

Systemic Importance of Banks and Market Discipline: A Study of Indian Banks

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Abstract

We examine the relationship between the systemic importance of banks and market discipline in the Indian banking industry. This study has two objectives, first is to check if market discipline exists at different levels of the systemic importance of the banks and second, if market discipline exists, then does its strength differs across different systemic importance of the banks. This study is based on 38 banks including both public and private banks. The existence and strength of the market discipline have been tested with regard to its importance by analysing the responsiveness of the depositors towards the riskiness of the banks. The study uses fixed effects for the deposit growth model and system generalised method of moments (GMM) estimator in the cost of deposit model due to its dynamic nature. The results show that the market discipline is present at all levels of systemic importance.

JEL Code : E58, G00, G01, G21, G33, G28, G32

Keywords : Market Discipline; Banking; Systemic Importance; TBTF; GMM; PSB; Private Banks; India

I. Introduction

DURING THE 2008 financial crisis, it became apparent that due to the presence of big and interconnected institutions, even a manageable concern may become detrimental to the orderly functioning of the financial system and hence to the whole economy (Hett and Schmidt, 2017). The rescue of these institutions is important as their failure may have an adverse impact on the whole economy given their importance in the financial system (Moosa, 2010). Due to this, government intervention becomes necessary to facilitate their survival. But this intervention by the government has its consequences in the form of weak market discipline (Moosa, 2010; Hett and Schmidt, 2017). Therefore, it becomes imperative to increase banks' resilience to bear

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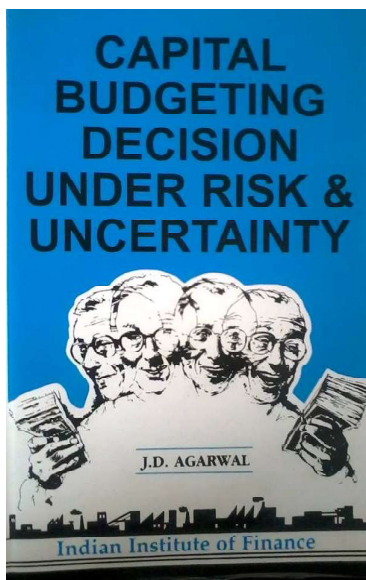
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