Stakeholder finance: before and after the crisis

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partly based on: V. D'Apice & G. Ferri (2009), L'instabilità finanziaria internazionale: dalla crisi messicana ai mutui subprime, Carocci

Incontro di Econometica: "Le conseguenze della crisi finanziaria dal capitalismo dello shareholder value al capitalismo degli stakeholder"

Università Milano Bicocca, 2 February 2009

Outline

- At the origin of the present crisis:
  - “max shareholder value” vision and risk pricing
  - the crucial role of banks’ business model
- Banking as the crisis moves on:
  - markets value more relationship banking oriented banks
  - trust seeking and the success of “stakeholder value” banks
  - “stakeholder value” banks and credit crunch prevention
- Any lessons?

Origin: "max sh value" vision & risk pricing - 1

- Though "the theory of moral sentiments" came before "the wealth of nations" suggesting that the State and the individuals should cooperate for the invisible hand to work:

- a Leviathan view prevailed in recent decades

$\Rightarrow$ minimize State and maximize shareholder value

- this affects also the approach to risk pricing, e.g. the CAPM assumes orthogonal risk of defaults between state & privates

$$\boldsymbol{ER_i = r + \beta_i(ER^m - r)}$$

where ER_i is the equilibrium expected return on asset i, r is the risk free return (approximated by government bond rates), ER^m is the equilibrium expected return on the diversified portfolio and $\beta_i = \mathrm{cov}(R_i\,,\,R^m)/\mathrm{var}(R^m)$

Origin: “max sh value” vision & risk pricing - 2

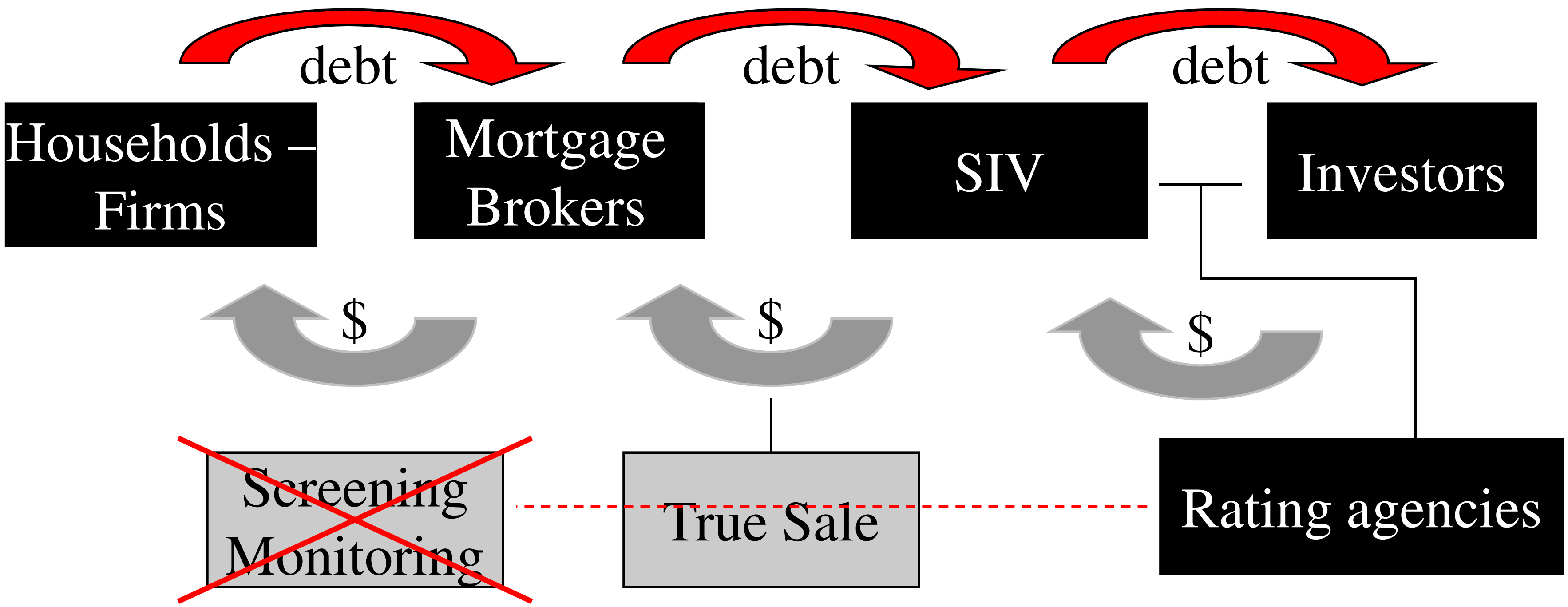
- The fallacy of this vision was highlighted by the fact that the State had to intervene to salvage imperiled financial intermediaries:
  - bank CDS were decreasing while state CDS were rising

