Capital Structure, Ownership and Crisis: How Different Are Banks?

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The Working Paper titled *'Capital Structure, Ownership and Crisis: How Different Are Banks?'* was published under the Reserve Bank of India Working Paper Series on December 18, 2015. This paper has been authored by Dr. Saibal Ghosh and Dr. Goutam Chatterjee.[1]

With the introduction of capital standards by the Basel Committee in the late 1980s, such norms have, by and large, been adopted universally with suitable country-specific refinements. According to one view, regulatory standards determine the capital ratios of banks with some cushion above the prescribed minimum level. Alternatively, following from the theory of the banking firm, banks may be guided by a similar set of incentives as non-financial firms in their capital structure decisions.

In this context, this paper contributes to the literature by analysing the determinants of capital structure for Indian banks for the period 1992-2012.

The major findings of the paper can be summarised as follows:

- Profitability, growth opportunities and risk are the factors that are most relevant in influencing bank capital. All these variables bear an inverse relationship with leverage. Comparing these results with a comparable sample of non-financial firms suggests that the capital structure of Indian banks broadly follows the corporate finance perspective.
- There does not appear to be any significant difference between the determinants of book and market leverage. The result refutes the wisdom that banks' capital structure is purely a response to regulatory requirements.
- Third, state-owned banks (SOBs) are observed to operate with higher leverage as compared with private banks. The effect is however quantitatively small.
- Fourth, the crisis appears to have exerted a perceptible impact on bank capital. It was essentially the riskier banks that deleveraged during the crisis. Similarly, there was evidence of deleveraging by bigger banks during the crisis.
- As regards the composition of bank liabilities, the evidence indicates that banks have been lowering the role of deposits in their funding structure. This phenomenon is observed to be particularly pronounced for bigger banks with high growth opportunities.
- Regulatory prescription appears to be an important consideration in influencing banks' capital behaviour. More specifically, the findings indicate that increase in regulatory pressure is initially associated with an increase in leverage as banks aggressively compete for market share, but once it exceeds a threshold, banks are compelled to increase equity to meet the regulatory standards.

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