Editorial

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Biographical notes: Peiyi Yu is a Senior Lecturer within the Finance, Economics and Risk field. Her current research interests include hybrid bank capital securities, panel data econometrics, bank mergers, financial reforms, and banking regulation. She obtained her PhD in Finance from the University of Birmingham. Her thesis focused on the profit-structure relationships of the banking industry. Her recent publications include papers in the *Review of Quantitative Finance and Accounting*, *Journal of Investing*, and the *Journal of Fixed Income*. She is a member of the German Finance Association and US Financial Management Association. In 2003, she was awarded a DAAD scholarship to carry out a research project related to the German banking industry at the University of Tuebingen in Germany. In 2006, she also won a research grant from the University of Wolverhampton to study barriers to entry in European Banking.

This special issue collects four papers that derive valuable lessons from the recent financial crisis of 2007–2009, focusing on: Banking, Executive Compensation and Risk Management. Many financial sector and regulatory practices contributed to the recent financial crisis, but among these were important failures in risk management practices and weaknesses in the compensation and governance policies in the financial industry. The list of potential causes may include failures in: rating agencies practices, capital adequacy, liquidity management, portfolio credit risk management, and counterparty credit risk management. Some of these failures can be linked to conflicts in incentives that led to excessive risk-taking.

The major contribution of the papers in this special issue is not only to provide empirical evidence across the Middle East, Europe, and Asian emerging markets, but also to help turn management and financial theory into management practice.

The recent financial crisis has changed companies' strategic environment and the responsibilities of strategic supervision have increased enormously. The first paper selected for this special issue is from Eulerich and Stiglbauer, which examines the effects of the crisis on German supervisory boards' work. The title of their paper is 'The supervision of strategy and risk in German two-tier boards: lessons learned from the crisis'. Eulerich and Stiglbauer suggest that boards collect information which is mostly past-oriented. For example, institutionalised corporate governance had its main focus on financial ratios and passive acting. They argue that good corporate governance requires sustainable and well-informed boards with a sustainable, holistic and strategic

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perspective. In their paper, they evaluate whether German supervisory boards' work and practice within the two-tier structure has changed in the aftermath of the crisis.

Based on three propositions on supervisory board members' understanding of their function, supervision structure and supply of information, Eulerich and Stiglbauer's findings differ strongly from previous findings that were based on studies conducted before the recent financial crisis. Their results suggest that supervisory boards' work did change due to the crisis. First, pro-active supervision might be considered as an urgent improvement for effective and efficient corporate governance in the two-tier board with a change of mind among supervisory board members. Secondly, they conclude that board members understand their role more and more not only as supervisors but also as consultants/discussants of executive boards. Thirdly, the uncertain environment forced the use of external and non-financial information to provide the best possible supervision.

Nevertheless, they note critically that there is still a focus of supervisory boards on the supply of information by the executive board as the basis of their decisions. Intensifying own information initiatives is necessary on the one hand to lower information asymmetries between executive board and supervisory board and on the other hand to professionally fulfil the monitoring and advising tasks and duties of the supervisory board.

The second paper we selected deals financial market efficiency in an emerging market economy after the recent financial crises. The paper from Yang, Chen and Lin is entitled 'How do securities dealers trade in the Taiwan stock market? Evidence from the financial crisis of 2008'. Yang, Chen and Lin investigate how securities dealers trade, before and after the 2008 financial crisis. Securities dealers who are granted the advantage of low transaction costs are expected to provide market liquidity with low price impact. The evidence shows that, during normal times, securities dealers do act as market makers to provide liquidity. Moreover, the authors observe that market making is the predominant cause of securities dealers' herding in Taiwan stock market. This may offer supporting evidence towards the notion that herding behaviour and liquidity provision performed by securities dealers are complementary.

