 3 | Limited rsification of financial ces | Introduction of new financial services: Banks should expand the rsification of services. For example, offering services such as ial credit lines for small and medium-sized businesses, innovative stment products and mobile payment solutions will increase petition. Customer Service Strategies: Each bank must develop its own ue customer service strategy and offer individual financial ions tailored to customer needs. This can increase customer ty. |
| 4 | Cost optimization efficiency issues | Optimizing operating costs: By expanding digital services and mating processes, operating costs can be reduced. This allows s to save resources and reduce the cost of services. Implementation of new technologies: Banks can increase ency and strengthen competitiveness by introducing advanced nologies such as artificial intelligence, blockchain and automated ces. |
| 5 | Low financial icy | Financial literacy programs: Government and banks should nd financial literacy campaigns and training programs. It helps ple learn how to get loans, invest, and access other financial ces. Simplification of financial services: Banks should simplify the gn of services to make them convenient and understandable for a |

[8] Author's development

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| № | Problems | Proposed solutions |
|---|---|---|
| | | r population. More people will become familiar with these ces and increase the competition between banks. |

To develop the competitiveness of the banking sector of Uzbekistan, it is necessary to reduce the participation of the state, accelerate technological development, diversify financial services and increase operational efficiency. At the same time, the joint efforts of the state and banks to increase financial literacy will ensure the population's wider use of financial services. When a competitive environment is created, banks invest more in innovation and try to provide more suitable services to customers.

By developing the competition between commercial banks in our country, it is possible to achieve healthy competition between them and, as a result, the development of the economy. We can cite the following as prospects for the development of competition between commercial banks.

1. Technological development and digital transformation. Commercial banks strive to quickly introduce technological innovations in order to win the competition. By cooperating with digital banking services and fintech companies, banks will be able to provide fast, convenient and secure services to customers. The development of mobile banking, online transactions and electronic payment systems plays an important role in meeting the needs of customers.

2. Offering new products and services. Commercial banks should create new products and services to increase competition between banks. This is done through innovation in areas such as lending, deposits and investment products. For example, banks can increase their competitiveness by offering microloans, small and medium business loans, or products tailored to the rural population.

3. Competitive interest rates and transparency. In order to develop competition between banks, information about interest rates and services should be transparent. Giving customers the opportunity to choose the best offer from different banks increases competition. It is also important that commercial banks publicly announce different rates and service information.

4. Creating favorable conditions for customers. Improving the quality of customer service is also important in increasing competition. Banks need to develop a culture of customer service, create convenience and show individual approaches to attract new customers. Also, banks' introduction of new technologies, automation of operations, and offering of low-cost services increase customer satisfaction.

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5. Market entry of foreign banks. The entry of foreign banks into the market of Uzbekistan may increase competition. This makes it possible for domestic banks to exchange experience and adapt to international standards. International competition encourages domestic banks to provide quality services and increase financial stability.

**Conclusion:** The differences in NPL ratios between the commercial banks in the table create a varied competitive landscape. Banks with lower NPL ratios (such as National bank of Uzbekistan and Agrobank) are likely to have a competitive advantage due to their financial strength, profitability, and lower risk exposure. These banks can offer better loan terms, attract more customers, and invest in innovation. On the other hand, banks with higher NPL ratios (such as People's bank and Asaka bank) may face challenges in profitability, capital adequacy, and customer acquisition, making them less competitive in the market. while the NPL levels are within a manageable range for most banks, there is room for improvement, especially for those with higher NPL shares. Reducing NPLs can strengthen their financial position, reduce risk exposure, and increase their competitiveness in the market.

Increasing competition between banks is vital for driving innovation, reducing costs, and improving service quality. Regulatory reforms, technological integration, market diversification, and customer empowerment are key strategies that can help create a more competitive banking environment. While challenges remain, a concerted effort by regulators, banks, and consumers can lead to a healthier, more dynamic financial sector.

**Recommendations:**

As a result of scientific research, we would like to put forward the following scientific proposal and practical recommendations.

- Regulatory Bodies: Simplify licensing for new and digital banks, and support the development of fintech through clear, fair regulations.
- Banks: Embrace fintech partnerships and adopt new technologies to stay competitive.
- Consumers: Take advantage of financial literacy programs and explore alternative banking services for better choices.
- Enhanced NPL Disclosure and Transparency: Regulators and banks should ensure that NPL ratios and related metrics are transparently disclosed to the public and stakeholders.
- Develop Cross-Border NPL Markets: To increase competition between banks, regulators can explore creating cross-border markets for NPLs.

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➢ Introduce Regulatory Incentives for NPL Reduction: Regulatory authorities could introduce temporary incentives such as tax breaks or reduced capital adequacy requirements for banks that successfully reduce their NPL ratios.

By implementing these measures, countries can foster a banking ecosystem that is more competitive, innovative, and customer-focused.

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