

THE EFFECTS OF OWNERSHIP STRUCTURE AND COMPETITION ON RISK-TAKING BEHAVIOR: EVIDENCE FROM UAE CONVENTIONAL AND ISLAMIC BANKS

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ABSTRACT

The objective of this study is to examine the effect of ownership structure and competition on risk-taking behaviour of UAE banks during the period 1998–2010. The study covers 15 national banks, including eleven conventional banks and four are Islamic banks. The proportion of ownership by government, private sector and institutional ownership measures ownership structure. Concentration is used as a measure of competition. Three control variables are also included in the analysis economic condition, bank size and profitability. The main findings of this study are that UAE conventional banks are riskier than Islamic banks; concentration of UAE conventional national banks is negatively associated with bank risk-taking, but this inverse relationship is not confirmed in the case of Islamic banks; and the private ownership of UAE national banks is negatively associated with bank risk-taking. Finally, the results indicate that there is a significant difference between UAE conventional banks and Islamic banks regarding risk-taking behaviour.

JEL: G20, G21

KEYWORDS: Ownership Structure, Competition, Risk-taking, UAE Conventional National Banks, UAE Islamic banks

INTRODUCTION

At the end of 2010, the UAE had 51 commercial banks, of which 23 were national banks and the remaining 28 were foreign banks. Among the national banks, there were eight Islamic banks. The total assets of the national banks increased from AED 162.9 billion in 1998 (about US\$ 44.4 billion) to AED 1,373.5 billion (about US\$ 374 billion) in 2010. The total assets of Islamic banks increased from AED 9.2 billion in 1998 (about US\$ 2.5 billion) to AED 262 billion (about US\$ 71.4 billion) in 2010. The proportion of UAE Islamic banks' assets increased from 4.1 percent of the UAE banking sector's total assets and 5.65 percent of the UAE national banks' assets in 1998 to 16.3 percent and 19.1 percent in 2010, respectively (Emirates Banks Association). According to the UAE Central Bank, the number of branches of UAE Islamic banks in 2010 was 247 compared with 507 branches of the conventional banks, representing 28.6% of the total branches of the UAE commercial banks.

The objective of this study is to examine the effect of ownership structure and competition on risk-taking behaviour of UAE banks. The current study represents an attempt to investigate the effect of concentration and the three types of ownership structure, government, institutional and private sector, on risk-taking behaviour of UAE banks. Boubakri et al. (2005) indicate that the impact of concentration and the three types of ownership structure on risk taking is crucial in the context of banks. In the current study a comparison was made between the two sets of banks in UAE, the conventional and Islamic banks.

The paper is organized as follows. In the following section we discuss the literature related to the ownership structure and concentration on risk-taking behaviour. This section is followed by an exposition

of the empirical model and data. The fourth section is devoted to discussion of the empirical findings. In the final section a brief summary of the paper and conclusions concerning the main results are provided.

LITERATURE REVIEW

A large number of empirical studies address the effect of ownership structure and concentration on risk-taking behaviour. However, there is no such known study in the case of UAE banks, which represents the main motivation for the current study. The following is a summary of the main findings of some of the related studies. Hassan et al. (2005) investigated the impact of ownership structure and regulation on the risk-taking behaviour of commercial banks and savings and loans in the U.S. The authors found a positive relationship, but only for lower levels of ownership concentration. The results also indicate there are no significant risk-differentials between commercial banks and savings and loans. In addition, there are no significant risk-differentials between depository institutions that are state-chartered and those that are chartered nationally. Teresa and Dolores (2008) analyze the determinants of risk-taking in Spanish financial intermediaries, with special emphasis on the ownership structure and size of the different entities. It was found that the specific legal configuration of Spanish savings banks may lead them to differ from commercial banks in their risk behaviour. In particular, they may invest in riskier projects.