Yang, Chen and Lin also examine how securities dealers responded to the 2008 global financial crisis. They found that, when faced with the 2008 crisis, securities dealers changed their behaviour significantly and began acting more as proprietary traders than liquidity providers. Securities dealers who are granted with trading advantages could not help but fend for themselves during the global financial crisis. Even after the crisis, securities dealers did not reverse to their roles as market makers. Instead, they acted as contrarian traders selling stocks with positive past returns.

The fact that there are no designated dealers provides warning signals to both securities regulators and market practitioners regarding the necessity of having designated dealers in an emerging stock market, especially during financial crises.

The third paper concentrates on the Gulf Cooperation Council (GCC) financial markets. Written by Al Janabi, the paper is 'On the appraisal of LVaR throughout the close-out period: an investment management outlook from recent global financial crisis'. Under special conditions when changes in market risk factors are normally distributed, Liquidity-Adjusted Value-at-Risk (LVaR) can be calculated using a closed-form parametric approach. However, for an emerging market environment, one needs to supplement the closed-form parametric approach with other analysis such as stress-testing and what-if simulation analysis. In his paper, Al Janabi launches a practical modus-operandi for the assessment of potential market risk exposures for financial

trading portfolios by providing an investment management perspective of the most recent global financial crisis.

In order to clarify the accurate use of LVaR and stress-testing methods, he carries out 14 full simulation case-studies using GCC market indices with the objective of calculating LVaR numbers under various scenarios and under different market conditions. The different scenarios are performed with distinct asset allocations and study the effects of illiquidity of trading assets by imposing different close-out horizons for each trading asset.

The model presented could be valuable for GCC banks. In contrast to other commonly used liquidity models, the modified liquidity risk factor approach proposed by Al Janabi could lead to further reduction in the overall portfolio trading risk; and hence in the amount of regulatory-capital and/or economic-capital, as specified by Basel II and the forthcoming Basel III requirements on banking supervision.

Al Janabi also derives lessons for regulators. It is important that local regulatory authorities and policymakers in the GCC zone consider the inclusion of asset liquidity risk as an integral part of their risk management methodologies and in the design of prudential regulatory policies and procedures. This ultimately will aid GCC financial markets in minimising the impact of unexpected losses especially during severe market turmoil.

The last paper in this special issue focuses on European financial markets. This paper written by Luu and Sondhi deals with 'Financial market returns before, during and after five European banking crises'. Banking crises are not a new phenomenon. While the current global credit crisis is more internationally spread and severe than most post-war cases, historical analysis of previous crises still provides valuable lessons for financial market performance. Luu and Sondhi examine equity and bond market returns before, during, and after the following five European banking crises in the 1990s: Denmark, Finland, Italy, Norway and Sweden. The authors construct returns to various equity market factors for these countries, including Price-to-Book, Dividend Yield, Size, Momentum, Value vs. Growth and Sector. For fixed income, they look at the yield levels and spreads between different maturities of government bonds.

Some investment implications are derived from Luu and Sondhi's analysis. First, Large-cap and Growth biases are beneficial going into the crisis. Second, when the end of the crisis is near, investors should consider re-positioning towards Small-Cap and Value stocks for the next 12 months. Third, Dividend Yield can be an unreliable indicator of defensiveness, Dividend Cover appears to be a better indicator in that respect. Fourth, if the banking crisis is country-specific, one should expect that country's stock market to underperform against other markets, but to rebound in relative terms in the 12 months after the end of the crisis. Fifth, it appears advisable to be underweight Financials well after the crisis has ended. Crises often end with governments taking large ownership stakes in banks, which does not seem to lift bank equity prices. Finally, in fixed income markets the analysis suggests that investors position for yield curve steepening going into a banking crisis and keep that position on until well after the crisis has ended. Overall, Luu and Sondhi's study is useful input for consideration in portfolio construction and manager selection for institutional and private investors. In particular, they recommend style biases that appear likely to enhance expected returns and reduce risk both during the current crisis and when it is over.