Rethinking bank shareholder equity: The case of Deutsche Bank

Yuri Biondi\textsuperscript{a,b,∗}, Imke Graeff\textsuperscript{b}
\textsuperscript{a} Cnrs - IRISSO, University Paris Dauphine PSL, France
\textsuperscript{b} Labex Refi (ESCP Europe), France

ARTICLE INFO

JEL classification:
G21
G28
G34
G35
G38
M41
D83

Keywords:
Capital requirements
Bank equity presentation
Bank equity composition
Shareholder equity movements
Financial analysis
Capital adequacy
Equity quality
Capital movements
Transactions with shareholders

ABSTRACT

We introduce and apply an innovative accounting approach to analyse the equity position of a European systemically important financial institution, Deutsche Bank, between 2001 and 2015. According to our findings, the actual contribution by shareholders to bank equity capital was limited, while shareholder payout policies, including share buybacks and trading on its own shares, were both material. These findings raise concerns on the actual capacity by shareholder equity to assure protection against (residual) risk and loss absorption. Customer and investor protections appear to lay with bank entity equity dynamics. These findings have implications for bank financial sustainability and resilience, company capital maintenance, and regulatory capital requirements. Further developments based upon this innovative methodology may improve on existing prudential and accounting regulations.

1. Introduction

The recent financial crisis revealed the inadequacy of current regulatory capital requirements. Banks such as Commerzbank and Royal Bank of Scotland with regulatory capital above minimum level were required to receive governmental support during the financial crisis. The new capital accord, Basel III, responds with higher capital requirements and narrowed scope of eligible capital. Common shares and retained earnings build the foundation of new regulatory capital (Basel Committee, 2011). This shows a shift back to clean accounting equity for regulatory purposes (Schoenmaker, 2015) and to the focus on ordinary shareholders as the main external providers of regulatory capital.

This paper builds upon this shift to introduce an innovative accounting approach to bank equity measurement and analysis. This methodology is applied to the equity position of a European systemically important institution, Deutsche Bank (DB), between 2001 and 2015.

Our innovative measurement of the equity position assesses the actual contribution of shareholders to the bank equity including its regulatory capital. For this, transactions with shareholders are disentangled and allocated to a specific class of equity (shareholder equity), which is then distinguished from the residual entity equity. One distinctive feature of this method is the recognition and
consequent allocation of the cost of equity to shareholder equity. This approach helps clarifying the relationship between shareholders and the bank entity as a going concern, in line with the entity perspective (Biondi, 2005; Biondi et al., 2007), but also with a prudent proprietary view which recognises undistributable reserves.

Through development and application of this innovative method, the paper contributes to the literature surrounding the analysis and regulatory proposals of banks’ payout restrictions as one way to maintain bank equity capital, as well as to the literature which links the recent changes in corporate strategy to the financialisation phenomenon and the related advent of shareholder value and shareholder primacy in corporate governance (Andersson, Haslam, Lee, & Tsitsianis, 2008; Haslam, Lee, & Tsitsianis, 2008).

Scholars argue that corporate strategy have recently been financialised in a way that favours financial investors (Andersson et al., 2008; Haslam et al., 2008). Indeed, researchers have documented extensive distributions to shareholders prior and during the financial crisis (Acharya, Gujral, Kulkami, & Shin, 2011; Al-Khasawneh, Shari, & Al-Zubi, 2012). Similarly, Chief Economist at the Bank of England, Andy Haldane, has repeatedly emphasised that shareholders receive excessive remuneration (Chu, 2015; Giugliano, 2015; Haldane, 2015a, 2015b; Rawlinson, 2015). Fox and Lorsch (2012) also report high capital transfers from entities to their shareholders. As a consequence, scholars as well as regulators start to consider the implementation of restrictions or omissions on bank payout policies (Atrash, Bibi, & Zheng, 2016; Basel Committee, 2011).

