

Productivity Gains of Financial Industry: Empirical Evidence from Malaysia

Rossazana Ab-Rahim*

Nor Ghani Md. Nor**

Faculty of Economics and Business, UNIMAS, 94300 Kota Samarahan, Sarawak.

Faculty of Economics and Business, UKM, 43600 Bangi, Selangor.

ABSTRACT

The increased competitive forces due to structural reform in banking environment would stimulate the incumbents which operating inside the production frontier. Banks invest more in innovation and technological tools; as a result, the production frontier shifts outwards. Employing Data Envelopment Analysis (DEA) windows analysis, this study investigates the trend of productivity in Malaysian commercial banking over the study period of 1995 to 2005. The productivity change is decomposed into technological change and technical efficiency change. During the study period, the growth in productivity is mainly contributed by technological improvement rather than technical efficiency change. It is worth noting that the domestic commercial banks have exhibited the technological progress as the source of productivity.

Keywords: Banking, DEA Window Analysis, Productivity

JEL Classification: M21

1. Introduction

At the onset of the 1997 crisis; the banking industry, the non-banking financial intermediaries, and the financial markets are the layout of Malaysian financial industry while the central bank, Bank Negara Malaysia constitutes the apex of the industry. The crisis has changed the scenario in the Malaysian banking market profoundly. Prior to the crisis, Malaysian banking was regarded as a well-developed supervisory and regulatory framework. As the crisis evolved, banks tend to preserve the quality of the balance sheets instead of generating new loans. The sluggish momentum in loan activities had hampered the smooth function of the intermediation process; eventually, it pushed the economy into greater recession.

Hence, Bank Negara has taken a series of reform to improve the efficiency and soundness of banks by strengthening pre-emptive prudential regulations and transparency. The measures consist of loan classification and provisioning standards, refining capital adequacy ratio, limit lending to the property industry and the purchase of stocks and shares, single customer limits, greater disclosure and monitoring and last not least, the establishment of asset management company. Finally, the structural reform in the financial industry was taken through a four-pronged pre-emptive measure which involved the establishment of Danaharta, Danamodal and