Risk and Return of Online Channel Adoption in the Banking Industry

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February 2020

Summary

Online banking has become an important distribution channel for commercial banks. We construct a bank-specific indicator of online channel adoption to study the risk and return of online channels based on a sample of 118 Chinese banks in the period 2002-2016. Our empirical results find that online channel adoption improves the profit efficiency (i.e., positive return) of the adopting banks. Even though cost efficiency deteriorates, such improvement can be attributed to the rise in non-interest income efficiency. In reference to risk management, online channel adoption weakens the loan quality of the adopting banks, which also raises their solvency risk accordingly. Overall, our results suggest that online channel adoption alters the risk-return trade-off of adopting banks. Such risk-return effects are heterogeneous depending on the size, management skill and labour intensity of

adopting banks. However, there is no significant return related to the costly content enrichment of online channels. Finally, our results are robust to alternative specifications, alternative sample selection, alternative measures of bank efficiency and risk, alternative estimation methods, and omitted variable biases.