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THE EFFECT OF BANK SIZE ON RISK RATIOS: IMPLICATIONS OF BANKS' PERFORMANCE

Abstract:

The aim of this study is to investigate the effects of bank capital and liquidity ratios on banks' profitability. The analysis of these ratios makes it possible to observe the behaviour of the banks in terms of risk during the current period. The empirical analysis relates to a sample of 1270 European banks observed over the period 2005-2012. Three panels' data are considered respectively large, medium and small banks in order to compare European banks according to their size. First, tests indicate homogeneity in behaviour of large banks. For the other samples, fixed effects regressions are implemented to insert individual specific effects in the models. To account for profitability persistence, we apply a dynamic panel model, using Generalized Methods of Moments (GMM). Estimation results show the evidence of positive and significant profitability persistence for medium sized bank. Finally, we find no real evidence of a positive relationship between greater efficiency and bank profitability. While capitalization levels increase bank profitability, liquidity risk depends on the size of the bank.

Keywords:

bank profitability, panel data, bank capital, liquidity ratios, fixed effects model, dynamic panel.

JEL Classification: G21, C23, L25