

**An Analysis of Reckless Investment by Irish Banks - Was the 2008 Irish
Financial Crisis Home-grown?**

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Declaration:

I declare that all the work in this dissertation is entirely my own unless the words have been placed in inverted commas and referenced with the original source. Furthermore, texts cited are referenced as such, and placed in the reference section. A full reference section is included within this thesis.

No part of this work has been previously submitted for assessment, in any form, either at Dublin Business School or any other institution.

Signed:.....

Date:.....

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I would like to thank my parents, my sisters and my brother along with all the relatives for their constant support and encouragement during research investigation.

Abstract

This study will analyse the business practices of Irish banks over the period 2004 – 2007 in an attempt to determine if the 2008 Irish Financial Crisis was predominantly home-grown or the result of uncontrollable external factors. The first chapter provides the reader with an introduction to my chosen topic, why I chose to research the topic, my approach to the research, and the general organisation of the dissertation. The next chapter is a summary of all literatures reviewed on this topic extracting important information from the literature that may help in answering the research question. Following this will be a detailed section on the methodologies adopted when researching the topic. This will include the research methodology adopted for both primary and secondary research. The analysis of data collected and a discussion of the findings will come next. This will include analysis both of a set of questionnaires as well as data obtained through conducting a trend and ratio analysis. The next chapter will be the conclusion where I will give an opinion on the research question based on the research conducted. Finally there will be a self reflection chapter. This will sum up my own learning and performance experiences as I completed the dissertation.

Chapter 1 – Introduction

1.1 – The Research Problem

Ireland has recently suffered one of its worst economic collapses in history. The subsequent recession has been widely felt within the country with the past trend of emigration returning as a lack of jobs leads to many leaving the country in search of employment. Debate has been ongoing over the last number of years as to the exact causes of the crisis. Several factors within the country as well as several external factors have been cited as having some level of effect on the crisis, none any more so than the Irish banks. As stated in the abstract, this research will analyse the business practices of Irish banks over the years 2004 – 2007 in an attempt to determine if the 2008 Irish Financial Crisis was predominantly home-grown or the result of uncontrollable external factors.

1.2 – Aims and Objectives

I completed all modules of the degree of MSc in International Banking and Finance over the period September 2010 – May 2011. Undertaking this course when I did meant the recent Irish Financial Crisis was at the core of many of the modules. This was particularly the case in both my ‘Financial Institutions’ and ‘Macroeconomics’ modules. This being the case I developed a keen interest in how such a catastrophe could happen to a country that seemed to be so stable and indeed economically impressive. Implicated by almost every corner of economic thinking in the root of the crisis are the Irish banks. Therefore it is the aim of this study to analyse the business practices of the Irish banks in an attempt to determine just how much of an adverse effect they had on this country’s economy.

1.3 – Approach to the research

Both primary and secondary research methods will be employed for this research. In terms of primary research, questionnaires will be used to elicit the opinions of important figures within the economy and the banking system itself as to the causes of the crisis. For the secondary research I will conduct a trend and ratio

analysis using figures taken off the financial statements of three Irish banks; Anglo Irish Bank, Allied Irish Bank and Bank of Ireland. Here is where I believe I can research this much-discussed topic in a new way. I will include three Canadian banks in the trend and ratio analysis against which to compare the results of the Irish banks. The three Canadian banks chosen are The Royal Bank of Canada (RBC), The Bank of Nova Scotia (Scotia Bank) and The Toronto-Dominion Bank (TD). Canada is the chosen country as it was along very similar lines of economic development as Ireland pre-2008 and has since emerged from the International Financial Crisis in much healthier economic condition. With this in mind, analysing the business activity of both sets of banks as well as the parallel changes in the relevant base countries' key economic indicators should help provide some clarification as to how much of an effect Irish banks had on the crisis.

