Chapter-1 or below average efficiency. efficiency of

Business, Industries

Chapter-1IntroductionEfficientand effective utilization of resources is the key objective of every bank.

Thisobjectivehas always beenimportant in banking, but a number of recent events are helping to lay greateremphasis on bankingefficiency. Increasing competition for financial services, technologicalinnovation, andbanking consolidation, for example, are all focusing more attention oncontrolling costs inbanking, and providing services and products efficiently. Increasingcompetition from non- bankinginstitutions as well as banking institutions, expanding into new markets, isputting strong pressureon banks to improve their earnings and to control costs. Efficiency is clearlya critical factor forremaining competitive.

A number of recent statistical studies have shown thatthe most efficient bankshave substantial cost and competitive advantages over those with average orbelow average efficiency. Efficiency of banks is now a verysignificant issue. Nowadays the efficiency of banks has been studied in wide rangein the banking literature, as the banks have very crucial role in the economicdevelopment of a country. For the country like Bangladesh the banks efficiency hasa great importance. The banking industry of Bangladesh comprises of four typesof scheduled banks; these are state owned, nationalized, specialized, privateand foreign banks. In the presently total of 57 banks are in operation inBangladesh, among these 6 are state owned, 2 are specialized, 32 banks areconventional PCBs, 8 are Shariah based banks and the rest 9 are the foreign commercialbanks. The ultimate focus of the study is tomeasure the efficiency of the two core segments of the PCBs in Bangladesh.

These are how efficiently the banks control their cost and the efficiency levelof the earnings of private commercial banks in Bangladesh. Data EnvelopmentAnalysis is used as the tool to measure the efficiency.

1. 1Statement of the ProblemThe principalproblem of the study is dealing with the efficiencies in different segments ofbanks. To find the solution of the problem, the study will focus on two coresegments of banks. The study will have the focus on the cost and earningefficiency of private commercial banks in Bangladesh.

1. 2 Scope of the studyTo measure the efficiency of theprivate commercial banks of Bangladesh the study is conducting to the 22 banksare taken as the sample to represent the conventional private commercial banksin Bangladesh. For measuring the efficiency some statistical tests have been conductedaccording to the nature and objectives of the study. Relative financial ratiosare analyzed to measure the efficiency. 1. 3 Objectives of the StudyThe main objective of this study isto measure and to analyze the Cost and Earning efficiency of private commercialbanks in Bangladesh and to give some recommendations to improve theirefficiency.

To do this, the specific objectives are 1. To examine how efficient the cost andthe earnings of private commercial banks are, by examining the sample banks. 2. To draw conclusion for the population onthe basis of the efficiency result of sample Banks. 3. To find the correlation between inputoutput variables. 1.

4Rational of the StudyFrom the very beginning of business evolution in the history efficiencyis a very significant term. In every step of national economy and businessefficiency is very significant. As thebanking sector has the major and crucial role in the economy of the country andin the advancement of the national economy banking sector has great influence, efficiency analysis of this sector is one of the principal task. So the reporthas a great significance. 1. 5 Limitations of the study The study of this kind is generallyencountered with some limitations.   i.

Unavailability related and accurateinformation and data is a big problem.   ii.   From among the 40 PCBs only 21 banks aretaken as the sample for the study.   iii.

Accuracy of data cannot be assured sincemainly secondary data collected from Annual Reports of the sample banks, various financial stability reports, Economic trends are used in this study.   iv.   Time was an significant constraint. It wasdifficult to organize the report in the simple manner within limited time frame. However, repeated and sincereefforts have been given to ensure the accuracy of the data used in this study. Chapter-2Literature ReviewOnlyfew related works have been reviewed in order to understand or elicit the efficiencydifferences among private, public and foreign banksin Bangladesh. Yasmeen (2006), conducted a study to find out the technicalefficiency and productivity growth of various banks in Bangladesh.