Zou and Adams (2008) investigated the effect of corporate ownership on a firm's equity risk and stock returns in China. They found that the various types of corporate ownership have important, but different impacts on equity risk and returns. Companies with more state ownership have higher risk and lower returns. In contrast, companies with more legal-person ownership tend to have lower risk and higher stock returns. Foreign and managerial ownership are found to have little effect on firms' equity risk and returns. Kalluru (2009) examined the effect of ownership on performance and risk of commercial banks in India. The study, using t-test, fixed effects and random effects models, examines whether there exists any significant difference in performance and risk among state-owned banks, domestic private banks and foreign banks. The results indicate significant differences in the performance and risk, and foreign banks were more profitable and more risk-taking than the other two sets of banks. Bank capital and demand deposits were positively associated and loans were negatively associated with bank profitability, whereas size of banks and growth rate of economy were negatively associated with bank risk.

Huang and Ming Huang (2009) examined the influences of ownership structure on the capital structure of Chinese-listed companies. The key factors used were state ownership, institutional ownership, and the risk of default. The results confirm that the expected default risk is important in explaining debt decisions. The results also indicate that ownership by the state and by institutions has a positive effect on corporate leverage in high-leveraged companies but not in low-leveraged firms. The authors defined state ownership as the proportion of shares owned by the government, while institutional ownership was measured as the ratio of shares owned to outstanding shares by domestic, foreign and founding institution investors. ChUNET et al. (2011) investigated the effects of managerial ownership on the risk-taking behaviour of Korean and Japanese banks. The main finding is that managerial ownership alone does not affect either the risk or the profit levels of Korean banks. Whereas an increase in managerial ownership adds to the total risk of Japanese banks, increased risk-taking behaviour does not produce higher levels of profit for Japanese banks. Chou and Lin (2011) examined bank's risk-taking and ownership structure of Taiwan banks. The main objective of their study was to investigate the effects of specific types of ownership on the risk-taking behaviours of banks under differential ownership structures. The results show that banks with higher inside management ownership and higher government ownership have higher overdue loans (higher risk) and lower capital adequacy ratios. Banks with higher foreign institution ownership and stronger relative governance strength are associated with lower overdue loans (lower risk) and higher regulatory capital. Fazlzade and Mahboubi (2011) investigated the role of ownership structure on firm performance of 137 listed firms of the Tehran stock exchange within the period 2001 to 2006. The ownership structure included ownership concentration, institutional ownership and institutional

ownership concentration. They concluded that ownership concentration doesn't have any significant effect on firm performance but the two other variables are significant. Institutional ownership has positive significant effect on firm performance but the effect of concentrated institutional ownership is negative. The negative association between market concentration and bank risk taking has been established by many others including Dam, et al., (2011) and Repullo (2004). However, Forssbäcka and Shehzad (2011) tested the effect of banking-sector competition on bank risk-taking on a sample of around 400 European banks during the period 1995-2010. The results reveal a relatively clear indication of a positive competition-risk effect on risk-taking behaviour of European banks.

From the above literature review, the following conclusions can be derived: 1.) Privatization improves the banking performance and decreases its exposure to risk, 2.) There is a negative relation between private ownership and bank risk, 3.) Managers holding a high level of shares, are exposed to a high level of risk, 4.) Companies with more state ownership tend to have higher risk and lower returns, 5.) Foreign banks are more profitable and more risk-taking than state and private banks 6.) Ownership by the state and by institutions has a positive effect on corporate leverage in high-leveraged companies, 7.) Managerial ownership alone does not affect either the risk or the profit levels, 8.) Higher government ownership involves higher overdue loans (higher risk), 9.) Higher foreign institution ownership involves lower overdue loans (lower risk), 10.) Ownership concentration doesn't have any significant effect on firm performance, 11.) Institutional ownership has positive significant effect on firm performance and 12.) There is a negative relation between competition and bank risk.

Based on the literature review, the following three hypotheses are formulated:

H1: Competition among UAE national banks is negatively associated with bank risk-taking.

