What Drives Stock Market Performance of Banks / Universal Banks? A Critical Examination of Literature

Antonio J. Dayag, CPA, MBA, FFA, FIPA, FAIA (Acad)

Corresponding AuthorUniversity of Sto. Tomas (UST), España, Manila

ORCID ID: 0000-0003-0696-0902

Fernando Trinidad, PhD

University of Sto. Tomas (UST), Graduate School, Manila

Abstract

The purpose of this paper is to determine performance drivers of universal banks using review of literatures as research method. Universal banks combine commercial loan services and public deposit functions with investment, and other services such as home and auto financing, mutual funds, pension and insurance to name a few. The importance of universal banks have been recognized in emerging economies, and its growth spur economic growth and development of many countries in the world. Most universal banks are listed in stock exchanges, and as financial intermediaries, not only these banks expand their already wide portfolios but they allow more global investors into the fold, almost like a foreign direct investor, the difference only is, the investor don't have to leave the home country. Since these banks are considered to be among the key players in stock markets, and this study seeks to understand what factors drive their performance in stock exchange so that global investors be aided in making investment decisions on universal banks. The variables dividend policy, dividend yields, ROE, ROA, EPS, P/E ratio, and bank size can form basis for model development that would drive bank value in stock markets. These variables can be utilized for future research endeavours.

Introduction

USLegal (2019) generally defined universal bank as an entity that combines commercial banking and investment banking. Apart from its loan and deposit functions, it is allowed to distribute new issues of debt and equity, and act as trader and broker of securities of all tupes (USLegal, 2019). Benston (1994) and Morrison (2012) concurred that universal banks have the lending and payment services of commercial banks, though commercial banks are not allowed to offer full services securities transactions. Financial markets are tasked to deploy capital as efficient as it can, and in the past, there were some critics who were skeptical about allowing the entry of universal banks because they claimed that these institutions may hurt stock markets (Benston, 1994). The reason was, when these banks trade and hold securities, it was assumed that it discourages the emergence of an active stock exchange and competed with independent stock brokers and dealers (Benston, 1994). However, evidences were weak to claim that universal banks reduced stock market activity (Benston, 1994). Universal banks are large banks that operate on an extensive network of branches, and directly participate in the corporate governance of firms that are heavily dependent on banks for sources of funds or as underwriters for insurance (Calomiris, 1995). Because of the large size and extent of banking activities operated on, complexity included, universal banks are also exposed to risks that makes its participation in stock exchanges influence the overall volatility of these financial markets. For example, banks constantly choose between intermediation on "borrower" and "depositor" while retaining credit risk in their own books; or between "issuers" and "investors" to which credit risk is transferred to the investors (Goldschmidt, 2016). The risk is further raised, when issuers also become borrowers, as what appeared to be the cause of the 1930 financial crash that led to the imposition of the Glass Seagall Act (Goldschmidt, 2016). This act was enacted to separate commercial and banking activities, however, the Act was repealed in1998 because of the decision to deregulate financial markets in the US. This made stock market performance of universal banks to under much scrutiny as the relative risks appear to be increasing rather than diminishing. The immense economic role combined with the intriguing complexity of universal banks led the motivation for this research, and understanding what drives universal banks' performance in stock markets would significantly aid in more objective investment decision making, rather than simply be attracted to banking model itself. This paper is an investigative study of worldwide experiences of banks and universal banks stock market performance, including how stocks of listed universal banks impact stock markets. Basically, the research is organized in reference with various published documents that are filtered for their scholarly and authoritative contents.

The rest of the paper is organized in the following manner: literature review process, literature review, synthesis, and concluding remarks.

Literature Review Process

Inclusion Criteria

Literatures reviewed were as a minimum, from 2008 and onwards. The papers were sourced from journals not included in predatory lists. Abstracts, titles, and journal contents that contained keywords such as universal banks, universal banking, stock market performance of banks, banks, and banking were utilized. And as Short (2009) recommended, the best practice for literature review is to look for studies in known academic databases.

Literature review on banks listed on stock exchanges

According to Shukla (2019), the top ten stock exchanges in the world ranked based on market capitalization are: (1) New York Stock Exchange, (2) NASDAQ, (3) Tokyo Stock Exchange, (4) Shanghai Stock Exchange, (5) Hong Kong Stock Exchange, (6) Euronext, (7) London Stock Exchange, (8) Shenzhen Stock Exchange, (9) Toronto Stock Exchange, and (10) Bombay Stock Exchange. As of January 1, 2019, there are 93 banks listed in NYSE (TopForeignStocks.com), 342 banks listed in NASDAQ, (TopForeignStocks.com),in Tokyo Stock Exchange, 40% of listed banks is held by Bank of Japan alone (Tomita, 2018), in Shanghai Stock Exchange, 55 out of 1,515 companies listed are in the financial sector (Shanghai Stock Exchange website).

