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Corporate governance and risk management at unprotected banks: National banks in the 1890s[1]

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Abstract

We examine bank governance and risk choices from the 1890s, a period without distortions from deposit insurance or other government assistance to banks. We link differences in managerial ownership to different corporate governance policies, risk, and methods of risk management. Formal corporate governance and high manager ownership are negatively correlated. Managerial salaries and self-lending are greater when managerial ownership is higher and lower when formal governance is employed. Banks with high managerial ownership (low formal governance) target lower default risk. High managerial ownership, not formal governance is associated with greater reliance on cash instead of equity to limit risk.

JEL classification

G21, G32, N21

Keywords

Manager ownership, Corporate governance, Rent seeking, Risk preferences, Bank failures

1. Introduction

Incentives of managers can conflict with those of outside shareholders and creditors, particular at highly leveraged and opaque institutions such as banks. Agency problems arise both with respect to the outright transfer of resources (e.g., excessive salaries or subsidized access to credit) and implicit transfers related to risk management practices (e.g., inadequate risk management effort or transfers from creditors to stockholders through risk shifting). Some risk