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Influence of board and ownership structure on bank profitability: evidence from South East Europe

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We investigate the impact of board and ownership structure on profitability of 74 commercial banks from four transition economies of South East Europe over the 2005–2010 period. We analyse this relation using Ordinary Least Squares regression analysis on an unbalanced panel data-set of 377 observations. We find negative and significant relationship between board size and bank profitability, while the proportion of independent directors on the board is negatively, but insignificantly related to bank profitability. Impact of ownership concentration on bank profitability is negative, but weak. We also find that privately held domestic banks outperform state-owned and foreign banks. Important factors influencing bank profitability in South East Europe are also bank size and bank capitalisation.

Keywords: commercial banks; board structure; ownership structure; bank profitability

JEL classification: G21, G34.

1. Introduction

The objective of this article is to examine the profitability of banks operating in four South East European (SEE) transition economies, namely Bosnia and Herzegovina, Croatia, Macedonia and Serbia, and the impact of bank governance, ownership structure, and other bank specific factors on bank profitability. We focus on a specific industry in specific environment of transition economies for two reasons. First, although some aspects of governance in nonfinancial firms can be applied to banks, complexity of banking business increase information asymmetry and make it difficult to shareholders and other stakeholders to monitor bank managers. Banks are also a key element in the payment system, and are subject to more intense regulation than other firms. Second, weak institutional environment, weak protection of investors and high ownership concentration in transition economies give rise to conflicts between controlling shareholder and minority shareholders more often than between managers and shareholders. In this regard, La Porta, Lopez-de-Silanes, Shleifer, and Vishny (2002) and Young, Peng, Ahlstrom, Bruton, and Jiang (2008) stress that, unlike developed economies where principal-agent conflicts are major concern of corporate governance, principal–principal conflicts are major issue in emerging economies requiring solutions beyond those devised in standard agency theory.

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