It is assumed this will be a negative relationship because when market share is small (market concentration is low), banks are motivated to engage in more risky activities in order to increase their market share. Dam et al.(2011) indicate in this regard that banks become more risky as their markets share becomes more concentrated or when the market concentration is low, banks invest in more risky assets. The same finding has been reached by Jiménez et al., (2007), which is the negative relationship between competition and bank risk.

H2: Private ownership of UAE national banks is negatively associated with bank risk-taking.

If private ownership is dominant, banks are expected to be more conservative and take fewer risks than those with government-dominated ownership. La Porta et al. (2002) and Cornett et al. (2003) conclude that public-owned banks take more risks than other banks. They mention that the behaviour of public-owned banks is justified by political and social objectives, which reflects the crucial role of banks in the economy. On the other hand, banks highly dominated by government ownership are less risky because they are politically protected from a lack of financial resources (see Kwan, 2004).

H3: Government ownership of UAE national banks is positively associated with bank risk-taking.

It is assumed that the domination of government ownership encourages banks to take more risks in order to be able to implement their political and social role.

H4: There is a significant difference in the level of risk-taking between the UAE conventional banks and Islamic banks.

There are some similarities between the products and services of conventional and Islamic banks. Meanwhile there are some differences between these two types of banks, the key difference being that

Islamic banking is based on a Shariah foundation (Islamic principles). Therefore all dealings, transactions, business approaches, product features and investment focus are derived from the Shariah law, which leads to significant difference in many aspects of the operations from conventional banking. Based on these differences, it is assumed that there is a significant difference in the level of risk-taking between UAE conventional banks and Islamic banks.

DATA AND METHODOLOGY

The data used in this study were for the period 1998–2010 and the banks covered were 15 national banks, of which 11 were conventional banks and the remaining four were Islamic banks. The study did not cover all national banks because some of them are new or because they are small and the data are incomplete. The foreign banks were not included because it is difficult to get data about ownership structure as they represent branches of foreign banks. Furthermore, the national banks' proportion of total assets was 78.1 % in 2010 which reflects the domination of the national banks in the UAE's banking industry. To test the study's hypotheses, the following two regression models were used:

$$\text{RISK} = f(\text{ECON}, \text{SIZE}, \text{ROA}, \text{CON})$$

$$\text{RISK} = f(\text{ECON}, \text{SIZE}, \text{ROA}, \text{GOG}, \text{INSIT}, \text{PRIV})$$

Where:

- RISK – is a measure of risk = the risk-weighted assets / total assets;
- ECON - is a measure of economic conditions = GDP growth rate;
- SIZE - is a measure of banks' size measured by total assets;
- ROA- is a measure of banks' profitability
- CONT- is a measure of banks' concentration;
- GOV- is a measure of government ownership
- INSIT- is a measure of institutional ownership;
- PRIV- is a measure of private sector ownership.

In addition, a dummy variable was used as an independent variable to reflect the bank type (TYPE) of which 0 was allocated to Islamic banks and 1 to conventional banks. The dependent variable in the two models was risk-taking behavior and it was measured by dividing the risk-weighted assets / total assets. This method was used by Shrieves and Dahl (1992), Jacques and Nigro (1997) and Murinde and Yaseen (2004). Concentration (CONT) was used as a measure of competition. The Herfindahl index was used in this regard (www.wikipedia.com) and calculated by the sum of the squares of the market share. The second measure was the proportion of shares owned by government, institutions and private sector (see Gursoy and Aydogan, 2002; Yi Huang et al., 2009; Hassan et al., 2005; Meca, 2009; Fazlzadeh et al., 2011). Regarding the control variables, three common variables were used; the first one was GDP growth rate which reflects economic conditions as there is a positive relationship between economic growth and financial development (see for example Wang, 2009 and Beck et al., 2008). The second control variable was total assets (the bank size) as larger banks would be able to diversify their assets risk (see Sanders et al., 1990 and Kalluru, 2009). The third control variable was profitability measured by ROA; it is assumed that a bank with high earnings might have higher risk (see Yi Huang et al., 2009

and Ta Ho and ShunWu, 2006) The data used in this study were mainly obtained from four sources: the UAE Central Bank annual reports and statistical bulletins, the UAE commercial banks annual reports published by the Emirates Banks Association, and the BankScope and ORISIS databases. Table 1 provides descriptive statistics for concentration, ownership and the risk factor.