$\Rightarrow$ the orthogonality assumption was just wrong

- Risk pricing models have to be revised
  - a possible objection: systemic crises are such rare events that we don’t need to bother about them
  - counter-arguments: i) flooding may also be rare but the law forbids building dwellings in dry river beds; ii) systemic crises are becoming more frequent and severe

The crucial role of the bank business model

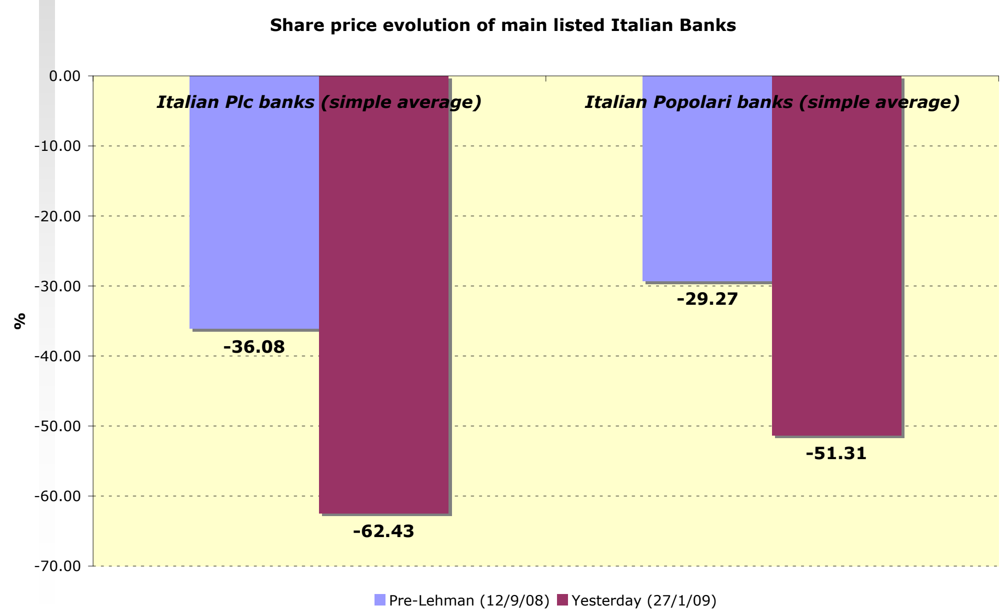
- From "*originate and hold*" to "*originate and distribute*"

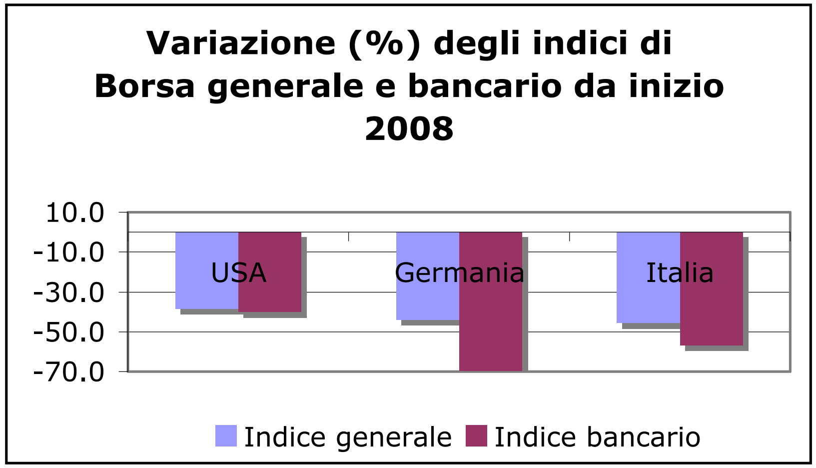


As the crisis moves on: markets value more relationship banking oriented banks - 1

Stock markets re-priced financial intermediaries the most:

But the impact was much Smaller for RB oriented coop banks:

