

MERGER, COMPETITION AND EFFICIENCY IN MALAYSIAN BANKING

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Competition and efficiency are closely entwined in banking; however, previous studies on banking competition had tended to neglect the nexus between competition and efficiency. There is also some concern that attempts to investigate the relationship between competition and efficiency in the banking industry had tended to rely on structural measure by taking concentration per se as a proxy for competition; whilst efficiency is measured by financial ratios. By addressing the above discussion as the gap in the literature, this study contributes to the existing literature by utilizing Data Envelopment Analysis to compute efficiency and Lerner indexes to estimate competition. The first objective of this study is to estimate banking efficiency and competition index while the second objective is to analyze the running causality between efficiency and competition. Causality tests between competition and various measures of efficiency are undertaken to achieve the second objective. The Granger causality tests indicate a positive effect of competition on technical efficiency, pure technical efficiency and scale efficiency. In addition, a negative causality running from efficiency to competition is also found in technical efficiency and its sources.

JEL Classification: D24, G21, L25.

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1. INTRODUCTION

Mergers and acquisitions in the Malaysian banking industry can be traced to the historical reluctance of local banks to merge. In Malaysia, the policy had always been to allow for market forces to dictate the pace of mergers; however, there was slow progress. For instance, due to the economic recession in the mid 80's, Central Bank of Malaysia (hereafter denoted as CBM) had introduced a rescue scheme to maintain the integrity of public savings and the stability of financial systems. Even with the government's efforts, the banking institutions were sluggish in responding to the call of mergers. Between 1980 and 1999, the number of domestic commercial banks remained relatively constant at 21 banks. It was claimed that Malaysia was over-banked

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