Table 1: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
privcon	13	.37	.40	.3797	.01147
insitcon	13	.19	.22	.2074	.01058
govcon	13	.40	.42	.4092	.00643
privis	13	.53	.53	.53	.00000
insitis	13	.09	.09	.09	.00000
govis	13	.38	.38	.38	.00000
riskcon	13	.77	.92	.8198	.04847
riskis	13	.65	.78	.7073	.04699
contcon	13	.40	.49	.4476	.02405
contis	13	.00	.02	.0122	.00744

PRIVCON- is a measure of private sector ownership(Conventional banks);
INSITCON- is a measure of institutional ownership (Conventional banks);;
GOVCON- is a measure of government ownership(Conventional banks);
PRIVIS- is a measure of private sector ownership(Islamic Banks);
INSITIS- is a measure of institutional ownership(Islamic Banks);
GOVIS- is a measure of government ownership (Islamic Banks);
RISKCON – is a measure of Conventional banks’ risk = the risk-weighted assets / total assets;
RISKIS – is a measure of Islamic banks’ risk = the risk-weighted assets / total assets;
CONTCON- is a measure of Conventional banks’ concentration;
CONTIS- is a measure of Islamic banks’ concentration.

RESULTS

The purpose of this study was to compare the ownership structure, competition and risk-taking behaviour between the two types of commercial banks in the UAE, Islamic banks and conventional banks. It is worth mentioning here the main features of these two sets of banks regarding ownership structure and the level of risk. The ownership structure of both Islamic banks and conventional banks is almost the same. For the risk factor, the conventional banks are riskier than Islamic banks as expected, as the latter are more conservative. Table 2 reveals the ratio of the risk-weighted assets / total assets; it can be seen that the average of this ratio during the period 1998–2010 was 82 percent for the conventional banks compared with 70.7 percent for the Islamic banks.

Table 2: Ratio of risk-weighted assets to total assets of UAE commercial banks

Year	Islamic Banks	Conventional Banks
1998	.68	.78
1999	.67	.81
2000	.68	.81
2001	.65	.78
2002	.68	.80
2003	.67	.77
2004	.72	.78
2005	.66	.78
2006	.78	.84
2007	.73	.84
2008	.75	.90
2009	.78	.92
2010	.77	.85
Average	.71	.82

Table 2 shows the ratio of the risk-weighted assets / total assets, the average of this ratio for the period 1998–2010 was 82 percent for the conventional banks and 70.7 percent for Islamic banks.

The First Model

The first model includes the bank risk-taking measured by the risk-weighted assets / total assets as a dependent variable and four independent variables; competition among UAE banks measured by concentration (CONC) and three control variables namely, economic conditions (ECON) measured by economic growth, the banks’ size (SIZE) measured by total assets, profitability measured by ROA. Table 3-a and Table 3-b provide a summary of the regression results of the first model for the two sets of banks. It can be seen from Table 2-a that the explanatory power of

Table 3-a: Summary of Regression Results-UAE Conventional Banks

	Beta	t
(Constant)		7.356
ECON	.160	1.085
SIZE	.667	4.396**
ROA	-.282	-1.312
CONC	-.192	-1.172
R		.942
R Square		.887
Adjusted R Square		.831
Std. Error of the Estimate		01994

Dependent Variable: RISK(the risk-weighted assets / total assets) **Statistically significant at the 5 percent level Note: This table shows the regression estimates of the equation: $RISK = f(ECON, SIZE, ROA, CONC)$. The table reveals the coefficient values, the t-statistics and the significant level.

