Research in International Business and Finance 38 (2016) 214–223

Contents lists available at ScienceDirect

Research in International Business and Finance

journal homepage: www.elsevier.com/locate/ribaf

Full length article

Bank efficiency determinant: Evidence from the gulf cooperation council countries

Anwar Al-Gasaymeh

Skyline University, Sharjah, United Arab Emirates

ARTICLE INFO

Article history:
Received 6 December 2015
Accepted 29 April 2016
Available online 2 May 2016

Keywords:
Efficiency
Country risk
SFA
GMM
GCC

ABSTRACT

Using data from 2007 to 2014, we investigate the effects of inflation, unemployment rate and GDP per capita growth on bank efficiency for the Gulf Cooperation Council countries in an unbalanced panel consisting of 75 banks and 415 observations. Applying stochastic frontier estimation procedures, we compute cost efficiency taking account of both time and country effects directly. In second-stage regressions, we use the efficiency measures to investigate the influence of country risk variables and concentration ratio applying Generalized Method of Moments technique with respect to the impact of political risk, credit ratings and debt in default. The finding suggests that banks in countries with low country risk, and low concentration tend to perform more efficiently. Furthermore, a negative but insignificant relationship between total assets and bank efficiency reflects the fact that larger banks in developing countries suffer from diseconomies of scale.

© 2016 Elsevier B.V. All rights reserved.

1. Introduction

Financial markets witnessed several environmental changes in the last two decades in the Middle Eastern countries to facilitate the process of financial integration. These changes were designed to liberalize the provision of services and the degree of economic stability, as well as to increase competition in strengthening the efficiency of the financial markets. In the context of the Gulf Cooperation Council (GCC) countries, they intend to form an union in the near future to promote financial integration (Laabas and Limam, 2002; Sturm and Siegfried, 2005; Takagi, 2012). One of the main criteria of forming a union is that member countries ought to have similar levels of economic performance, particularly in the banking system. Therefore, the potential Gulf union should ensure that their banking sector has an ability to compete within the GCC members. Banking efficiency is an important issue for policy makers to ensure economic stability and for the development of the economy. The primary goal of banks is to stabilize target markets by making efficient use of available resources. Banks endeavour to allocate resources to the most productive projects that contribute towards realising these objectives. Managerial decisions and the environment play a critical role in ensuring proper and efficient allocation of the resources. Earlier studies have investigated the impact of internal environments as well as economic conditions on the efficiency of banking sector.

How efficient is the banking sector within the GCC countries is very interesting issues to explore because the region is still at the developing stage, in which warrants special attention to improve the levels of banking performance and monitoring the operations of banks. In fact, the GCC intends to transform from cooperation to a union to enhancing economic integration, strengthening the economy and eliminating the barriers across country. Moreover, efficiency of the GCC banks is an imperative for monetary establishments to successfully maintain their businesses in the face of increasing competition

E-mail addresses: gasaymeh@yahoo.com, gasaymeh2014@gmail.com

http://dx.doi.org/10.1016/j.ribaf.2016.04.018
0275-5319/© 2016 Elsevier B.V. All rights reserved.

within the financial markets and rapid technological advances in banking operations and services. GCC began the program of liberalization of the banking sector and privatization since the early 1990s. The objective was to increase efficiency and avoid future financial crises, as well as to promote economic stability.

In order for the GCC countries to have a successful union in the near future, the government and policy makers in these countries should aware the role of country risk and the levels of competition in influencing their banking sector (Al-Gasaymeh et al., 2014). This is an essential consideration due to the fact that presence of different governmental regulations across countries in which could affect the level of efficiency among the banks in the GCC countries. Hence, banks' efficiency measures are good indicators of the success of the potential Gulf union in future. It is natural that banks, which are less efficient, would lose their market share and be replaced by banks that are more efficient. Thus, it is vital to policy maker in examining the main factors that can influence the banking efficiency in the GCC countries. This is essential to the authorities and policy makers in recognizing the environmental variables such as political risks, credit ratings, debit indicator and the degree of concentration in identifying and formulating policies to improve the efficiency of their banking sector. The comparison of banking efficiency across countries is important to allow not only for variations in relative factor prices but also for country-level variables that could influence the level of efficiency of the banks. The efficiency level across countries could differ due to the environment, macroeconomic conditions or the degree of country risk, apart from the level of competition in the country. Therefore, it is essential to focus on the determinants of efficiency such as macroeconomic variables, including gross domestic product, inflation, population density, gross national income, and country risk variables. Cross-border efficiency might also be affected by the market conditions and policies of the home country (Berger, 2003).