She examinedfour ratios: two for input and two for output by taking the datafrom 2003-2007 of 35 banks. The findings also providedsome indication on the likelihood of dynamic convergence of these banks’performance as well as the challenges that these banks faced amidrising competition. Anotherwork had been carried out byKhanam & Nghiem (2004), on the efficiency of commercial banks in Bangladeshand the data consist of only one year on 48 banks. Theyconsidered seven ratios of which five were inputs and two wereoutputs. They also found that the technical efficiency score of banks in thesample is 84 percent(income based model)1 and 80percent (user-cost model)2, which is consistent with results from a parametricapproach called parametric linear programming. However, the proof onrelationship between foreign ownership on bank efficiency is not importantfor the income-based model. Uddinand Suzuki (2011) had undertaken a study to investigate the performance ofcommercial banks in Bangladesh after theimplementation of a significant financial reform. They considered datafrom2001-2008 of 38 banks including state owned, private owned, Islamic and foreignbanks and they had considered three inputs and two outputs tomeasure the efficiency.

Their findings indicated that incomeefficiency and cost efficiency of sample banks have increased by 37. 84 percentand 15. 28 percent in 2008 and 2001 respectively. On the contrary, private proprietorship has positive influence on efficiency of income, returnon assets, and non-performing loans, whereas unfavorable influence on efficiencyof cost. Akhtaret al. (2011), used data envelopment analysis to estimate the relevantefficiency of 12 commercial banks of Pakistan. The results of their study offered some very constructive managerialinsightsinto evaluation and advancing of banking operations.

The estimated result showsthat 6 banks are relatively efficient when their efficiency ismeasured in terms of ‘ constant returns to scale’2 and 8 banks are relativelyefficient when their efficiency is measured in terms of ‘ variable return toscale’. However, they suggested that by improving the handling of operating expenses, advances, capital and by boosting banking investment operations, the lessefficient banks can successfully endorse resource utilizationefficiency. Several models based on Data Envelopment Analysis(DEA)-have been developed in order to Operationalize the framework, andtheir use has been illustrated using data for the branches of a commercialBank. Specially, the service-profit chain has been casted as a source ofefficiency measurementmodels.

Exploratory outcome shows that superior insights can be gained by analyzingat onetime operations, service quality and profitability than the informationobtained from benchmarking studies of these three dimensionsseparately (Soteriou 1997). Fiordelisiet al. (2010), assess the inter-temporal relationships among bank efficiency, capital and risk for the Europeancommercial banking industry. They build on previous work using Grangercausality methods 3 (Berger and De Young 1997) in a panel data framework. The outcomeshow that restrainedbank efficiency (cost or revenue) Granger causes risk supporting the “ badmanagement” and the “ efficiency version of the moral hazard” hypotheses.

They found only limited evidence of relationshipsbetween capital and risk in line with the moral hazard hypothesis. The findingsshowed lowerefficiency scores (either cost or revenue) suggest greater future risks andefficiency improvementstend to shore up banks’ capital positions. Their findings also emphasize theimportance ofattaining long-term efficiency gains to support financial stability objectives.

Subsequentlythe profitability test focused by Spong Et Al. (1995), the core distinctions betweenthe most and least efficient banks seem to be highly related to the personnel expenses. In thecontext of important technological improvements in banks’ productive processes, the study suggestedan urgent need for greater labor market flexibility and the consequentsubstitution of labor for capital.

In addition, inefficient banks always come up with lower levels of equity/assets and higherlevelsof nonperforming loans. Their finding also suggested that efficient banks areassigning more attention and resources to loan origination, monitoring and other credit judgment activities. Finally, the analysisisalso shows that there is no clear relationship between the size of assets andbank efficiency. Yiweiet al.

(2011), found that the average profit efficiency of Eastern Europe isclose to the Central Eastern Europe region, but average cost efficiency leaves considerable room for improvement. Theyalso found that foreign owned banks are somewhat less cost efficient thandomestic private banks. It is also evident that progress in theimplementation of major economic reforms such as enterpriserestructuring and privatization are positively associated with bankingefficiency. Moreover, banking efficiency affects the development of the capitalmarket. This focuses that the relationship betweenbanks and the capital market is both competitive and supplementary.

Whenbanks are very inefficient, an increase in banking efficiency actually resultsin more borrowers migrating to the capital market. Beyond a certainpoint, an increase in the efficiency of banks attracts moreborrowers to banks. Thus, the quality cut-off that determines which borrowersgo to the market and which go to the banks is non-monotonic with respectto bank efficiency. It may not be possible to develop agood capital market in an economy if it does not have good banks. In this way, theinitial focus in a developing financial system should be on improving the efficiencyof banks.