

Dissertation Title:

The Effects Of Capital, Information Asymmetry And Deposit Insurance On Bank Behavior: Empirical Evidence From Panel Data Of Asian Banks

Dissertation Summary

This dissertation falls under the umbrella of empirical studies on banking regulation that focus on bank conduct and strategy. It adds the empirical banking literature by carrying out an investigation into the behavior of banks in response to capital, information asymmetry and explicit deposit insurance. This dissertation attempts to answer three main questions. How is the lending behavior of a bank affected by the banks maintained capital position? How does information asymmetry affect the capital position maintained by banks and does it justify the need for capital regulation? And finally how does the implementation of explicit deposit insurance affect the liability side of the banks balance sheet and its maintained leverage ratio? The dissertation is divided in to 3 chapters each focusing on answering on of the aforementioned questions.

The first question is answered by trying to find empirical evidence of what effects the behavior of the lending function of banks, does the bank capital position have any role to play in it and do Islamic banks exhibit the same behavior or not. In order to do so Panel data from Pakistan is used. Theory suggests that the bank changes its lending behavior when its CAR is closer to its lower bound. In other words, when the capital falls to a certain level close to the regulatory requirements the bank reduces it's lending. This behavior is a consequence of the banks attempt to avoid falling below the capital adequacy ratio (CAR) that the regulatory authority in the country enforces on the banks. The study finds the presence of this nonlinear lending behaviour in Pakistani banks. It finds that Islamic banks also exhibit a similar behavior but the degree of the nonlinearity is lower in their case. Chapter 2 of the dissertation reports the complete study.

In chapter 3 the second question is investigated. An empirical study on how the capital structure of banks is influenced by the information asymmetry in the

banking environment is carried out. The study incorporates corporate finance proxies for information asymmetry along with bank specific information asymmetry proxies to investigate this effect. It uses 1,638 listed and non-listed banks from 15 countries and finds evidence of a sizable and significant influence of information asymmetry on the capital structure of banks. It studies whether the determinants of capital structure of nonfinancial firms have any explanatory power on banks. Substantive evidence of adverse effect of information asymmetry on the leverage ratio maintained by banks is found justifying the need for capital regulation.

In chapter 4 an empirical analysis of the effect of explicit deposit insurance and its design on the liability structure of banks is investigated. It provides an insight into the behavior of the banks liability side balance sheet in response to explicit deposit insurance implementation. Data from 30 Asian countries is used in order to carry out this investigation. The study tests how the banks liability is affected because of the safety net and its design. The banks leverage ratio is determined by how the deposit and non-deposit liabilities respond to the explicit deposit insurance. It finds evidence of depositor shifting funds between the types of deposits in the bank as a result of the explicit deposit insurance. It provides evidence of the importance of setting the right coverage in order to prevent the adverse effects that the deposit insurance induces. It studies how the safety net design features affect the bank liability structure. The study finds that besides the explicit deposit insurance the bank liability structure is affected by other factors like tax expense, bank size, overhead and dividend pay-out.