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Bank capital in the crisis: It's not just how much you have but who provides it

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Abstract: Bank capital is the cornerstone of bank regulation and is considered a key determinant of a bank's ability to withstand economic shocks. In the area of bank capital regulation, the general view is that more bank capital is better, irrespective of who provides it. In this paper, we investigate whether the investment horizon of bank capital providers matters for bank performance during the recent financial crisis. We observe that banks with more short-term investor ownership have worse stock returns during the crisis. Further exploration suggests that this is partially because banks with higher short-term investor ownership took more risk prior to the crisis but mainly because they experienced higher selling pressure during the crisis. Our results confirm the economic benefit of bank capital in helping banks to perform better during crises. However, when we decompose bank capital by the nature of its providers, we show that more capital is associated with worse performance when it is provided by short-term institutional investors.

Keywords: financial crisis, investor horizons, institutional investors, bank capital

JEL Classification: G01, G21, G23, G28, G32

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