This debate raises the question of which part of bank equity accrues and can presently be distributed to shareholders. Moreover, recent changes in the composition of regulatory capital feature the actual contribution by external shareholders. Both issues point to the relationship between shareholders and the bank equity, especially the measurement of their actual contribution to bank equity capital which is the main focus of our analysis of the DB case study.

Our findings show drastically decreasing shareholder contribution to the bank entity as well as to regulatory capital prior and during the financial crisis. In the aftermath of the financial crisis, shareholder contribution increases, bolstered by capital increases and reduced payout policies; it however remains low. If our refined measurement of shareholder equity was taken as an indicator for distribution omissions, Deutsche Bank would have been restricted to compensate shareholders as early as in 2006. These preliminary results recommend further investigation concerning maintenance of bank equity through governance and regulatory measures, including restriction or omission on bank payout policies.

The rest of the paper is organised as follows. Section 2 redefines the relationship between the bank entity and its shareholders; Section 3 provides an overview of related literature; Section 4 illustrates the case study; Section 5 introduces the methodology and summarises its main results; Section 6 provides discussions and implications; Section 7 concludes.

2. Methodological foundation

Our approach assumes the bank entity as an ongoing economic organisation and social institution distinct from its shareholders. This concept paves the way for a refined understanding of the relationship between the bank entity and its shareholders. Shareholders are no longer seen as the owners of the firm but as outside capital providers (Biondi et al., 2007). This approach is in line with an entity perspective, but it is quite consistent with a prudent proprietary view. According to the entity view, the bank firm as an entity maintains its autonomous continuity over time while all its stakeholders, including shareholders, hold claims and obligations related to this continuity. According to the proprietary view, although the shareholders remain the ultimate residual claimants of entity income, distributable income must be prudently estimated through time and circumstances, while its actual distribution has to be carefully restricted to avoid conflicts of interest, manipulation and abuse.

2.1. Cost of shareholder equity

In an ongoing economic organisation, the entity becomes the residual addressee of the outcomes of the business process after deduction of all costs; including the cost of shareholder equity. This economic rationale has been largely utilised to derive a benchmark for remuneration of management. Recently, it was also introduced into taxation, to overcome high debt reliance due to preferable treatment of debt interest under tax laws.

In financial accounting, the recognition of cost of equity has extensively been debated as early as in 1920s with revivals in later decades. Hesitations for the adoption were seen in the subjectivity of the calculation of the cost of equity (in the following also: shareholder equity interest) as well as in the “heavy hand of tradition” (Anthony, 2004, p. 88). With the introduction of shareholder equity interest in taxation and the consequent acknowledgment of conventional ways for its measurement, its recognition in financial reporting may be reconsidered. Furthermore, an entity basis has recently been claimed by the International Accounting Standards Board (IASB) Conceptual Framework (IASB, 2010, OB2).

2.2. Entity basis of accounting

By construction, an entity basis disentangles shareholders as outside capital providers in financial reporting. From the entity perspective, the actual contribution of shareholders to the firm does no longer comprise total equity; but it is derived by the identification of shareholders’ direct contributions to the firm – that is, committed cash flows to bank equity – and their indirect contributions to the firm – that is, unpaid cost of equity.

---

1 In 2012, Italy introduced a tax system which features cost of equity as a tax-deductible item.
دریافت فوری متن کامل مقاله

امکان دانلود نسخه تمام متن مقالات انگلیسی
امکان دانلود نسخه ترجمه شده مقالات
پذیرش سفارش ترجمه تخصصی
امکان جستجو در آرشیو جامعی از صدها موضوع و هزاران مقاله
امکان دانلود رایگان ۲ صفحه اول هر مقاله
امکان پرداخت اینترنتی با کلیه کارت های عضو شتاب
دانلود فوری مقاله پس از پرداخت آنلاین
پشتیبانی کامل خرید با بهره مندی از سیستم هوشمند رهگیری سفارشات