

RESEARCH ARTICLE

# Financial Development, Efficiency, and Competition of ASEAN Banking Market

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**Abstract:** Theoretically, the financial sector fosters economic development of a nation. Weak institutions, poor contract enforcement, and macroeconomic instability are negatively correlated with an underdeveloped financial sector. The global trends have revived the need for the ASEAN to continue to work for further integration among member countries. ASEAN banks serve as the important intermediaries in increasing the connectivity among ASEAN members and supporting the financial integration in the region. The strong growth of ASEAN financial institutions is driven by the development of business fundamental and the increasing competitiveness of financial institutions in this region. Therefore, this study aims to examine the nexus between financial development, competition, and efficiency of ASEAN banks over the period 2011 to 2016. Using dataset of 78 banks across ASEAN countries, data envelopment analysis (DEA) is used to measure efficiency, Herfindahl-Hirschman index to measure market concentration, and Lerner index to measure market power. The dynamic panel approach, namely the generalized method of moments (GMM), is employed to examine the nexus between financial development, competition, and efficiency of banks. The empirical results of nexus between financial development, competition, and efficiency indicate that competition is positively related to efficiency (technical efficiency and pure technical efficiency). However, competition is negatively related to scale efficiency. The results also show that financial development is negatively related to efficiency (pure technical efficiency) and competition. Nevertheless, GDP is positively related to competition. The results of this study imply that development in the financial sector makes banks inefficient and underutilized resources as banks improve their market power. The results of this study imply that competition in the banking sector must be encouraged to foster efficiency.

**Keywords:** ASEAN, banking, competition, efficiency, financial development

The banking sector serves as an important part of the Association of Southeast Asian Nations (ASEAN) economies as their performances influence the health of general economies at large. This can be seen during the outbreak of the 1997 Asian financial crisis. The crisis is considered contagious

as the crisis from another country could hamper the economic stability of another country (Kim, Kose, & Plummer, 2001). In this period of crisis, the currencies constantly depreciate against the U.S. dollar, and the amount of unhedged foreign borrowings and the non-performing loans in the ASEAN countries mounted.