THE TECHNICAL EFFICIENCY OF MALAYSIAN BANKING INDUSTRY

Foreign VS Domestic Banks

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1.0 Introduction

Over the past few decades, Malaysian banking section has seen its fair share of financial liberalization. Bank Negara Malaysia issued to Australia and New Zealand Banking Group Limited (ANZ) the very first foreign bank representative status license in 1971. Though not permitted to undertake any commercial banking activity or sell any financial product, this mark the revolutionary effort of the Malaysian government in opening local market in accordance with the globalization trend in global finance. This globalization phenomenon brings a liberal for any venture to board upon our shores, attracting competition from the adventurous and aggressive expansion of developed nations' large corporate sections. Since then, local banks have been challenged hard by foreign banks presence; presenting a significant test in internal operations, customers dealing, and inter-institutional relationships (Balachander, Staunton and Shanmugam, 1999). Perhaps the government seen such challenges are the necessary push that as essential to adopt a positive competition between foreign and local banks with an aim of improving local banks efficiency and competency. Foreign banks, to their defense, are altering local economic landscape for good by refining efficiency of resource allocation and risk management, among other things (Mallikamas, 2012).

Factors determining the efficiency of banks in the nation are an area that has received relatively little attention to date. In recent years, the world financial structure has changed rapidly making the banking industry has faced competitive pressure worldwide. In such a market, how efficiently banks transform their expensive inputs into various financial

products and services are concerned by the banks' regulator, managers, and investors. Berger and Humphrey (1997) explain that information obtained from efficiency studies can be used for a variety of purposes. They can inform government policy by assessing the effects of various regulatory changes on efficiency. Managerial performance can be improved by identifying "best practice" and "worst practice" associated with high and low efficiency firms, respectively.

If banks are efficient, we can expect improved profitability, better prices and better service quality for consumers and it can lead to greater amounts of funds being intermediated (Berger et al., 1993b). This paper focuses on the question whether there is any differ of technical efficiency of foreign bank and domestic bank.

Data envelopment analysis is a Linear Programming Problem that provides a means of calculating apparent efficiency levels within a group of organizations. The efficiency of an organization is calculated relative to the group's observed best practice. In this paper we use non-parametric Data Envelopment Analysis (DEA) method to analyze the overall, pure technical and scale efficiency of Malaysian banking industry over the period of 2006 to 2010. The technical, pure technical and scale efficiencies are three different types of efficiency which can be distinguished from non-parametric Data Envelopment Analysis (DEA) methodology.

To discuss DEA in more detail it is essential to look at the concepts of efficiency. The most common efficiency concept is technical efficiency.

Technical efficiency is the conversion of inputs, such as the total assets and total deposits of a bank, into outputs relative to best practice. In other words, given present technology, there is no wastage of inputs whatsoever in producing the given amount of output. An organization functioning at best practice is supposed to be 100% technically efficient. If operating below best practice levels, then the organization's technical efficiency is expressed as a percentage of best practice. Managerial practices and the scale or size of operations affect technical efficiency, which is founded on engineering relationships but not on prices and cost.