Ownership & Governance of Banks

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Motivation and goals

- Banks profoundly influence growth & equity
  - Regulation has 1^{st}-order welfare implications
- Designing appropriate regulations, requires understanding of bank governance. So:
  - Ownership structure
  - How ownership structure and regulations interact in affecting governance and risk taking.

1. Who owns banks?

Are banks widely-held?

Who controls banks?

Determinants?

Who owns banks? Data

- 10 largest listed banks in each country
- 244 banks across 44 countries

Who owns banks? Definition

- Controlling owner: direct + indirect control rights (CR) > 10%
- Trace through possible pyramidal ownership structures
  - Identify all major shareholder (i.e., > 5% of votes)
  - If any are corporations, find its ultimate owners (if any)
- Find controlling owner – if any -- with maximum votes

Who owns banks? Definition

- Widely-held
- Controlling owner
  - Family (individual)
  - State
  - Widely-held (non-financial) corporation
  - Widely-held financial institution
  - Other (trust, foundation)

Who owns banks? Cash-Flow Rights

- CF = cash flow right of controlling owner and zero if there is no controlling owner

Who owns banks?

	Widely	Family	State	Fin	Corp	Other	CF
Country mean (CR)	0.25	0.39	0.14	0.07	0.02	0.14	0.26
% of owner (=x/0.75)		0.52	0.19	0.09	0.03	0.19	

In 14 out of 44 countries, the controlling owner averages more than 50% of the CR.

In Australia, Canada, Ireland, UK, & US, either NO bank has a controlling owner or the average is less than 2% of CR

Who owns banks?

1) Though enormous X-Country variation,
   - Banks are generally not widely-held
   - Individual / Family ownership is very important

2) Legal protection of shareholder rights helps account for X-Country differences:
   - When the law protects minority shareholders, less of a need for a large shareholder
   - When the law does not protect minority shareholders, widely held banks do not emerge.

How do ownership and regulation affect risk taking?

Why would ownership affect regulation's impact?

Does it?

Policy implications?

Owners, managers, and risk: Theory

- *Diversified* owners seek more risk
  - Than debt holders (Galai / Masulis, 1976; Esty, 1998).
  - Than *non-shareholder* managers (Jensen / Meckling, 1976)

- Thus:
  - Risk-taking depends on the comparative power of owners within the corporate governance structure of banks

  - If regulations affect owners differently from managers, then regulations impact on risk depends on the power of owners.

Owners, managers, and risk: Theory

- Regulations affect risk incentives of owners differently from managers & debt holders

- Examples:
  - Deposit insurance intensifies risk incentives of owners

Owners, managers, and risk: Theory

More examples:

- Capital and activity restrictions
  - More capital → Reduce risk incentives of owners
  - Fewer activities → Fewer risk taking opportunities
  - Owner's utility ⇓ → compensate by risk ⇑

    (Koehn and Santomero, 1980; Boyd et al 1988; etc.
- Also, more capital MIGHT not reduce risk-taking incentives of controlling owners

Broad testable predictions

- Banks with powerful owners will be riskier than widely-held banks, ceteris paribus
  - Conditional on owner's wealth in bank
  - Conditional on managerial shareholdings

- Regulations have different effect on banks with powerful owners than widely-held banks
  - Subject to same conditions

More powerful owner → less bank stability

		Fixed effects		IV	
CF	-1.406***	-0.504*	-1.180***	-3.484***	-0.913**
Revenue growth	0.075	0.261	0.232	0.434	-0.125
Per capita income			0.161***	0.059	0.413*
Rights					0.091
Capital requirements					0.185*
Capital stringency					0.05
Restrict					-0.094**
DI					-0.568***
Enforce					-0.046
Concentration					-0.37
M&A					0
Size					-0.098*
Loan loss provision					-0.036
Liquidity					0.724
Large owner on mgt board					0.003
Managerial ownership					0.363
Number of countries	46	46	46	43	37
Observations	251	251	251	248	189
R-squared	0.14	0.03	0.19	--	0.37

Robust …

- Control for owner's wealth concentration
  - Founder on board (3%)
  - Descendants on board (14%)
- Managerial shareholdings
  - Large Shareholder on board (35%)
  - Cash-flow rights of Senior *Management*
    - *Average: 6% s.d.: 15%*

Impressions …

- Risk ↔ ownership, not only a country trait.
- Results are consistent with the following view:
  - Equity holders have an incentive to increase risk
  - The incentives frequently clash with the incentives of other decision makers.
  - Large owners have greater power to increase risk than small shareholders
- Other measures of bank risk → similar results

Now consider second prediction

- Regulations have different effect on banks with powerful owners than widely-held banks

CF – Capital regulations

CF	5.247**
Revenue growth	0.363
Per capita income	0.176***
Rights	0.044
Capital stringency	0.154**
CF * Capital stringency	-0.383**
Restrict	-0.078*
CF * Restrict	-0.187**
DI	-0.315
CF * DI	-1.764***
Observations	219
R-squared	0.4

Stabilizing effects of capital regulations ↓ with large ownership:

- **Mechanically → less risk**
- **Owners seek risk to compensate**

Ignoring ownership → wrong conclusions

Widely-held: Capital regulations↑(1σ) → Stability ↑**
Majority-held: Capital regulations↑(1σ) → Stability ↓**

More

- Deposit insurance
  - With widely-held banks, more generous deposit insurance does not increase risk significantly
  - As ownership power rises, DI has a more pronounced effects on risk taking.
- Activity restrictions … Similar results
  - Widely held, little effect
  - Powerful owner … Greater risk taking

Summary

- Ownership affects
  - Corporate governance & Risk taking
  - Response to regulation
    - Huge differences in response
    - Sign may reverse!
- Ownership differs systematically C-countries
- Same regulation will have different effects in different countries

Broader implications

- **Regulation is more complex than other policies**
- **Need common goals / strategies**
- **Need customization of rules**