The fall of Spanish cajas: Lessons of ownership and governance for banks

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ARTICLE INFO

Article history:
Received 25 October 2015
Received in revised form 16 February 2017
Accepted 16 February 2017
Available online xxx

JEL classification:
G21

Keywords:
Ownership of banks
Governance
Banking crisis
Spain
Cajás
Business models

ABSTRACT

Ownership, governance, and institutional diversity among banks are a subject of public and regulatory concern. This paper addresses this issue by using a case study of Spain, where the retail banking market was split evenly between shareholder and stakeholder banks before the crisis. We examine how institutional diversity mattered in the accumulation of risk in the pre-crisis years, in the severity of losses caused by the crisis, and in the resilience to recover from the losses. The method of analysis consists in linking the risk position of the banks in the pre-crisis period and the losses arising during the crisis to the decisions of banks to migrate from business models based on deposit financing to models based on market-debt financing. We find that cajás migrated to more vulnerable business models following the strategy of the shareholder banks, but the losses in the crisis were much higher in the former than in the latter. The paper interprets this result as evidence that what matters most about the ownership of banks is their resilience in bad times.

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1 Introduction

The research claims that the ownership and governance of banks are greatly responsible for the causes and consequences of the financial crisis (Kirkpatrick, 2009; Mulbert, 2010; Berger et al., 2012; Hopt, 2013). However, the reforms proposed to improve corporate governance do not converge toward common ground on what good governance means. In this respect, the Walker Report (2009) for the United Kingdom adopts the shareholders’ perspective on good governance and recommends that banks should be managed under the single goal of profit maximization. The Basel Committee (2010) and the European Commission (2010) adopt a different view and recommend that the banks’ boards and senior managers perform their duties while taking into account the interests of shareholders, that is, depositors and other relevant stakeholders. The Liikanen (2012) report to the European Commission praises institutional diversity as the best organizational structure for the banking industry.

The diversity of views on what good governance means for banks reflects the lack of robust evidence on how the form of ownership and governance mechanisms affect the individual performance of banks and, more importantly, the stability of the whole industry. This paper draws from the Spanish banking crisis to examine the relevance of ownership and governance for financial stability in banks. The Spanish case is worth studying because of the severity of the crisis and because the banking industry was a good case of institutional diversity before the outburst of the crisis. The banking industry is split between for-profit and not-for-profit banks controlled by stakeholders. The latter are called cajás. In the crisis, the ex-post losses of government aid to compensate for losses in

http://dx.doi.org/10.1016/j.jfs.2017.02.004
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Please cite this article in press as: Martín-Oliver, A., et al., The fall of Spanish cajas: Lessons of ownership and governance for banks. J. Financial Stability (2017), http://dx.doi.org/10.1016/j.jfs.2017.02.004
the value of banks’ assets were much higher for cajas than for share-
holder banks: 85% of banks’ total assets seriously damaged by the
crisis belong to cajas and only 15% to corporate banks. These high
losses, together with some notorious cases of banking malprac-
tices, turned into a loss of social confidence in the cajas. Today, after
some regulatory reforms that transformed cajas into shareholder
banks, the traditional institutional diversity of Spanish banking has
disappeared.3

Our main interest in this paper is to understand the cajas’
responsibility for the crisis, why they were more damaged than
for-profit banks, and why some cajas performed differently than
others. However, we conduct this analysis of cajas in the context
of changes occurring in the whole banking industry since the Euro.
For this reason, the first part of the paper highlights the changes
in all Spanish banks from deposit-dependent to market-dependent
financing of bank credit (Almazán et al., 2015). The sample period
starts in 1999 and finishes in 2007, the year previous to the cri-
sis. The analysis evaluates how the migration of banks to models
more dependent on market financing made them more vulnerable
to negative external shocks. We investigate the possible reasons
for the migration to new business models and measure the effect
of the external shock of the crisis on the performance of banks in
each business model. Next, the paper focuses on the comparison
between shareholder banks and cajas and why cajas suffered more.

We identify two possible explanations for why the cajas did
not survive the financial crisis. One states that the uniqueness of
the cajas’ ownership and governance led them to make business
decisions different from those made by shareholders banks when
the Euro removed the constraints to market finance for all Spanish
banks. Thus, the higher losses for cajas might be due to different
ex-ante critical business decisions. The other hypothesis is that
the business decisions previous to the crisis were similar in cajas
and banks, but cajas adjusted less effectively to the external shock
of the crisis. The lower capability of cajas to adjust and respond
to an external shock might be a consequence of their unique owner-
ship and governance features. The empirical evidence in this paper
rejects the hypothesis that the cajas behaved differently from banks
in the pre-crisis period, and supports that the higher losses for cajas
can be explained because their unique ownership and governance
made them less resilient to external shocks.

