


Chapter 3

Banking Regulation and Efficiency: Evidence From Spain

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ABSTRACT

The banking system is an indicator of macroeconomic stability. Banking practices and regulation affect their operability, and hence, their efficiency in a competitive environment. Efficiency measures the optimal degree to which the needed resources to obtain the banking services are used. Knowledge on how to identify the combination of variables improves efficacy and, thus, assures the survival of financial entities in that competitive environment, also reinforcing macroeconomic stability. In this study the authors focus on Spain with the aim of analyzing the evolution of the efficiency in the Spanish banking system, segmented by size, during 2005 – 2020; thereby including different economic stages and regulation modifications carried out by the Bank of Spain about banking restructuring to improve its efficiency and profitability. Using the methodology of the analysis of ratios proposed by the International Monetary Fund, results evidence uneven effects for profitability and cost efficiency depending on the size of financial entities.

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1. INTRODUCTION

The banking system is one of the most relevant indicators of macroeconomic stability (Drake et al., 2006; Hunjra et al., 2022; Khan, 2022; Pozo, 2023). Hence the proliferation of studies (see, among others: Barth et al., 2013; Bhatia et al., 2018; Blanco-Oliver, 2021; Chortareas et al., 2012; Gaganis & Pasiouras, 2013; Sarmiento & Galán, 2017) that analyze how banking practices and regulations affect their operability, and therefore, the efficiency to continue competing in a volatile scenario that moves around an economic and financial system that sets the pace for business development.

Regarding regulation, the European Banking Authority (EBA), as an independent institution of the European Union (EU), works and supervises the European banking sector with the aim of maintaining the financial stability in the EU and, therefore, ensuring the efficiency and correct operation of the banking sector. In the specific case of Spain, pursuant to the Spanish Royal Legislative Decree 4/2015 dated October 23, it is established that the Bank of Spain annually prepares a report about its supervising function regarding its intervention and procedures carried out, from which information about the Spanish banking system efficacy and efficiency can be deduced.

Efficiency is used to measure the optimal degree to which the needed resources to obtain the banking services have been used (Halkos & Salamouris, 2004; Tan, 2016). As Quesada (1994) indicates, an institution improves its efficiency when it reaches the same amount of output with the same or less amount of resources. Therefore, knowing how to identify the combination of variables gets efficacy to improve, which is the objective of any strategic plan of a financial institution because in proportion to this achievement, survival will be assured, not always easy in such a competitive environment. In fact, in recent years the structure of the Spanish banking system has changed (Delgado, 2012; Romani, 2012), with mergers and takeovers of institutions that try to take advantage of synergies to become more efficient and, therefore, more productive (Anthanassopoulos, 1998; Berger et al., 1993; Bhatia et al., 2018), starting this restructuring process with the regulatory effort of the Bank of Spain with the enactment of the Royal Decrees of 2012 (Delgado, 2012).

Despite the importance of the efficiency in the banking sector for any country and the special characteristics of the Spanish banking authority, the Bank of Spain, to the best of our knowledge we have not found studies in prior literature focusing on the study of the efficiency of the Spanish banking system and how it evolves over a long period of time, covering different economic moments, and in which the Bank of Spain has had a significant influence, due to its regulatory effect on the

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