

Diversification in banking: is non-interest income the answer? The case of Taiwan banking industry

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As Taiwan has conducted a series of financial reforms, the commercial banks faced a huge challenge. This research is aimed at investigate how non-interest income, which include Commission Earned, Trustee Fee, and exchange gains etc., affects the mean and variation of bank profits in Taiwan banking industry. We select the aggregate and individual bank data over the period 1992 - 2009 and follow Stiroh's (2004) method to measure the potential return and bank risk. At the aggregate level, although they may have diversification benefits from declining covariance between net interest income and non-interest income, non-interest income has much more variation than net interest income. At the bank level, there are positive significant to explain the diversification benefits will decline as non-interest income enlarges. By analyzing econometric model, the continued expansion in the component of non-interest income will lower risk-adjusted returns. From these overall results, we can conclude that inflating with nontraditional activities may not have diversification benefits in Taiwan banking industry.

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