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Institutional quality & bank stability: A study on Asean-5

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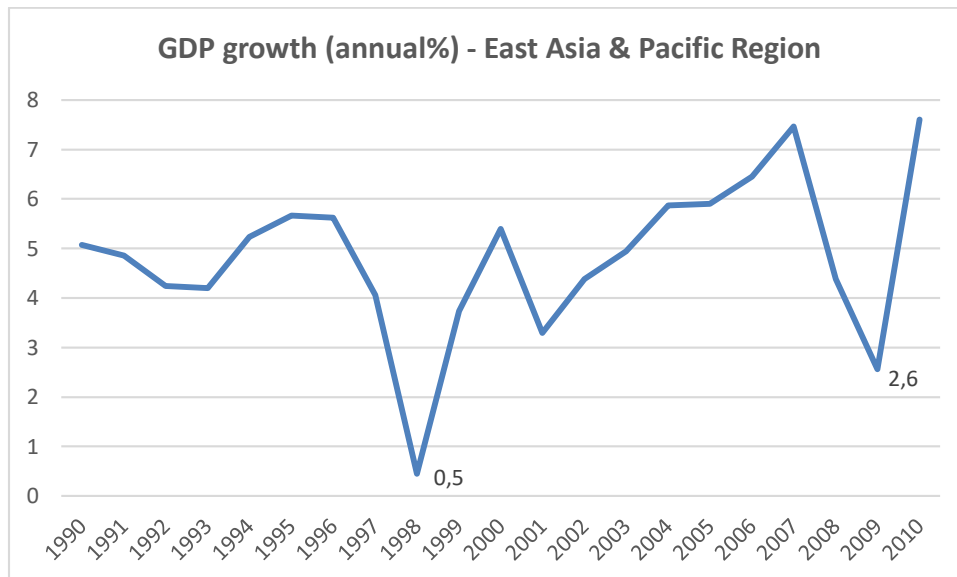
Abstract---This study aims to evaluate the effect of institutional quality and firm growth on bank stability in banking companies in Southeast Asia. The research population covers banking firms in the Southeast Asian region from 2013 to 2022, with a focus on the ASEAN-5, namely Indonesia, Malaysia, Philippines, Singapore, and Thailand. Based on data availability, the sample consists of 100 companies over 10 periods, resulting in a total of 1000 panel observations. The results of panel data linear regression analysis conducted using Eviews12 show that institutional quality has a negative and significant influence on banking stability.

Keywords---Institutional Quality, Firm Growth, Bank Stability.

Introduction

Banking stability is a crucial component in ensuring the economic and financial stability of a country (Shahriar et al., 2023). The role of banks in the financial ecosystem is central, where they act as collectors of funds from the public to be redistributed as credit to various sectors that drive the economy (Muizzuddin et al., 2021). Through this intermediation process, banks contribute to economic growth and job creation. Banks also offer a range of essential financial services to

individuals and businesses, including payment, investment, and risk management services (Saputro & Safuan, 2024).



Source: www.worldbank.org

Financial crises around the world have shown how banking sector instability can have a devastating impact on the economy. The Asian financial crisis in 1997 (Backhaus et al., 2003) and the 2008 global crisis that affected East Asia and the Pacific are clear examples of how quickly instability in the banking sector can trigger a widespread economic crisis. These crises generally result in serious impacts such as economic recession, rising unemployment rates, and declining living standards (Hertati et al., 2020).

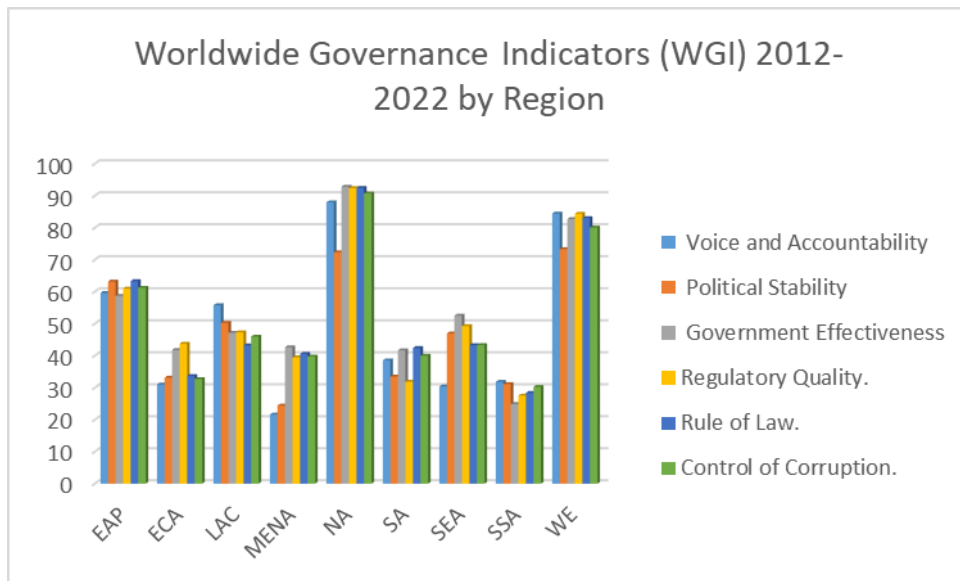
Instability in the banking sector can undermine public confidence in the financial system, cause massive withdrawals or bank runs, and interrupt the financial intermediation process (Marie et al., 2021); (Khan et al., 2022). Therefore, maintaining banking stability is key to avoiding these negative consequences and ensuring long-term economic stability (Ali & Puah, 2019). A stable bank not only supports sustainable economic growth but also improves the general welfare of society (Park & Oh, 2022).

