

# Explaining Bank Efficiency: Bank Size or Ownership Structure?\*

Rodrigo Fuentes  
Central Bank of Chile

Marcos Vergara  
Universidad de Chile

## Abstract

Bank mergers have been one of the main characteristics of the Chilean banking system in the last decade. This paper uses cost and profit functions to estimate efficiency at the bank level for the 90s in Chile. Using these measures we explained cross-bank differences over time, which are related to bank size, ownership structure and other relevant variables. Our main findings are 1) banks that are established as open corporations in Chile tend to show higher level of efficiency compared to offices of international banks. These banks have higher probability of takeover in Chile since the ownership structure is known and thus managers act in the best interest of stockholders. An alternative hypothesis is that the mix of output is different for the two groups of banks. Branches of international banks tend to intermediate instruments rather than acting as loan-deposit institutions, which is the case of banks that are open corporations. 2) Banks that have higher property concentration show higher level of efficiency. These differences are statistically significant at the conventional level of significance. The two results point in the direction that principal-agent problem mitigation is the key to explain bank efficiency.

Key words: Cost efficiency, profit efficiency, ownership structure, and principal agent problem

JEL classification: G21, D21, G30

May 2003

---

\* We thank useful comments from Solange Berstein, Gino Loyola, Ricardo Paredes and José Miguel Sanchez to an earlier version of this work. Corresponding author: Rodrigo Fuentes. Address: Central Bank of Chile, Agustinas 1180, Santiago-Chile. Tel.: (56-2) 670-2386. Fax: (56-2) 670-2853. E-mail address: rfuentes@bcentral.cl