
Efficiency in banking: does the choice of inputs and outputs matter?

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Abstract: This paper examines banking efficiency using recent data from PIGS countries (i.e., Portugal, Italy, Greece and Spain), which suffer from debt problems. We employ a two-stage approach based on the effect of several items of balance sheets on cash flows and data envelopment analysis (DEA). More specifically, we extend previous studies by giving attention to the deposit dilemma. The reported results show that the choice of inputs and outputs does matter in the case of European banking efficiency. Although the role of deposits is controversial, we find that deposits may be an output variable, owing to liquidity issues that play a major role in the efficiency of PIGS' banking sector. We also report that the DEA model with deposits as an output variable generates efficiency scores that fall between periods. These results are helpful to bank managers and financial analysts dealing with efficiency modelling.

Keywords: PIGS; banking sector; efficiency; deposits dilemma; two-stage approach; cash flows; DEA; data envelopment analysis; regression.

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