The role of institutional quality in maintaining banking stability is crucial, and the effects may vary depending on the country (Bermpei et al., 2018). Strong and efficient institutions can increase confidence in the banking system and its stability, which directly supports more effective bank operations and better risk management (Masron & Abdullah, 2010). However, in the Southeast Asian region, variations in institutional quality among countries present challenges (Lee & Hsieh, 2014); (Uddin et al., 2020). The region encompasses countries with varying levels of economic development, regulations, and policies, all of which affect the stability of banking in each country (Q. K. Nguyen & Dang, 2022); (Samsudin, 2018).

Southeast Asia, a region experiencing significant economic growth, often faces challenges in maintaining financial stability (Ovi et al., 2014); (Q. K. Nguyen, 2022). Rapid economic growth in the region is often associated with increased financial risks, requiring a robust banking system and efficient regulation to manage these risks. Challenges to financial stability in Southeast Asia may stem from a variety of factors, including market volatility, changes in economic policies, and the effects of external shocks, such as the global financial crisis (Yen et al., 2023); (Sari & Prastyani, 2021).

The diverse economic, social, and political conditions in the region make analysing bank stability complex and interesting. Each country in Southeast Asia has unique characteristics that affect bank stability, ranging from different regulations to diverse market conditions (Banna & Alam, 2021); (Ullah & Khan, 2017). Countries with strict regulations and strong legal systems may have more stable banks than those with weak regulations (Sodokin et al., 2023); (Chan et al., 2015).

The World Bank released the Worldwide Governance Indicators (WGI) which aims to evaluate the quality of governance in more than 220 countries. This evaluation is carried out through six main indicators, namely voice and accountability, non-violent political stability, government effectiveness, regulatory quality, rule of law, and control of corruption (Boulanouar et al., 2021).



Source: www.worldbank.org

In the graph above, each region is represented with a set of bars showing their score in each governance indicator. Scores range from 0 to 100, with 100 indicating the best governance. It can be seen that the North America (NA) and Western Europe (WE) regions dominate the 6 indicators overall. This is because both regions provide factors including active participation of the public in the

political process, high political stability, government effectiveness, good business regulation, a strong legal system, and effective control of corruption.

Followed by 3rd place is the East Asia & Pacific (EAP) region, in 4th place is the Latin America & Caribbean (LAC) region. Overall, the Southeast Asia region is able to compete in the top 5 and even above 4 other regions, namely Europe & Central Asia (ECA), South Asia (SA), Middle East & North Africa (MENA), and Sub-Saharan Africa (SSA). The Southeast Asia region is able to compete in the top five and even surpass some other regions. Southeast Asia's success is attributed to rapid economic growth, political stability, and positive government reforms in countries such as Singapore, Brunei Darussalam, and Malaysia.

The diverse Southeast Asian region also requires special attention to control variables such as bank growth, which reflects asset and operational expansion, can significantly affect bank stability (H. T. Nguyen, 2023); (Wikantioso, 2018). A rapidly growing bank usually demonstrates the ability to attract more customers, increase lending, and expand service networks. This growth is often seen as a sign of a bank's health and competitiveness, which can increase public confidence and bank stability in the long run. Based on this phenomenon, the researcher investigates "The Effect of Institutional Quality & Firm Growth on Bank Stability: A Study on ASEAN-5"

Method

The objective of this study is to explore the importance of institutional quality in supporting financial stability and its effects on banks in Southeast Asia. The method used is a quantitative approach, through regression estimation to analyse the effect of the independent variable, Institutional Quality, on the dependent variable, Bank Stability. This approach is designed to test theory, develop evidence, and identify relationships between variables.