In Hong Kong Stock Exchange, there are 51 banks listed (Aastocks, 2019), in London Stock Exchange, 3 of the 30 largest publicly listed companies are from the banking sector (Disfold, 2019). In Toronto Stock Exchange, 10 out the 30 largest publicly listed companies are from the banking and financial sector (Disfold, 2019), in Bombay Stock Exchange, 20 public banks and 18 private banks are listed (Moneycontrol.com).

On performance of banks in stock exchanges

The study of Yao, Luo, & Stephen (2008) determined whether banks drove the Shanghai Stock Exchange Index [SSEi] that significantly increased from 1718 in 2006 to more than 6000 in 2007. Using Granger causality test of a sample of 10 listed banks, the study found a long-run, stable relationship exists between bank stock price and SSEi composite index (Yao, Luo, & Stephen, 2008).

The study of Ruthenberg, Pearl & Landskroner (2011) explored the factors that affect stock market performance of Israeli banks, particularly, the largest five banking groups from March 1994 to September 2005. Using regression analysis, the study found risk, return, and market and economic conditions significantly impact, market-to-book ratio as proxy for stock market performance.

The study of Srairi, Harrathi, & Kouki (2012) examined how technical and pure technical changes in efficiency influence share returns of Islamic banks operating in the Gulf Cooperation Council, from 2003 to 2009. The study found a positive relation between changes in technical and pure technical efficiency and performance in stock exchanged (Srairi, Harrathi, & Kouki, 2012). Changes in scale efficiency do not affect stock performance, while a positive and significant relationship is found between market return and book-to-market equity ratio with share prices of these banks (Srairi, Harrathi, & Kouki, 2012).

The study of Adepoju (2013) analyzed the stock market performance of Nigerian commercial banks in times of economic turbulences. The study, using data trend analysis and one-way ANOVA of eight banks from first generation and new generation banks, found that financially weak banks showed significant weakness in stock market performance compared to healthier ones in times of crises (Adepoju, 2013).

Aruomoaghe & Olugbenga (2014). confirmed how banks have contributed well in the financial capital investing and stock market of Nigeria since funds needed for enhanced production of goods were quickly mobilized and made available through the stock market.

The paper of Hossain (2016) showed the over-reliance of the Dhaka Stock Exchange [DSE], Bangladesh's stock market on bank stocks, one apparent characteristic of it is, many banks invested beyond the limit of 10 percent in the capital market (Hossain, 2016). This over-reliance was criticized, claiming that putting in too much money from the banking sector to the stock market do not assure development of the market, thus, it is strongly recommended that a limit on banks' exposure on stock markets be implemented and strictly monitored by central banks (Hossain, 2016).

The study of Odhiambo (2016) examined the relationship between banks and stock market development in South Africa using financial reports obtained from the South African Reserve Bank from 1969 to 2008. Using Autoregressive Distributive Lag [ARDL] showed that a positive and distinctive relationship bank development and stock market development in South Africa, both in the short and long run (Odhiambo, 2016).

On factors that affect bank share prices

The study of Oladele (2013) analyzed what drives value in the Nigerian banking industry using data of 21 universal banks listed in the Nigerian Stock Exchange. The study showed that profitability and dividend policy drive stock market performance of these banks while financial policies do not necessarily drive value (Oladele, 2013).

The study of Masum (2014) examined factors that influence stock prices of all 30 banks listed in Dhaka Stock Exchange. According to the study, EPS, ROE, retention ratio, and dividend policy positively impact share prices while dividend yield and profit after tax has no signficant impact on stock prices (Masum, 2014).

The study of Chhipa & Nabi (2015) examined the factors that affect share prices of banks in Pakistan, using 20 banks listed in Pakistan Stock Exchange from 2010 to 2017. According to the study, dividend yield, asset growth, earnings per share, and return on assets all positively impact bank share prices (Chhipa & Nabi,

2015). The result is slightly different from the study of Ghauri (2014) of 15 banks listed in Karachi Stock Exchange which narrowed down only to bank size having a positive, significant relationship while dividend yield, return on asset, and asset growth do not have positive, signficant relationship with bank share price (Ghauri, 2014).

Bhattarai (2014) examined the factors that influence share prices of commercial banks in Nepal, using data from banks listed in Nepal Stock Exchange from 2006 to 2014. According to the study, dividend yield, earnings per share, and price-earnings ratio significantly and positive influence commercial banks share prices in Nepal (Bhattarai, 2014).

Rauf (2015) identified quantitative factors that impact share price of the banking sector in Colombo Stock Exchange from 2005 to 2014. Findings of the study showed that dividend per share, earnings per share, book value per share, P/E ratio, and bank size all have positive, significant impact on bank share price (Rauf, 2015).

