Title: Diversification and Target Leverage of Financial Institutions

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Diversification and Target Leverage of Financial Institutions [1]

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Diversification and Target Leverage

Highlights

- Activity and geographic diversification are negatively related to leverage ratio.
- More-diversified financial institutions have lower leverage ratios.
- Financial institution's SOA is higher than US and European bank's SOA.
- Diversified financial institution gap's is adjusted within 17 to 18 months.
- Listed financial institutions that are geographically diversified have higher SOA.

of Financial Institutions[3]

Abstract

This study examines the relationship between banks corporate strategy (i.e. asset side diversification) choices and capital structure decisions. We first estimate financial institutions target debt ratio. The partial adjustment model is used to investigate whether the banks actual leverage is related to their activity and geographic diversification choices. Jointly, we estimate the speed of adjustment (SOA) to target leverage and the effect of diversification on the institutions actual debt ratios. The main results suggest a negative relationship between diversification and leverage holds for both activity and geographic diversification. Furthermore, the speed of adjustment found for financial institutions is higher than those estimated for other US and European banks in the literature. These findings are robust after taking into account the alternative method used to assess target leverage and the institution's classification. The listed financial institutions that are geographically diversified have less debt than those which diversify their activities.

***Keywords*:** Geographic Diversification; Activity Diversification; Capital Structure; Target Leverage; Financial Institutions.

JEL classification: G21,G23, G32, L19, L25

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[2] I am member of the research laboratory "**B**usiness and **E**conomic **ST**atistics **MOD**eling (**BESTMOD**)" at the Higher Institute of Management of Tunis and I am a member of the Research Unit "Management and Risk Management".

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