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Does Geographical Complexity of Colombian Financial Conglomerates Increase Banks' Risk? The Role of Diversification, Regulatory Arbitrage and Funding Costs

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Abstract

During the last decade Colombian international financial conglomerates (IFC) expanded abroad, significantly increasing their geographical complexity. This paper analyzes the effect of this change in geographical complexity on the risk level of individual Colombian banks. We use monthly bank-level data on financial indicators and complexity measures for the period 2007- 2018. We use the Z-score as a measure of bank risk and the number of countries in which a Colombian IFC has foreign banks subsidiaries as a measure of geographical complexity. Our results suggest that complexity is associated with higher levels of individual bank risk, as a result of an expansion to countries with large GDP co-movements and lower regulatory qualities. In addition, we find that banks with access to international funding respond differently to monetary policy changes. In particular, during periods of domestic monetary policy tightening (loosening), individual banks of complex IFCs present higher (lower) levels of risk, suggesting that the monetary policy risk taking channel is affected by the level of geographical complexity.

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