the adjusted R^2 explained 83.1.8% of the variation of conventional national banks’ risk factor and 59% in the case of Islamic banks. The estimated coefficient of concentration (CON) was, as expected, negative but statistically insignificant. This result is expected because the conventional national banks were highly concentrated, and therefore there was no need to engage in more risky activities. However, the estimated coefficient of concentration (CON) of Islamic banks was unexpectedly positive, but statistically insignificant. The result was not expected in the case of Islamic banks because of the low concentration of these banks, which would lead them to engage in more risky activities. These results are consistent with the conclusions reached by Body Dam et al. (2011 and Jiménez et al.,(2007),). The results partially confirm the first hypothesis in which it is assumed that concentration among UAE banks is negatively associated with bank risk-taking.

Table 3-b: Summary of Regression Results Islamic Banks

	Beta	t
(Constant)		25.225
ECON	.122	.556
SIZE	.701	1.373
ROA	-.027	-.141
CONC	.152	.297
R		.852
R Square		.727
Adjusted R Square		.590
Std. Error of the Estimate		.03009

Dependent Variable: RISK(the risk-weighted assets / total assets) Note: This table shows the regression estimates of the equation: $RISK = f(ECON, SIZE, ROA, CONC)$. The table reveals the coefficient values and the t-statistics.

The Second Model

This model includes the bank risk-taking as a dependent variable measured by the risk-weighted assets / total assets and six independent variables, including three control variables namely, economic conditions (ECON) measured by economic growth, the banks’ size (SIZE) measured by total assets and profitability measured by ROA; in addition to the ownership structure measured by three variables, namely the proportion of government ownership (GOVS), private sector ownership (PRIVS) and institutional

ownership (INSTS). Table 3-a and Table 4-b show the results of the regression model. It can be seen from the table that the adjusted R square is 89.9% in the case of conventional banks and 75.3% for Islamic banks. This indicates that the six independent variables explain 89.9% and 75.3% of the risk-taking behaviour by UAE conventional national banks and Islamic banks respectively. For conventional banks, the estimated coefficients of two independent variables were, as expected, negative and statistically significant at the 5 percent level in the case of private ownership and 10 percent in the case of institutional ownership. For Islamic banks, the estimated coefficients of private ownership and institutional ownership were as expected negative and statistically significant at the 10 percent level. In general, the results confirm the second hypothesis which states: Private ownership of UAE national banks is negatively associated with bank risk-taking. This finding is consistent with the conclusions of

Table 4-a: Summary of Regression Results-UAE Conventional Banks

	Beta	t
(Constant)		2.049
ECON	.284	2.704**
SIZE	.977	2.767**
ROA	-.384	-2.448**
GOVS	.293	1.117
PRIVS	-.978	-2.612**
INSTS	-.899	-2.006*
R	.974	
R Square	.949	
Adjusted R Square	.899	
Std. Error of the Estimate	.01544	

Dependent Variable: RISK(the risk-weighted assets / total assets) n b Note: This table shows the regression estimates of the equation: $RISK = f(ECON, SIZE, ROA, GOG, INST, PRIV)$ The table reveals the coefficient values, the t-statistics and the significant level. **Statistically significant at the 5 percent level *Statistically significant at the 10 percent level

La Porta et al. (2002) and Cornett et al. (2003). The estimated coefficient of government ownership is as expected positive but statistically insignificant in the case conventional banks, but it is unexpectedly negative and statistically significant at 10 percent in the case of Islamic banks. The results did not confirm hypothesis three which states: Government ownership of UAE national banks is positively associated with bank risk-taking. This is consistent with conclusion of Kwan (2004).