In this study, the type of data used is secondary data obtained through indirect sources such as documents, archives, journals, and external reports. The data used in this study comes from datasets accessed from BankFocus and the World Bank. This data includes information from five countries in the Southeast Asian region, specifically banks operating during the period 2013-2022. The data collection method used is documentation and literature study, where the dataset is obtained through documentation techniques. The selection of this data is based on the availability of complete financial statements for at least ten years.

Operational Definition and Measurement of Variables

According to Sugiyono, the operational definition of variables is the steps taken to transform abstract concepts into something that can be measured clearly and objectively. Operational definitions provide guidance on how to measure variables in research, making it easier for researchers in the data analysis process and increasing research validity. Sugiyono emphasises the importance of operational definitions to ensure research can be reproduced by other researchers and the results can be interpreted easily (Sugiyono, 2018).

Dependent Variable

Bank Stability (Bank): Bank stability refers to the ability of a bank to survive and operate effectively without experiencing significant disruptions in fluctuating economic conditions. Z-Score Bank Stability is measured using the following calculation:

$$ZROA_{i,t} = \frac{ROA_{i,t} + EQTA_{i,t}}{\sigma ROA_{i,t}}$$

Independent Variable

Institutional Quality (Qi): Institutional quality refers to the efficiency, transparency, and accountability of the institutions that regulate and supervise the banking sector. Institutional quality includes transparency, rule of law, strong supervision, and sound risk management to support bank stability.

Control Variable

To ensure measurement accuracy only between the independent variables and the dependent variable, this study excluded the influence of irrelevant external factors. This is important to maintain the internal validity of the study by reducing or eliminating other influences that might affect the results. In this study, the use of the control variable firm growth allows the researcher to account for the impact of internal firm factors on bank stability.

- Company Growth: The change in a company's total assets, which includes both increases and decreases, defines the company's growth during the year. According to Brigham and Houston (2009), the growth of a company is characterised by changes in the total amount of assets owned. In this study, asset growth is measured based on the proportion of the increase in the company's total assets.
- Company Growth (*Growth*) = $\frac{\text{Total Asset (t)} - \text{Total Asset (t-1)}}{\text{Total Asset (t-1)}}$

Table 1 Operational Definition of Variables

Variable	Definition	Formula
Dependent Variable: $ZROA_{i,t}$	The Z-Score value illustrates the extent of the balance between the bank's assets and liabilities and gives an idea of the bank's bankruptcy risk.	$ZROA_{i,t} = \frac{ROA_{i,t} + EQTA_{i,t}}{\sigma ROA_{i,t}}$

Variable	Definition	Formula
Qualities		
Institutional		
<i>voice and accountability</i>	Measures the extent to which citizens have the right to voice their opinions and the extent to which the government is accountable to its citizens Assesses the extent to which government regulations and policies support economic and social development. Measures the extent to which corruption is controlled within the government.	$voice \ \& \ accountability = Qi_va$
<i>regulatory equality</i>	Measures the extent to which citizens have the right to voice their opinions and the extent to which the government is accountable to its citizens Assesses the extent to which government regulations and policies support economic and social development. Measures the extent to which corruption is controlled within the government.	$regulatory \ equality = Qi_rq$
<i>control of corruption</i>	Measures the extent to which citizens have the right to voice their opinions and the extent to which the government is accountable to its citizens Assesses the extent to which government regulations and policies support economic and social development. Measures the extent to which corruption is	$contol \ of \ corruption = Qi_coc$

Variable	Definition	Formula
	controlled within the government.	
Control Variable: <i>growth</i>	annualised change (growth rate) of total assets (Jogiyanto 2018)	$\frac{Total Asset (t) - Total Asset (t - 1)}{tTotal Asset (t - 1)}$

Source: Data processed by the author, 2024

Panel Data Linear Regression Analysis

The data analysis technique in this study involves applying a panel data statistical model to evaluate the impact of institutional quality on financial stability. This study aims to examine the influence of institutions on the stability of the banking sector in Southeast Asia. For this purpose, a panel data regression analysis was conducted which explores the relationship or influence between the independent variables and the dependent variable. The model used in the study is described as follows:

$$ZROA_{i,j,t} = \alpha + \beta_1 Qi + \beta_3 growth + \varepsilon_{i,t}$$

Description:

