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Ownership structure, risk and performance in the European banking industry

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Abstract

We compare the performance and risk of a sample of 181 large banks from 15 European countries over the 1999–2004 period and evaluate the impact of alternative ownership models, together with the degree of ownership concentration, on their profitability, cost efficiency and risk. Three main results emerge. First, after controlling for bank characteristics, country and time effects, mutual banks and government-owned banks exhibit a lower profitability than privately owned banks, in spite of their lower costs. Second, public sector banks have poorer loan quality and higher insolvency risk than other types of banks while mutual banks have better loan quality and lower asset risk than both private and public sector banks. Finally, while ownership concentration does not significantly affect a bank's profitability, a higher ownership concentration is associated with better loan quality, lower asset risk and lower insolvency risk. These differences, along with differences in asset composition and funding mix, indicate a different financial intermediation model for the different ownership forms.

JEL classification: G21; G32; G34

Keywords: European banking; Ownership; Governance; Performance

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1. Introduction

A firm's ownership structure can be defined along two main dimensions. First, the degree of ownership concentration: firms may differ because their ownership is more or less dispersed. Second, the nature of the owners: given the same degree of concentration, two firms may differ if the government holds a (majority) stake in one of them; similarly, a stock firm with dispersed ownership is different from a mutual firm. Within the European banking industry different ownership structures coexist: privately owned stock banks (POBs), mutual banks (MBs), and government-owned banks (GOBs).[1] POBs, in turn, have different degrees of ownership concentration. Although their roots are different, large MBs, GOBs, and POBs (with different ownership concentration) have typically evolved to a similar full-service banking model, thereby competing in the same markets within the same regulatory framework. Indeed, these banks are virtually indistinguishable in terms of their range of activities.

The relevance of firms' ownership structure has been extensively explored in the theoretical literature. As far as ownership concentration is concerned, Bearle and Means (1932) point out that the separation of ownership and control may create a conflict of interests between owners and managers. Moreover, Jensen and Meckling (1976) posit that the agency costs of deviation from value maximization increase as managers' equity stake decreases and ownership becomes more dispersed. The argument may weaken if the dispersed ownership went along with the public trading of the firm's securities. As pointed out by Fama (1980), the signals provided by an efficient capital market about the value of a firm's securities are likely to discipline the firm's management. Regarding the nature of owners, the property rights hypothesis (e.g. Alchian, 1965) suggests that private firms should perform more efficiently and more profitably than both government-owned and mutual firms. In the case of government-owned firms, as Shleifer and Vishny (1997) point out, while they are technically "*controlled by the public*", they are run by bureaucrats who can be thought of as having "*extremely concentrated control rights, but no significant cash flow rights*". Additionally, political bureaucrats have goals that are often in conflict with social welfare improvements and are dictated by political interests. In mutual firms, ownership cannot be concentrated as in the case of stock companies (Fama and Jensen, 1983a,b). This may cause inefficiency as the benefits of concentrated ownership are forgone.

Moving to the empirical literature and restricting the analysis to the banking industry, we briefly review previous works on relative performances concerning (i) GOBs, (ii) MBs, and (iii) concentrated banks. As far as the relative performance of GOBs is concerned, Altunbas et al. (2001), focusing on the German banking industry, find little evidence to suggest that POBs are more efficient than GOBs, although the latter have slight cost and profit advantages over POBs. Sapienza (2004) focuses on banks lending relationships in Italy, comparing the interest rate charged to two sets of companies with identical credit scores which are borrowing either from GOBs or POBs, or both. She finds that GOBs tend to charge lower interest rates than POBs. By examining the profitability of a large sample of banks from both developing and developed countries, Micco et al. (2004) find that in industrial countries there is no significant difference between the Return on Assets of GOBs and that of similar POBs. Finally, Berger et al. (2005) find that GOBs in Argentina have lower long-term performance than that of POBs.

[1] Hereafter, with the terms private banks and privately owned banks we refer to banks whose owners are not government entities and that have not mutual form.