Our results can be of interest to regulators because they provide
insights about the ownership and governance of banks as medi-
ators in the transmission of external shocks to financial stability.
We also examine the effects of the interaction between the form
of ownership and the business models of banks (Ayadi et al., 2011,
2012; Llewellyn, 2013; Köhler, 2015) on the build-up of risk dur-
ing the period of economic expansion and on the losses caused by
those risks. The conclusion is that business models alone are not
sufficient to fix selective regulatory requirements. Although Spain
lost institutional diversity in the banking industry, there are other
countries where saving banks and credit cooperatives continue to
play a relevant role in the provision of banking services for which
the regulatory lessons from our research are relevant.

The rest of the paper is organized as follows: Section 2 con-
tains a review of the literature and outlines the paper in the context
of the research. Section 3 presents the results of the cluster analysis
used to identify the business models of Spanish banks, including a
comparison of clusters in operational decisions and performance.
Section 4 examines the migration of Spanish banks toward riskier
business models and evaluates the ex-post losses in each business
model during the crisis. Section 5 analyzes the differences between
cajas and corporate banks in choosing business models as well as
the heterogeneity in governance among cajas as it relates to ex-ante
risk decisions and ex-post losses. Finally, the conclusion summa-
rizes the main results of the paper.

2. Literature review and research design

2.1. Literature review

This section reviews the literature that studies the effect of own-
ership and governance on the banks’ risk-taking decisions. Banks,
like any business firm, make decisions that involve a trade-off
between risk and return. The legal status of limited liability corpo-
rations, which binds the amount of losses but leaves the benefits
unbundled, creates incentives for shareholders to make decisions
with excessive risks in relation to the expected returns. This phe-
nomenon of risk shifting in nonfinancial firms (Jensen and Meckling,
1976) is exacerbated in banks because their business model is
highly leveraged by nature with a large fraction of insured debt
(deposits) (Merton, 1977; Bhattacharya and Thakor, 1993), and
because of easy risk manipulation (Myers and Rayan, 1998). Addi-
tionally, the private costs of bankruptcy to shareholders of banks
from risk-taking decisions are much lower than the social ones.4
The singularity of banks justifies the study of the effect of owner-
ship and governance on performance, as opposed to the general
literature on this topic.5

In the research on ownership, one line of interest has been
the comparison of the contributions to financial stability of state-
owned banks versus private banks.6 On the positive side, state
ownerships could lead politicians to control the decisions of banks
in such a way that the social negative effects of risk shifting are
internalized to induce higher financial stability. On the negative
side, if bureaucrats pursue their own interests that do not neces-
arily coincide with social interests, state ownership can be a source
of additional fragility in banks (La Porta et al., 2002).

Within privately-owned banks, there are different types of own-
ership forms: cooperatives, saving banks, and shareholder banks.
Cooperatives and saving banks are a priori candidates to have less
risk-taking than shareholder banks because they have a more sta-
ble deposit and customer base, focus on capital preservation, and
they care more about consumer surplus than profits. Moreover,
in a perfect world, shareholders of banks directly benefit from
risk-shifting with higher shares prices. Within for-profit banks,
the concentration of shareholdings can also affect risk-shifting.
Managers of banks with dispersed shareholdings receive a small fraction
of the private benefits from risk shifting, and they are more con-
servative in making risky decisions, compared to banks with large
shareholders that have direct influence on the banks’ decisions.

The empirical evidence confirms these predictions. Hesse and
Cihák (2007), in a sample of banks from OECD countries, find that
cooperative banks are more stable than banks owned by corporate
shareholders. Iannotta et al. (2007) find that cooperative banks are
the most stable banking group, followed by shareholder banks and
state-owned banks, after examining a sample of large European
banks. García-Marco and Robles-Fernández (2008) find that Span-
ish saving banks are less exposed to financial risks than shareholder

4 The difference between private and social costs of bank failures have to do with
the external effects ignored by banks’ owners and managers, including the disrup-
tions to the payment system, disruptions in credit flows, and contagion effects.
Laeven and Valencia (2013) estimate average fiscal costs of resolving banking crises
in the past 40 years as 13% of countries GDP.
context.
6 La Porta et al. (2002) find that, on average, more than 41% of the assets of the
largest ten banks in each country were either owned or controlled by the state in
1995.
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