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Bank efficiency and shareholder value in Asia Pacific☆

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ABSTRACT

This paper uses dynamic panel estimation approaches to investigate the relationship between shareholder value and efficiency for a large sample of commercial banks in 14 Asia-Pacific economies between 2003 and 2010. In general, the results indicate that shareholder value is positively linked to improvements in both cost and profit efficiency, and the influence varies over time. The findings also suggest that bank size, credit losses, and market risk significantly influence bank performance. These results are robust to various model specifications.

1. Introduction

The global banking industry has been transformed over the last two decades. Forces driving this transformation include technological innovation, structural deregulation, prudential reregulation, internationalization, and changes in corporate behavior, such as growing disintermediation and

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increased emphasis on shareholder value (Berger et al., 2010). The global financial crisis of 2008–2009 also accentuated these pressures and illustrated that bank performance can have dramatic effects on capital allocation, company growth, and economic development – namely via increased capital and funding costs. It is well known that capital costs are linked to sovereign and other risks (see IMF, 2011; BIS, 2011, 2013). Post-crisis, regulators in the developed world have forced banks to raise massive amounts of new capital and these firms are struggling to achieve returns in excess of the cost of capital (ECB, 2012). The big, internationally active banks are being asked to hold even more capital and liquidity under Basel III. In such an environment, many banks are finding it too costly and therefore difficult to issue new capital and the only way they can boost capital is to refrain from capital costly activity – so they are cutting lending, selling or shrinking capital costly investment banking and other businesses (Economist, 2013). This is related to shareholder value creation that focuses on generating returns in excess of the cost of capital to create value for owners (namely, shareholder value creation). In a world characterized by increasing capital costs it may be difficult for banks (particularly from the developed world) to 'add value'. A major motivation of this paper, therefore, is to investigate whether banks from Asia Pacific (a region less affected by the global 2008–2009 crisis) are creating value for their shareholders and whether operational efficiency influences value creation.

An accepted financial axiom is that the objective of management is to maximize the shareholders' wealth by the efficient allocation of resources, like minimizing costs and maximizing profits. Although there is a rich body of literature on bank performance, only a handful of papers associate bank efficiency with shareholder value.[1] The majority of these studies utilize stock returns to measure shareholder value in testing such relationships for banks in the US and Europe (e.g., Adenso-Diaz and Gascon, 1997; Eisenbeis et al., 1999; Beccalli et al., 2006; Erdem and Erdem, 2008; Pasiouras et al., 2008; Liadaki and Gaganis, 2010). Only one paper, a study of European banks, employs Tobin's *Q* as a measure for shareholder value (De Jonghe and Vander Vennet, 2008). Two studies (Fiordelisi, 2007; Fiordelisi and Molyneux, 2010) adopt Economic Value Added (EVA) as a measure of shareholder value creation to test such relationships for European banks.

Focusing on studies that address banks in the Asia-Pacific region, Chu and Lim (1998) evaluate the relationship between efficiency and stock returns for a panel of six Singapore-listed banks between 1992 and 1996. The results show that changes in stock prices positively reflect variation in profit – rather than cost-efficiency. Kirkwood and Nahm (2006) examine the effects of changes in profit efficiency on stock returns for Australian banks from 1995 to 2002; their findings suggest that changes in profit efficiency are significantly and positively reflected in bank stock returns, particularly for regional banks. Sufian and Majid (2006) analyze the relationship between efficiency and stock returns in Malaysian banking over 2002–2003 and find that both cost and profit efficiencies are positively linked to stock prices. In addition, stock prices react more to improvements in profit efficiency than to improvements in cost efficiency. Majid and Sufian (2008) investigate whether the stock performance of Chinese listed banks are related to their efficiency during the 1997–2006 period, and their findings indicate that changes in technical efficiency are statistically significant in determining banks' stock price returns, whereas scale efficiency does not explain variation in the same returns.

The recent global financial turmoil was the worst economic crisis in over 60 years, but most Asia-Pacific countries weathered it quite successfully with a rapid and comprehensive policy response; maintaining a substantial cushion of official reserves; and generally robust corporate balance sheets and banking systems (IMF, 2008). Thus, we argue that this region offers a particularly interesting environment in which to study the relationship between bank efficiency and shareholder value. To our knowledge, there is only one cross-country study in this field. Ioannidis et al. (2008) examine the relationship between changes in bank efficiency and stock price returns for a sample of Asian and Latin American listed banks over the 2000–2006 period. The results indicate a positive relationship between changes in profit efficiency and stock returns, whereas there is no link between changes in cost efficiency and stock returns. The main limitation of this study is that it uses only simple stock returns as a measure of shareholder value, and shareholder value might be overstated because the valuation does not take into account the replacement cost of assets; additionally, it only estimates

[1] Appendix 1 provides a brief summary of these studies.