CHAPTER 1: INTRODUCTION

1.1 Introduction

The financial crisis that hit Asian in mid 1997 also known as the Asian Financial Crisis had prompted bank regulators to undertake various measures to reform the banking system. The consolidation process includes recapitalizing, takeover and merging of banks to avoid closure of distressed banks (Hawkins & Turner, 1999).

A large number of studies have been made to compare the pre and post bank consolidation in terms of efficiency however the findings are inconsistent. Apart from the inconsistency of findings, the number of literature comparing bank efficiency across ASEAN countries is limited.

Karim (2001) had investigated on the bank efficiency across select countries in Asean region which includes Indonesia, Malaysia, Philippines and Thailand where the results shows that ASEAN banks enjoy increasing returns to scale and the scale economies for ASEAN banks decrease with asset sizes, and larger banks tends to have higher cost efficiency than smaller banks.

Berger et al. (1999) had stated that the consolidation process although having little or no cost efficiency improvement, the consolidation involving previously inefficient firms may have “woken up” the management and had also indicated that the consensus findings that medium sized banks are being slighly more efficient than either the large or small banks.

As past researches on the bank efficiency are usually done on banks within a single country, this research will provide a cross country comparison within selected ASEAN countries. Apart from that, the other key motivation for this study is to understand the relationship of the size of the banks towards the efficiency of banks in ASEAN countries.

The sub sections below provide an overview of the banking system in the selected ASEAN countries, Malaysia, Philippines, Thailand and Vietnam which will provide an outlook on the current banking system in the selected country which will be included in this study.

1.1.1 Overview of Banking System in Malaysia

The financial sector in Malaysia has undergone transformation via a series of consolidation, restructuring and rationalization activities.

The central bank of Malaysia, Bank Negara Malaysia (BNM) was established on 26 January 1959 under Central Bank of Malaysia Act 1958 (Revised – 1994). Following the Asian Financial Crisis, the BNM introduced a Financial Sector Master Plan in 2001 to revamp the finance sector. As of today, there are 23 commercial banks operating in Malaysia whereby 9 are locally owned.

1.1.2 Overview of Banking System in Philippines

The Philippines banking system is composed of universal and commercial banks, thrift banks, and rural and cooperatives bank. The universal and commercial banks represent the largest single group. The thrift banking system is made up of savings and mortgage banks, private development banks, stock savings, loan associations and microfinance thrift banks. The rural banks are more common in rural areas where it serve to promote and expand the rural economy.

The central bank of Republic of the Philippines, Bangko Sentral Pilipinas (BSP) was established on 3 July 1993 under the provision of the 1987 Philippine Constitution and the New Central Bank Act of 1993 where BSP undertook the role from the Central Bank of Philippines established earlier on 3 January 1949. Today, there are 23 commercial banks, 84 thrift banks, 711 rural banks 44 credit unions and 12 non-banks with quasi functions operating in Philippines.

1.1.3 Overview of Banking System in Thailand

After the Asian Financial crisis in 1997, Thailand financial sector had made a substantial progress. The Bank of Thailand (BOT) was set up as the Thai National Banking Bureau on 10 December 1942 under the Bank of Thailand Act 1942 (Revised 2008).

The government's Financial Sector Reform Master Plan was introduced early 2004 to strengthen the financial sector through the consolidation of commercial, state-owned and foreign-owned institutions. Today, there are 14 commercial banks, 2 retail banks and 15 foreign banks operating in Thailand.

1.1.4 Overview of Banking System in Vietnam

The Vietnam banking system reformation started since 1986 where from 1988 to 1990 the mono-tiered banking system was being dissolved and as a result, a two tier banking system was being introduced.

The State Bank of Vietnam was founded on 6th May 1951 and in 1976, the formerly National Bank of Vietnam became the central bank of the country. Today, there are 6 state owned credit institutions, 37 joint stock commercial banks and 5 foreign banks operating in Vietnam.

Based on the overview of the banking system in the 4 different countries that will be studied on, it is notable that the approach taken by the different countries to establish its financial system has its own differences and it would be worthy to understand if the approach taken by the different countries would create banks that are efficient.

1.2 Problem Statement

The banking industry is a crucial component in ensuring a sound financial market environment. Banking institutions plays a vital role in the intermediation process. The role of financial intermediaries in the process of mobilizing funds is a critical element in fostering technical innovation and economic growth (Schumpeter, 1911).