- $ZROA_{i,j,t}$: Dependent variable in the form of *Bank Stability*, company to - I, country to -J and time to - t
- α : The constant value of the equation of the regression model.
- $\beta_1 Qi$: *Institutional Qualities Variable*
- $\beta_3 growth$: Company growth control variable
- $\varepsilon_{i,t}$: Error value of regression equation for Bank Stability

Discussion

Based on the results of the Chow test and Hausman test, the most appropriate panel data regression model for this study was identified as the Fixed Effects Model. The results of the regression are shown below:

Table 2
Panel Data Regression Test Results

Variable	Coefficient	t-statistik	Sig	Ket.
<i>Qi.va</i>	-0.254674	-1.983220	0.0476	
<i>Qi.rq</i>	0.456466	3.530902	0.0004	
<i>Qi.coc</i>	0.220198	2.077909	0.0380	
<i>growth</i>	0.518068	0.542750	0.2063	
<u>R-squared</u>	0.905126			
<u>F-statistik</u>	77.89750			
<u>Sig (F-statistik)</u>	0.000000			

The results of the analysis using the Fixed Effects Model, displayed in the attached table, provide the following regression model equation that includes the dependent variable of bank stability, the independent variable of institutional quality, and the control variable of firm growth (Growth):

$$Y_{Zroa} = 191.04495204 - 0.254673969998 Qi_va + 0.456466014596 Qi_rq + 0.2201979233 Qi_coc - 2.78206830857 growth$$

- **Qi_va** (Voice and Accountability) shows a significant negative relationship with bank stability (coefficient -0.254674, probability 0.0476).
- **Qi_rq** (Regulatory Quality) has a significant positive relationship with bank stability (coefficient 0.454666, probability 0.0183).
- **Qi_coc** (Control of Corruption) shows a significant positive relationship with bank stability (coefficient 0.221098, probability 0.0380).
- Bank growth factor shows no significant relationship with bank stability (coefficient 0.518068, probability 0.2063).

The Effect of Qi_va (Voice and Accountability) on Bank Stability

The study found that Qi_va, or Voice and Accountability, has a significant negative relationship with bank stability in the Southeast Asian region. The resulting coefficient is -0.254674 with a probability of 0.0476. This result is in line with (Abuzayed et al., 2018). An increase in Qi_va tends to decrease bank stability. This may be due to several factors, such as less effective supervisory policies and practices in some countries in the region. High levels of freedom and accountability can trigger uncertainty in financial markets if not matched by a strong and stable regulatory framework. In addition, frequent or inconsistent policy changes may also undermine the confidence of banking industry players, which in turn negatively affects bank stability.

The Effect of Qi_rq (Regulatory Quality) on Bank Stability

In contrast, Qi_rq or Regulatory Quality shows a significant positive relationship with bank stability, with a coefficient of 0.454666 and probability of 0.0183. these results are in line with the results of (Muizzuddin et al., 2021); (Sodokin et al., 2023); (Bermpei et al., 2018); (H. T. Nguyen, 2023); (Yen et al., 2023).

Improvements in regulatory quality contribute positively to bank stability. Good regulatory quality includes clear, transparent, and consistent rules that the banking industry can rely on. Effective regulation helps to reduce risk and uncertainty, and increases stakeholder confidence in the banking system. Therefore, countries in the Southeast Asian region that focus on improving their regulatory quality tend to have more stable banking sectors.

The Effect of Qi_coc (Control of Corruption) on Bank Stability

The results also show that Qi_coc, or Control of Corruption, has a significant positive relationship with bank stability, with a coefficient of 0.221098 and a probability of 0.0380. these results are in line with the results of (Muizzuddin et al., 2021); (Sodokin et al., 2023); (Bermpei et al., 2018); (H. T. Nguyen, 2023); (Yen et al., 2023).

Effective corruption control efforts have a positive impact on bank stability. Low corruption creates a more transparent and fair business environment, which in turn increases confidence and stability in the banking sector. Banks operating in an environment with low levels of corruption are more likely to operate efficiently and in compliance with regulations, thereby reducing the risk of bank failure.

Effect of Bank Growth Factor on Bank Stability

Interestingly, bank growth does not show a significant relationship with bank stability, with a coefficient of 0.518068 and probability of 0.2063. This indicates that while bank growth is important, it is not the main determinant of bank stability in the region. Other factors such as regulatory quality, corruption control, and accountability seem to have more influence on bank stability. Rapid bank growth unaccompanied by good risk management and strict regulation may not be enough to ensure bank stability.

Conclusion

1. Institutional quality has a mixed impact, with some indicators such as Regulatory Quality and Control of Corruption positively related to bank stability, while Voice and Accountability is negatively related.
2. Bank growth does not show a significant effect on bank stability.

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