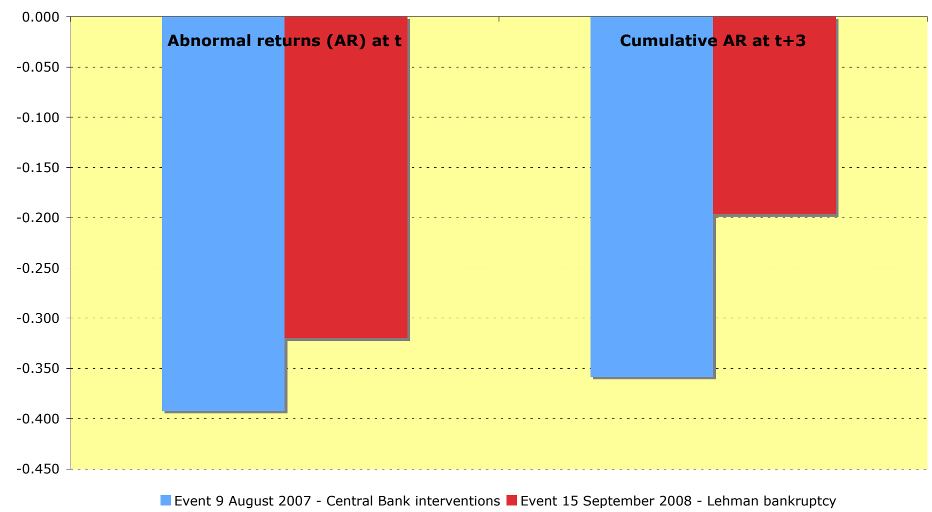




As the crisis moves on: markets value more relationship banking oriented banks - 2

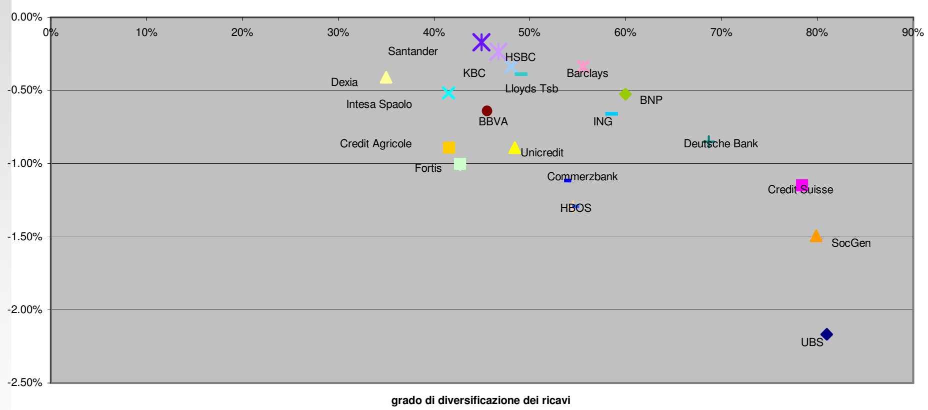
Contrary to the Too Big To Fail doctrine, stock markets re-priced more heavily the larger intermediaries:

Correlation with individual banks' total assets



This is consistent with less penalization for RB oriented banks

Figura 2: La reazione del mercato



fonte: Bankscope, Datastream

In the crisis: trust seeking & success of "stakeholder value" banks

- The crisis triggered a trust seeking deposit flight from shareholder value to stakeholder value banks:

- banche di credito cooperativo and Banche popolari experienced a strong growth of deposits (even Sole 24 ore of 1/2/2009 noticed it)

- cooperative banks are also expanding their lona market share, particularly vis-à-vis SMEs

- similar trends elsewhere in Europe

In the crisis: “stakeholder value” banks & the credit crunch

- There are essentially three ways in which – compared to ordinary commercial banks – credit cooperatives may be helpful at a time of credit crunch:
- they may be less inclined to ration credit to customers;
- they may be less prone to raise the loan rate during a time of financial stress;
- thanks to better capitalization and more prudent lending, credit cooperatives may be less likely to be distressed themselves and, therefore, may be better able to continue assisting their customers in a time of financial stress.
- All of the three potential effects of the credit cooperatives stem from their governance, business model & specialization, which heavily relies on relationship-based retail banking

Lessons

- Three consequences of the crisis:

- the idolatry of (purely) self regulating financial markets **is** over

  $\Rightarrow$ *but how to re-regulate?*

- the fixation with the single company model - i.e. shareholder value maximizing - **may be** over;

  $\Rightarrow$ *but we need a lot of effort to clean up (e.g. the fake debate on the best practices of corporate governance)*

- all of this **will have to be achieved** within a multi-polar world - as the US will be weaker - in which Asia and Europe will have, respectively, rising and declining weight