Table 4-b: Summary of Regression Results- UAE Islamic Banks

	Beta	t
(Constant)		2.217
ECON	-.064	-.334
SIZE	2.058	3.462*
ROA	-.132	-.812
GOVS	-2.074	-2.110**
PRIVS	-2.404	-1.979**
INSTS	-.897	-2.226**
R	.936	
R Square	.876	
Adjusted R Square	.753	
Std. Error of the Estimate	.02337	

*Dependent Variable: RISK(the risk-weighted assets / total assets) Note: This table shows the regression estimates of the equation: $RISK = f(ECON, SIZE, ROA, GOG, INST, PRIV)$ The table reveals the coefficient values, the t-statistics and the significant level. **Statistically significant at the 5 percent level *Statistically significant at the 10 percent level*

An attempt has been made to examine the above mentioned model by considering the data for all UAE banks(conventional and Islamic banks). Table 5 reveals the results of the test. It can be seen that all the coefficient values are statistically insignificant, which gives the support of dividing the sample into two groups, conventional and Islamic banks.

Finally, the difference between the UAE conventional national banks and Islamic banks regarding risk-taking behaviour was examined. Table 4 shows the results of One-Way ANOVA analysis for the differences between UAE Islamic banks and the conventional banks regarding risk-taking behaviour to

test hypothesis four which states: There is a significant difference in the level of risk-taking between the UAE conventional banks and Islamic banks. It can be seen from the table that there is as expected a significant difference between the UAE conventional banks and Islamic banks regarding risk-taking behaviour, that is statistically significant at the 1 percent level. The results are expected because of the nature of operations, activities and the risk exposure of each type of bank. These results confirm hypothesis four.

Table 5: Summary of Regression Results- UAE Banks

	Beta	t
(Constant)		.728
ECON	1.691	1.116
SIZE	-.454	-.388
ROA	-.150	-.667
GOVS	.375	.974
PRIVS	1.691	1.116
INSTS	-.724	-.981
R	.954	
R Square	.911	
Adjusted R Square	.786	
Std. Error of the Estimate	.02083	

Dependent Variable: RISK (the risk-weighted assets / total assets) Note: This table shows the regression estimates of the equation: $RISK = f(ECON, SIZE, ROA, GOG, INSIT, PRIV)$ The table reveals the coefficient values, the t-statistics and the significant level.

Table 5: The Results of Analysis of Variance for Islamic Banks and Conventional Banks

	Sum of Squares	df	Mean Square	F	Sig.
RISK				36.080	.000
Between Groups	.082	1	.082		
Within Groups	.055	24	.002		
Total	.137	25			

RISK is the risk-weighted assets / total assets) The two groups are conventional banks and Islamic banks

CONCLUDING COMMENTS

The objective of this study was to examine the effect of the ownership structure and competition on risk-taking behaviour of the UAE banks during the period 1998–2010. Concentration was used as measure of competition, whereas the proportion of ownership by government, private sector and institutional ownership was used in the case of ownership structure. In addition, we used three control variables: economic condition, bank size and profitability. To test the study’s hypotheses, two regression models were used, in which concentration and ownership were used alternatively as a dependent variable in the two models.. The main findings of this study are: 1) that the UAE conventional banks are riskier than the Islamic banks, which is to be expected because the latter are more conservative; 2) that the ownership structure of UAE conventional national banks is negatively associated with bank risk-taking when concentration is used as a measure of ownership structure, but that this inverse relationship is not confirmed in the case of Islamic banks; 3) that the private ownership of UAE national banks is negatively associated with bank risk-taking; but 4) that the results did not support the assumption that government ownership of UAE national banks is positively associated with bank risk-taking in the case of both sets of banks, the conventional and Islamic banks; and finally 5) that there is as expected a significant difference between UAE conventional banks and Islamic banks regarding risk-taking behaviour. Among the limitations of this research is the data availability, as the data was available somehow for a short period. In addition, the study did not cover all the national banks because of insufficient data. For further research, it is highly recommended to cover all UAE banks and it is interesting to examine the same topic to include commercial banks of the Gulf region..

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