

UNIVERSITY OF PIRAEUS



THE DETERMINANTS OF BANKS' NON INTEREST INCOME

Thesis prepared by

SOTIRIOS KARLOS

Supervising professor  
Dr A. Antzoulatos

JUNE 2009  
UNIVERSITY OF PIRAEUS

## THE DETERMINANTS OF BANKS' NON INTEREST INCOME

### ABSTRACT

Non interest income now accounts for over 40 percent of operating income in the U.S. commercial banking industry. This essay tries to determine links between bank non interest income, business strategies, technological change, and financial performance between 1988 and 2008. The results indicate that bank size plays a dear role in generating non interest income, while any attention towards core banking activities contribute more to interest income. Well-managed banks are present in non interest income activities, but their transition is slow and pre-planned. Non interest income is co-excising with interest income and leads to increased profitability ratios, but should be considered a secondary source of income, supplementary of core banking activities.

#### Key Words:

Banks, non interest income, deregulation, bank strategy.

# TABLE OF CONTENTS

1. INTRODUCTION	1
2. LITERATURE OVERVIEW	3
2.1 Financial intermediation theory	3
<i>Overview of intermediation theory</i>	3
<i>Focus on intermediation problems</i>	6
<i>Intermediation problems in emerging markets</i>	9
<i>Possible solution. Screening &amp; monitoring</i>	9
<i>Actual value of a bank</i>	10
2.2 The role of institutional framework	13
<i>The importance of the legal system</i>	13
<i>Background for bankruptcy and its importance</i>	15
2.3 Financial Liberalization & bank strategy	15
<i>The role of governments in emerging markets</i>	15
<i>Historical overview of government control</i>	17
<i>The role of banks in government control</i>	18
<i>The beginning of change. Turn towards privatization</i>	19
<i>Mass privatizations – Banks do not follow</i>	21
<i>Following privatization, how can banks make money? Varieties of strategies</i>	21
<i>Deregulation and its effects</i>	22
<i>Strategies categorized. Which ones work</i>	23
2.4 Non interest income	24
<i>First view of diversification of income</i>	24
<i>New challenges – choices on how to meet them</i>	25
<i>Diversification of activities, new sources of interest &amp; non interest income in detail</i>	28
3. DATA	35
4. EMPIRICAL ANALYSIS	43
<i>Full time employees / Total Deposits</i>	43
<i>Loans / Total Assets</i>	45
<i>Real Estate Loans / Total Assets</i>	46
<i>Commercial &amp; Industrial loans / Total Assets</i>	48
<i>Consumer Loans / Total Assets</i>	49
<i>Allocation of loan portfolio</i>	50
<i>Equity / Total Assets</i>	52
<i>Deposits / Total Assets</i>	54
<i>Money &amp; Capital Market Financing / Total Assets</i>	55
<i>Sources of funds</i>	57
<i>Loans / Deposits</i>	58
<i>In of Total Assets</i>	60
<i>Other Investments / Total Assets</i>	61
<i>Return on Equity</i>	62
<i>Return on Assets</i>	64
<i>Total Assets Growth</i>	64
<i>Relative ROE</i>	65
<i>Relative ROA</i>	65
<i>Calculation of formula and results</i>	65
5. CONCLUSIONS	70
<i>Epilogue</i>	
References	73