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WHAT DRIVES BANK EFFICIENCY? INTERACTION OF BANK INCOME DIVERSIFICATION AND OWNERSHIP

Abstract:

This paper examines the relationship between income diversification and bank efficiency in across 83 countries over the period 2003–2012. We also evaluate how ownership structure varies the impact of bank diversification on cost efficiency. Using stochastic frontier approach to estimate bank’s cost efficiency, we find the evidence that increased diversification tend to improve bank efficiency, and government-controlled banks with fewer volatile income sources are likely to have lower efficiency of income diversification. Our results also reveal that more diversified foreign-controlled banks tend to be less efficient in developed countries, while increased foreign ownership of banks appears to improve the diversification benefits in developing countries after the financial crisis. Our findings highlight the implications of bank income diversification and ownership for efficiency and are relevant to bank regulators who are considering additional regulations on bank efficiency.

Keywords:

Income diversification, ownership structure, efficiency, banking