Mousavi & Karshenasan (2017) analyzed the factors that affect value of bank shares in the Tehran Stock Exchange using data from 25 banks from 2018 to 2014. The study showed that bank size, bank performan ce, inflation rate and bank credit risk are those that impact market value of bank shares (Mousavi & Karshenasan, 2017).

The study of Nataraja, Nataraja, & Ganesh (2018) determined what factors influence stock market performance of 3 large private banks listed both in National Stock Exchange and Bombay Stock Exchange. The study found banks size, credit risk, operational efficiency, asset management, and debt ratio significantly impact internal and stock market performance of these three large banks (Nataraja, Nataraja, & Ganesh, 2018)

On factors that affect bank share prices return

The study of Ramakrishnan & Toppur (2016) examined banking stocks return using a mixture of 33 banks in the public and private sector listed in the Bombay Stock Exchange, and according to the study, net interest margin [NIM], non-performing assets [NPA], return on assets [ROA], and return equity [ROE] are those variables that can be utilized in Indian bank investments. Moreover, private sector banks are more efficient than public sector banks in terms of ROA and NIM, but comparable in ROE.

Using the Real Options Theory, the study of Ng & Trinidad (2018) developed a model for loan portfolios of universal banks actively trading in the Philippine Stock Exchange. The study proposed that micro-scale funding with smaller financing packages may provide a positive growth market that is possible, for actively trading universal banks (Ng & Trinidad, 2018).

Discussion

Literatures reveal that one of the driving force of stock market performance are the banks listed in exchanges. Many of these banks are universal banks that encompass the functions of saving, commercial, and investment banking. Studies showed that stock exchanges' performance that can be found in stock market indices are driven by bank stock price performance (Yao, Luo, & Stephen. 2008), market-to-book ratio of banks (Ruthenberg, Pearl & Landskroner, 2011; Srairi, Harrathi, & Kouki, 2012); over-reliance of stock markets on bank stocks as criticized in the paper of Hossain (2016); and the positive and distinctive relationship bank development and stock market development in South Africa, both in the short and long run (Odhiambo, 2016). This shows that stock markets are also influenced by the participation of banks in general that the level of volatility of these listed banks would significantly affect the overall stock market performance.

Banks share price are influenced mostly be firm specific variables such as dividend policy and dividend yields (Oladele, 2013; Masum, 2014; and Chhipa & Nabi, 2015;), P/E ratio, bank size and EPS (Rauf, 2015; Mousavi & Karshenasan, 2017; and Nataraja, Nataraja, & Ganesh, 2018). Notably, only one study included inflation rate as a significant variable (Mousavi & Karshenasan, 2017). In terms of banks share price return, similar variables that impact share price impact its return, with the inclusion of other firm-specific variables such as NIM, and NPA (Ramakrishnan & Toppur, 2016).

An important finding was the availability of capital funding for smaller financing packages for small to medium enterprises that showed growth in return among actively trading universal banks in the Philippines. It appears that smaller business are actually driving growth for such universal banks in the country.

The literatures though, did not specify the type of banking in most of the studies, nevertheless, since this German model of banking has been in existence for many years, most developed and developing economies are already adapting this banking model.

Firm specific variables appear to be the common findings in literature to be significantly impacting share price of banks in stock markets. Moreover, the performance of stock exchanges depend on banks' stocks performance such that when these banks collapse, so does the stock market. Because of this, the challenge for banks to perform better become greater as the whole financial system is largely dependent on them.

Conclusion

The literature review confirmed the major role that banks play in stock markets. However, as found in the experience of Dhaka Stock Exchange, a limit on banks' exposure in stock markets should be given attention, and central banks should strictly focus on banks' compliance on this limit. The global financial crisis is clear evidence of how an uncontrolled risk exposure those big banks put themselves into would trigger tremors in the interconnection among banks, businesses, and economies. Simply put, when universal banks crash, the whole financial market crash and economies will once again drown in depression.

The premise that stock markets are always volatile still holds true, however, that volatility should no longer be an excuse for poor performance, especially among banks that are listed in stock exchanges. The expansion of capital availability through stock market participation of banks allowed many economies to grow and flourish. This means that the huge role of banks in economic growth can no longer be disputed, therefore the variables mentioned to be contributing to bank share price – dividend policy, dividend yields, ROE, ROA, EPS, P/E ratio, and bank size can form basis for model development that would drive bank value in stock markets. This is the important contribution of this paper, that is, to identify what previous studies has defined to be drivers of share price of banks in stock exchange. Future researchers who could test significance with respect to their banks and bank characteristics of interest can use these variables.

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