Chapter 11

Capital and Liquidity Regulations, Resilience, and Bank Value

Md. Atiquur Rahman Khan
https://orcid.org/0000-0002-5815-2045
Faculty of Business Studies, University of Rajshahi, Bangladesh

ABSTRACT

In the business arena, particularly in the field of corporate finance, the scope of valuation is highly significant. There are several value drivers for a firm. However, due to its nature of business, a bank’s valuation is affected by several unique drivers including earnings diversification, risk capabilities, assets mix, and a lot of intangible factors. Since banking is a highly regulated sector, this chapter is designed to address the missing links between Basel capital and liquidity regulations, banking system resilience, and bank valuation.

INTRODUCTION

Valuation is a process to determine the value, in particular, the current economic value of a business by evaluating it’s all aspects. The process might include an analysis of the company’s management, ownership nature, capital structure, the expected market value of assets, risks, and most importantly future earnings prospects. There might be several reasons behind a firm’s valuation, namely, acquisitions and mergers, portfolio management, legal and taxation purpose. However, categorization of assets (tangible and intangible) is the biggest challenge for the managers today which have a significant impact on the firm value. A significant portion of earnings are induced from intangible assets in particular for the financial institutions.

In the business arena particularly in the field of corporate finance, the scope of valuation is highly important. Valuation has much significance in different areas of finance including a firm’s financing, investment, and dividend decisions. Within the objective of firm value maximization, the shareholders’
wealth maximization principle is incorporated. Further, among all the measures of a listed firm, the stock price is the most observable indicator that can be applied to assess the firm performance. In an efficient market, stock prices of a particular firm immediately reflect all newly disclosed information. Usually, managers’ decisions and actions are continuously compared with stock prices performance. A stock price upsurge is often credited to the value creation performance of the management (Kumar, 2016). The intrinsic or true value of stock contains all aspects (tangible and intangible factors) of a company, and these factors affect the perceived as well as the market price of a share.

There is also a crucial role of valuation in financing decisions for investment purposes. IPOs pricing is mainly based on the valuation process. Further, to set a long-term investment strategy, the value of a firm based on fundamental analysis help to understand whether it is overvalued or undervalued. Thus, the role of valuation in portfolio management possesses much importance, as it is an essential part of the fundamental analysis where the firm value is linked to its cash flow features in terms of timing, riskiness, and growth.

Valuation methods can generally be categorized into asset-, earnings-, and market-based valuation. However, in the last few decades, market-based valuation, which is also known as the shareholder value approach, has turned out to be the leading approach for business-performance measurement worldwide (Kumar, 2016). In addition, shareholders’ value maximization is the crucial objective for managerial decisions making process in different business sectors, including banks (Stephanie, 2006; Kumar, 2016). Considering the trust-based business nature, shareholder value creation has become the key goal of leading banks.

Scholars have identified several value drivers of banking institutions. Further to be noted, since the banking industry is highly regulated one, although few studies attempted to identify the effect of changing regulations on the stability and resilience of the banking system; no study is focused on whether the added regulations and increased resilience could increase the value of the banking firms as well as the shareholders’ wealth. However, there is a vital gap in existing literature whether the changing regulations could bring any value addition to the banks.

To identify the missing links between the new regulations, resilience and the value of the banking institutions, the remaining discussions are divided into additional 4 sections. While Section 2 presents how to value a bank, and the value drivers identified so far. Based on Basel initiatives, the regulations and resilience of the banking system are portrayed in Section 3. Section 4 addresses the effect of regulations on banks’ value. Lastly, Section 5 presents the concluding remarks.

**VALUING A BANK**

When valuing a bank, three matters are important. First, which valuation methods are appropriate for banks? Second, are any customization required for the standard methods for valuation; and third, on the basis of value drivers, how the customization be done? As outlined earlier, the shareholder value approach i.e. equity-based approach is better for banking institutions. However, the focus should be spotted on the value drivers. The key aspect of decision making in investment and asset management relies on a thoughtful study of the valuation as well as the sources of value. In addition to the fundamental factors, like, earnings, cash flows, revenue; business nature and risk-oriented factors are needed to be considered in the valuation.
Related Content

The Effects of Situational and Dispositional Factors on the Change in Financial Risk Tolerance
www.igi-global.com/chapter/the-effects-of-situational-and-dispositional-factors-on-the-change-in-financial-risk-tolerance/192377?camid=4v1a

The Role of Financial Innovation and the Derivatives Market in the World and Turkey in the Context of the Global Crisis of 2008

Integrated Risk-Based and Economic-Based (IRBEB) Methodology for Selection of Project Alternatives
www.igi-global.com/chapter/integrated-risk-based-and-economic-based-irbeb-methodology-for-selection-of-project-alternatives/172653?camid=4v1a

Production Scheduling Risk
(2018). Novel Six Sigma Approaches to Risk Assessment and Management (pp. 172-196).
www.igi-global.com/chapter/production-scheduling-risk/185963?camid=4v1a