

Agency Problems and Risk in Banking

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This dissertation analyzes agency conflicts between bank shareholders and bank managers, and between bank regulators and bank shareholders. While previous empirical research analyzed these two conflicts in separation, here we analyze their joint influence on the risk of large, publicly traded, U.S. commercial banks, between 1995 and 1999.

We test two hypotheses. The first argues that the institution's charter value, in concert with the degree of incentive alignment influence the risk of the institution. The second argues that it is ultimately the ownership stake of block holders that influences the risk of the institution. We employed two dependent variables to measure risk: the standard deviation of monthly equity returns, which is a historical risk measure, and the excess yield paid on large CDs, which is a contemporaneous risk measure. Results yielded by the latter risk variable were weak.

Our results support the hypothesis high charter values reduce the historical risk of the institution. Charter value's influence on contemporaneous risk provides mixed results.

The structure of the CEOs compensation contract is found to have a statistically significant influence on risk, the proportion of incentive and option compensation of total compensation impacts the historical risk of the institution positively. The pay-performance sensitivities of CEO wealth on historical risk were positive.

The single most important factor in determining the risk of the institution is the ownership stake of the CEO. The relationship between CEO ownership and institution risk is found to be non-linear. While higher CEO ownership stakes have a negative influence on both the historical and contemporaneous risk of the institution, higher block ownership stakes have a positive influence. The difference in risk influence is explained by diversification differences and charter value.