Executive rewards put banks at greater risk

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(PhysOrg.com) -- New University of Ediburgh research has linked the risks taken by banks with the compensation received by their executives.

According to the research, which analysed US bank acquisitions from 1993-2007, banks are more likely to engage in risky takeovers when their executives are personally compensated for doing so.

Consequently, the amount of risk taken on by banks - a major factor in the ongoing credit crunch - is a direct result of the amount of incentives given to banking executives, according to the Business School's Jens Hagendorff.

As the link between executive pay and bank risk encourages financial volatility, regulators should consider limiting the incentives, such as stock options, that bankers receive, he says.

Jens Hagendorff, Senior Lecturer, University of Edinburgh Business School, said: "Chief executive pay in banking is much more geared towards rewarding risk-taking than in any other industry. Our research shows that banking chief executives are clearly responsive to the risk-taking incentives they receive."

The research - carried out by researchers at the University of Edinburgh Business School and the University of Leeds - found that during 1993-2007, chief executives were offered increasingly large amounts of risk-based compensation.

It also found that banks whose chief executives received higher incentives engaged in riskier behavior than they had previously.

More information: The paper is published in the *Journal of Corporate Finance*. It is available here: dx.doi.org/10.1016/j.jcorpfin.2011.04.009

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