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IMPACT OF REGULATORY CAPITAL ON EUROPEAN BANKS FINANCIAL PERFORMANCE. A REVIEW OF POST GLOBAL FINANCIAL CRISIS.

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Abstract.

The importance of having sufficient regulatory capital has undeniably attracted immense attention since the 2008 financial crisis. The notion is that increased capital requirement negatively impact the financial performance of the banks. Using structural equation modelling, the article employs 4503 European banks data from 2001 to 2005 examining the interaction of tier 1 capital and financial performance. The results indicate that the banks have grown post the 2008 financial crisis. Likewise, the tier 1 has increased but the increase is not in line with the expansion. As expected there is a negative association between tier 1 capital and financial performance. The results also indicate that the banks have diversified their revenue streams compared with pre-2008. In terms of efficiency, the results indicate that the cost income ratio post 2008 is higher than pre-financial crisis. The results implies that the regulators must take account of the expansion of banks and the increase in their capital levels.

Keywords; tier 1; performance, efficiency, regulation.

Firms are managed by directors who act as agents of the shareholders. However, empirical evidence shows that, this agency relationship can be costly, especially on acquisition or takeover situations. This ultimately affects the share price because of conflicts of interest in which directors pursue their own interest. In effect, the agency cost can be said to be the value lost because of directors maximising their own interest at the expense of shareholders. The agency theory suggests that the choice of capital structure may help in mitigating this cost. That is high leverage reduces agency costs outside equity and increases the value of the firm by constraining and encouraging the directors to act in the best interest of the shareholders. The principle agency principle relationship is supported by the ownership and control separation. In this instance, shareholders have the sources to support the firm’s activities because of information asymmetry and the skills to run the firm.