Understanding the ownership-Risk-Performance relationship in the banking industry

ABSTRACT

Its criticality compounded by its vulnerability has made the banking industry one of the most regulated industries across the globe. Standing on the threshold of almost complete liberalization and slow decontrol, there was probably never a better time to study the Indian banking industry. The presence of various stakeholders – the usual ones such as the owners, the lenders and the managers along with the unusual ones such as the regulator, the deposit insurer and the tax payer – makes agency issues in the banking industry very different from that seen in most non-banking, relatively unregulated firms.

Using the agency theory framework, I have tried to look at how ownership – as defined by promoter identity and shareholding structure – influences strategy making that in turn defines the risk-profile in a bank, which further manifests in its final performance. Taking four types of domestic banks namely, state-owned, institution-promoted, hybrids of the first two and finally, community or individual promoted banks, plus foreign banks, we saw that while promoter identity ceases to have much impact on performance over time as competition intensifies, shareholding pattern does influence agency issues significantly that further manifest in risk-profile and performance of the respective banks. We saw that origin or parentage of a bank went a long way in explaining the business strategy adopted by the bank as origin can sometimes endow benefits and privileges while at the same time may put impediments in the way of rational and professional functioning of the bank.

One of the most interesting results of this work was the important 'mediating role' played by risk in the ownership-performance link in banks. Different types of risk were seen to assume importance in different types of banks. Another important conclusion we drew from this thesis

was the fact that risk-taking by a bank needs to be measured against its risk-management capabilities rather than in isolation before determining whether the bank exhibited a risk-averse or excessive risk-taking attitude. This line of thought helped us take the concept of 'optimal risk-taking' forward and we managed to get an idea about how different kinds of banks balanced different kinds of risks. This process helped us reveal the extent of conservativeness bordering on risk-aversion demonstrated by foreign banks in host countries. This also helped show the wide gap between the risk-management capabilities of domestic and foreign banks operating in emerging market economies.