The effect of high country risk would be greater if the countries are in the form of union. However, no studies have been done on union countries. Therefore, this paper will determine the effect of country risk and concentration level on GCC countries, as GCC is potentially to form a union. Moreover, a successful union requires member countries to have similar characteristics including the banking sectors performance.This will compare the six GCC countries in effort to see the performance of banks in the potential Gulf union. Previous study investigates the determinants of bank efficiencies in the GCC countries used bank specific and macroeconomics variables and did not take into account country risk variables and competition level. Hence, this paper will test the influence of country risk and concentration level on efficiency of the potential GCC union countries by employing the Generalized Method of Moments (GMM) technique in a dynamic panel data. The results show that country risk and bank concentration are positively influence bank efficiencies. Moreover, banks in countries with low country risk, and high competition levels tend to perform more efficiently. It is therefore, important for policy makers in the potential GCC union countries to decrease country risk and increase competition in order to have higher banking efficiency. This paper would contribute towards reducing the gap by providing new empirical evidence on the impact of country risk and competition on bank efficiency in the potential GCC union members.

The rest of the paper is organized as follows. The next Section presents the literature review, while Section 3 outlines the methodology. The data and empirical specifications are explained in Section 4 and the empirical results are given in Section 5. Finally, Section 6 provides the summary and conclusions.

2. Literature review

To predict the effects of the expected escalation in cross-border country risk and competition, it is important to determine the differences and similarities in the current efficiency of banks in different countries. However, cross-border comparisons have to account for potential differences arising from certain country-specific aspects of banking technology on one hand, and the environmental and regulatory conditions on the other. In particular, the economic environments are likely to differ significantly across countries, and could induce important differences in levels of bank efficiency through various channels. For instance, differences in country risks and competition level across countries could produce significant variances in the demand for banking products and services among households. Over the last two decades, an extensive research by financial economists measuring financial institutions' efficiency Fries and Taci (2005); Abdul-Majid et al. (2012); Goddard et al. (2011), Alshammari (2003); Al-Jarrah and Molyneux (2010); using alternative methodological approaches. Some of these studies have considered country-specific environmental conditions such as inflation and population density (Abdul-Majid et al., 2012; Bos and Kool, 2006). While, some studies have assessed the effects of deregulation and liberalisation on banks' efficiency (Barth et al., 2004; Chen et al., 2005; Demirguc-Kunt et al., 2003; Pasiouras et al., 2009). As control, variables explain differences in efficiency levels among banks. Country-specific control variables, such as country risk and macroeconomic conditions have significant influences on cross-county studies. The variables take account of heterogeneity as well as the different technologies in those countries. There have been a large number of studies on the impact of on economic growth in developed countries (De Haan and Siermann, 1998; De Haan and Sturm, 2000, 2003).

An important issue that affects banking efficiency is country risk, when business transactions take place across borders, they carry additional risks in domestic transactions which finally will affect bank efficiency (Meldrum, 2000). These risks, called country risks, usually include political risks arising from a variety of national differences in policies, socio-political institutions, geography, economic structures, and currencies. A political risk identifies the potential for these risks to affect the expected returns of a cross-border investment. Moreover, political risk is a change in government control or other non-economic factors, which may lead to inefficiency banking sector due to an instability economic conditions (Meldrum, 2000). Leibenstein (1966) argues that inefficiencies reduced by increased competition as manager's respond to the challenge. Goddard and Wilson (2009) suggest that, competition in the banking sector changes gradually over time. Some of the studies

Download English Version:

https://daneshyari.com/en/article/1003016

Download Persian Version:

https://daneshyari.com/article/1003016

Daneshyari.com