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Cost Efficiency of Medium-sized Banks in Russia

Although banks' cost efficiency studies have become popular all over the world the literature on Russian banks cost efficiency or X-efficiency estimation is quite scarce. As far as we know, there are only some papers, which take into account Russian banks' risk profile in cost frontier by using stochastic frontier approach. This year in order to obtain operating efficiency scores we applied stochastic frontier analysis (SFA) with output quality and risk factors to the banks' data. The reasons for choosing parametric method were the following. First of all, the Russian banks are heterogeneous, that is, there is a significant variation of balance indicators in the Russian banks data. Second, the Russian banks may have incentives to manipulate with reported data in order to reduce profit taxation. These facts increase sensitivity of the results, which can be obtained by using nonparametric approaches (data envelopment analysis (DEA) or free disposal hull (FDH)), thus, predetermine SFA usage. In the case of single frontier usage it is necessary to assume that all banks use the same production technology, consequently, provide banking services under the same frontier. In practice not all banks may use similar transformation function and so do not have the equal access to the single cost frontier. In the case of Russian medium-sized banks their cost efficiency was assessed in the homogeneous groups. To divide the Russian commercial banks into the homogeneous groups Zipf-Pareto distribution of banks' total assets value was used. So, the aim of this paper is two-fold. First, we estimate cost efficiency of Russian commercial banks using stochastic frontier analysis with output quality and risk factors applied to the data of the Russian medium-sized banks. Second, we explain the variations in cost efficiency among these banks. We found that medium-sized banks were characterized by the high level of cost efficiency. They performed an intermediation function actively. Finally, medium-sized banks with foreign capital seemed to be more cost efficient due to their better organization structure, advanced technology, corporate governance, know-how, and experienced in risk management.