DOES PRIVATIZATION IMPROVE EFFICIENCY?
(A Case Study of MCB and ABL)

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ABSTRACT

The emergence of fast paced dynamic environment in business world in general and financial services sector in particular, has highlighted the significance of competition and efficiency. The need for deregulation has become a touchstone of success in fostering both competition and efficiency especially in the economies, which are exposed to structural reforms. In addition to that, intense competition both among domestic and foreign banks, rapid speed of innovations and introduction of new financial instruments, changing consumer's demands and desire for product augmentation have changed the way a bank conducts business and services its customers. Larger the degree of competition, it is perceived that the firms would become more efficient. However, when the structure of an industry is product of the government regulations, the degree of competition is impaired markedly implying that the efficiency suffers negatively.

INTRODUCTION

Analysis of financial institutions in developing countries in the light of changes taking place in their structures and regulatory environment has immense value for regulators, policy makers, managers and investors. In particular, how these policy reforms affect efficiency of banks in developing countries has a wider appeal. Over the past decade a number of developing countries have embarked on a reform path and have witnessed improvements in their financial systems while others are contemplating on doing so. But there is no reason to expect that impact of reforms on performance would be positive and uniform across countries. In particular, it is not obvious how the reform process is influenced if economic growth environment in the country is not conducive (Burki *et al*., 2003).

The main criteria for judging performance of the financial system are:

1) Allocative efficiency, which depends on the system's ability, to arrange financing that is mutually beneficial to potential suppliers and users of capital. An allocationally efficient system will ensure that finance will be extended when there are users prepared to pay suppliers required return (for the amount and term sought).
2) Operational efficiency, which depends on cost effectiveness and reliability of the system.
3) Dynamic efficiency, which depends on the innovativeness of the system and on the resulting benefits to the system's users.

In fact, there are many previous studies discussing the efficiency and economies of scale in the banking industry. For example, Berger *et al.* (1997) investigated the branch efficiency of U.S. large commercial banks from 1989 to 1991, by separately estimating frontier-flexible and translog cost functions for several years. Their evidence shows that banks are likely to over-branch twice as many as the possible cost minimizing level, and technical inefficiency, namely X-inefficiency, amounts to about 20% m of their operation costs. Berger and Hannan (1998) also in part examine the U.S. bank efficiency, concluding that the efficiency cost (i.e. X-inefficiency) resulting from a lack of market discipline is much larger than the deadweight welfare loss due to misallocation by monopoly power. (Saunders, Scalise and Udell (1998)

Battese *et al* (1998) examine the efficiency of labor utilization in the Swedish banking industry, using the stochastic frontier analysis (SFA). Regressing the labor input on the outputs of financial services such as loans, guarantees,

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