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The Impact of Derivatives and CEO Overpower on Bank Risk-Taking Behavior: Evidence from Vietnam

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Abstract

Purpose: This research seeks to fill a literature gap by providing empirical evidence on how the adoption of derivatives instruments and the influence of powerful CEOs might impact bank risks. Given the growing complexity of financial markets and the potential implications for financial stability, this study addresses a critical gap in the literature concerning the role of powerful CEOs and financial derivatives and bank risks in Vietnam.

Design/methodology/approach: This study collects data from 38 Vietnamese commercial banks from 2009 to 2020. We utilize the Fixed Effect Model and dynamic system Generalized Method of Moments to analyze the nexus between financial derivatives, CEO overpower, and bank risks in Vietnam.

Findings: The findings suggest that increasing the use of derivatives helps reduce bank risks. In addition, the higher CEO salary and longer CEO tenure discourage the risk-taking behavior of commercial banks in Vietnam. However, the higher CEO ownership increases the bank risk. Finally, the impact of derivatives, CEO salary, and CEO ownership on banking risk are robust, even employing alternative risk proxies. Our results align with established theories such as Corporate Hedging Theory, Agency Theory, and the Convergence of Interests Hypothesis.

Research limitations/implications: While this research expands knowledge in banking, it is not exempt from data-related constraints. The publicly traded Vietnamese bank pool is notably smaller than that of more advanced economies. While subsequent studies might address these data constraints through cross-country analyses, these limitations do not negate the significance of the study's contributions. Instead, they present avenues for potential future research endeavors.

Practical Implications: Our study suggests two key policy directions. First, to harness derivatives for lower bank risk in Vietnam, prioritize transparent regulation, collaboration, and financial education. Second, address CEO ownership's impact on risk by enforcing robust governance, tailoring strategies, and aligning compensation and tenure with prudent risk management.

Originality/value: Risk management through derivatives and corporate governance in the banking sector is closely linked to decision sciences for several reasons. Decision sciences provide analytical tools and methodologies that facilitate effective decision-making in utilizing derivatives for risk management. The findings in our paper provide empirical evidence of the role of derivatives and powerful CEOs in bank risk-taking behavior in Vietnam. Our results enrich the literature within decision sciences, offering nuanced perspectives on the intricate decision-making processes, governance structures, and risk management practices pertinent to the banking industry in emerging markets.

Keywords: Derivatives; CEO Overpower; Bank Risk; GMM; Vietnam
JEL classifications: G20, G21, G28

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