A large intermediary, commercial or investment banks, are able to take advantage of specialization along with economies of scale and scope where this intermediary is able to deal with all types of credit and financial instruments leading to department store banking (Bhatt, 1989).

As geographical and product deregulation occurs, the resulting increase in competition should place banks in a situation where their success will depend on their ability to adapt and operate efficiently in the new environment and banks unable to do so will have difficulty surviving (Evanoff & Israilevich, 1991). Berger and Humphrey (1997) stated that the key objective of deregulation is to improve efficiency.

Existing literature on efficiency and the relationship with the bank size are usually done on banks within a single country and lacking of cross country study. Besides that, most of the literatures on efficiency are concentrated on developed countries.

As the banking industry in ASEAN region is currently in an expansion mode, the competition for the banks are not only within the same country. This study will provide an interesting opportunity to provide understand the relationship of size type of the bank towards efficiency.

1.3 Objectives of the Study

The objective of this study is to investigate the 'best practice' in terms of bank's size in determining the bank's efficiency in selected ASEAN countries. The specific objectives of this study are expressed as follows:

1. Develop and apply the Data Envelopment Analysis model to measure the efficiency of the banks based on the selected ASEAN countries.
2. Benchmarking the banks in the selected ASEAN countries by observing the relationship between efficiency and bank size.
3. Identify the productivity change of the different banks within the period of study based on Malmquist Productivity Index.
4. Determine the 'best practice' in deciding the bank size to achieve optimal efficiency.

This study covers the selected developing ASEAN countries namely, Malaysia, Philippines, Thailand and Vietnam with data obtained from the period of 2005 to 2009.

1.4 Significant of the Study

The study on banking efficiency have been extensively done by using traditional methods to study the input and output to measure efficiency or to even utilize Data Envelopment Analysis models however the environmental variables are not always used as part of the variables used in the study.

Furthermore, the study on ASEAN countries have been lacking as compared to banks located in developed countries. The cross country comparison among countries in ASEAN region is also lacking whereby as banks are expanding within the same region, this study would be able to serve as an indicator to the policy makers.

The study intends to understand the bank efficiency in the different countries within ASEAN in two perspectives. Firstly, the bank efficiency within the same country and secondly, the efficiency level of the banks operating in the different selected country.

As an extension to this, the bank specific variable which in this case is the size of the banks is used to understand if size is a contributing factor in the bank's efficiency of the different selected country.

Finally, the result obtained in this study will provide a benchmarking resource to assist in identifying banks which are best practice bank.

1.5 Scope of the Study

This research investigates the efficiency of banks that is located in selected ASEAN countries namely, Malaysia, Philippines, Thailand and Vietnam. The banks are selected based on the bank's specialization criteria whereby only banks categorised under commercial bank will be included in the study.

The data set for the period of 5 years from 2005 to 2009 will be used in this study. DeYoung (1997) has indicated that a period of 6 years study period would be reasonable in the context to address the concern of period of study for efficiency in banks. Besides that, having a period which is too long, the bank's efficiency score will be meaningless as the bank management might change over the period of time.

1.6 Contribution of the Study

This study is believed to provide valuable information to the policy maker and the banking industry as a whole by understanding the relationship of the bank size contributing to the overall efficiency of the bank.

Secondly, this study will also analyse on the efficiency level for the different banks in the selected developing countries located in ASEAN by decomposing them into technical efficiency and technology change using the Data Envelopment Analysis.

Based on the Malmquist Productivity Index, the efficiency score obtain can be compared against the previous scores, against the peers and cross country comparison.

As a conclusion, the contribution of study from this thesis, policy makers and banks are able to further understand their current standing and to strategise their next action to further enhance their competitiveness in the era of globalisation.

1.7 Organisation of the Study

This study begins with an introduction to initiate the overall objective of this study is being conducted and to provide an overview of the banking environment in the selected countries.

In Chapter 2, the literature review to review the critical points based on the existing findings that have been made as well as the different theories and methodology used in previous studies which has similarity to this thesis.

In Chapter 3, the methodology used to conduct this study is being outlined and discussed to provide the readers on the data source, collection process, research instruments and the data analysis techniques.

In Chapter 4, the analysis of the study is being presented and discussed further to establish the findings of the study.

The final chapter, Chapter 5 will be used to summarise the thesis and include the recommendation based on the findings.