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BANK OWNERSHIP, MARKET STRUCTURE AND RISK

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Abstract

This paper presents a model of a banking industry with heterogeneous banks that delivers predictions on the relationship between banks' risk of failure, market structure, bank ownership, and banks' screening and bankruptcy costs. These predictions are explored empirically using a large panel of individual banks data and ownership information for developing and emerging market countries during the 1993-2004 period. Three main empirical results are obtained. First, there is a positive and significant relationship between bank concentration and bank risk of failure, it is stronger when bank ownership is controlled for, and it is the strongest when state-owned banks have sizeable market shares. Second, conditional on country and firm specific characteristics, the risk profiles of foreign (state-owned) banks are significantly higher than (not significantly different from) those of private domestic banks. Third, private domestic banks do take on more risk as a result of larger market shares of both state-owned and foreign banks. The model rationalizes this evidence if both state-owned and foreign banks have either larger screening and/or lower bankruptcy costs than private domestic banks, banks' differences in market shares, screening or bankruptcy costs are not too large, and loan markets are sufficiently segmented across banks of different ownership.

Keywords: bank ownership, market structure, risk

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