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Management Behaviour in Indian Commercial Banks

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Abstract: The study explores management behavior in Indian commercial banks during the post reform period. The Granger causality approach of Berger and De Young (1997) is employed to examine four hypotheses such as bad management, bad luck, moral hazard and skimping behavior of Indian commercial banks. The empirical analysis conducted for Indian banks on its three ownership groups, viz., public sector, private domestic and foreign banks, reveal the existence of characteristics of the bad management and the bad luck in Indian banking operations. The econometric analysis for sub samples of the most cost efficient banks reveal that there is no skimping behavior, while the sub sample for the least capitalized banks supports the existence of moral hazard behavior in Indian banks. The study also finds an inverse relationship between cost efficiency and capitalization. Finally, economic effects of the four hypotheses are explored.

Keywords: Non-performing loans; Capitalization; X-efficiency; Stochastic frontier approach; Granger causality; Management behaviour; Economic effects.

1. Introduction

Over the last two decades the Indian banking system has become increasingly integrated. The two forces of deregulation and technological change led to the development of financial integration and increased competition in the banking system. As a result of the deregulatory process, there has been a remarkable stress on the role of efficiency in the banking system. That is, it has forced banks to perform closer to the efficient production frontier. On the other hand, the increase in competition reduces the market power of banks which could lead to greater risk taking behaviour in banks (Fiordelisi et al., 2011).