1.4 – Dissertation Organisation

The first chapter following this introduction is the literature review. Initially there will be analysis and summaries of literatures pertaining to Ireland's economy during the 1950s and up until the early 1990s. Following that will be the main focus of the chapter and this will consist of reviewing several literatures whose subject matter pertains to the 2008 Irish Financial Crisis. The sections included in this chapter are Irish economics after independence, Celtic Tiger, artificial boom, lending, loss of competitiveness, fiscal policy, regulatory and supervisory environment, Lehman Brothers, American influence on Europe and Economic and Monetary Union. These titles are chosen based on the most prominent themes uncovered while researching literature. The following chapter will detail the research methodology adopted for both the primary and secondary research. For this chapter I adopted the 'research onion' method as depicted by Saunders et al (2009). This is a six-stage approach to research and will include details concerning the approaches and philosophies I adopted when undertaking the research. The following chapter is the data analysis and findings. This will include all findings from the questionnaires, ratio analysis and the trend analysis as well as some discussion about these findings. In the penultimate chapter I will draw a conclusion as to the research question based on the data analysis and findings of the previous chapter. At this stage there will hopefully be sufficient information for me to conclude that the crisis is either home-grown or not and

whether or not it was the actions of Irish banks that was the main cause of the crisis. The last chapter of this dissertation will be self reflection. This chapter will detail the process of completing this dissertation from start to finish as well as the impact this process has had on me personally and professionally.

1.5 - Scope and Limitations of the Research

As mentioned earlier, this study will employ both primary and secondary methods of research. The primary research will consist of sending out questionnaires to two separate target groups; economists and bankers. This is in order to obtain varied opinion as to the causes of the crisis as well as reducing the risk of biased opinion affecting the conclusion. In terms of limitations, there were only two respondents to the questionnaire sent out to bankers. This obviously limits the weight that can be apportioned to the opinions obtained from this questionnaire. Most recipients responded saying they couldn't fill out the questionnaire due to concerns about confidentiality, which is understandable. I had already reduced the intrusiveness of the questions and to do so any more would mean not eliciting meaningful responses from respondents. The secondary research consists of a trend and ratio analysis and will incorporate three Irish banks and three Canadian banks that have already been named. In terms of limitations there are countless more figures from the financial statements as well as other financial ratios that I could have calculated. However, there was no scope to do so within the word restrictions of this dissertation. Also I will be analysing the results of the trend analysis parallel to changes in the key economic indicators of the two countries in order to draw a conclusion. Of course this is limited in the sense that there are plenty of other factors within an economy that could affect a country's KEI other than the activities of their main banks.

1.6 – Contributions of the Study

This topic has been one of the most extensively discussed and studied over the past number of years. As stated earlier, the new dimension I believe this study brings is the use of Canadian banks as a proxy against which to compare the activities of Irish banks. This will provide a sort of measuring stick not used before that could aid in determining just how much of an affect Irish banks had on the crisis.

Chapter 2 – Literature Review

2.1 – Introduction

In order to comprehend how the 2008 Irish financial crisis happened, it's important to understand the economic policies that led us into this crisis. In the case of Ireland this isn't as simple as examining the prevailing policies of the early 1990s though to 2008. T.K. Whitaker's 1958 policy paper titled 'Economic Development' sparked a revolution in terms of this country's economic stance. It is this revolution and its path towards free-trade and ultimately a very capitalist society that eventually led to the type of economic environment in which the crisis took place. This chapter will begin with reviewing literature relating to Irish economy in the unlikely era of the 1950s. I believe it is imperative to start here as this is where we see a major shift in Irish economic thinking, from economic nationalism and protecting indigenous industry to open-markets and international competition, that eventually led to the economic policies that took us to the forefront of European living standards, and then ultimately to collapse. This chapter will adopt a chronological flow starting from post-independence economic nationalism in the 1950s, taking us through the shift towards open-markets sparked by T.K. Whitaker in 1958, touching on growth and recession from the 1960s to the 1980s and then eventually to the Celtic Tiger. This will take us to the main focus of this chapter, the reviewing of existing literature on the 2008 Irish Financial Crisis. Several areas of the crisis are focused on individually and each area is given its own subchapter. After extensive reviewing of literature I thought this to be the most appropriate way to structure this chapter so as to ensure clarity and logical flow. The sub-chapters are titled as follows:

- Irish Economics after Independence
- Celtic Tiger
- Artificial Boom
- Lending
- Loss of Competitiveness
- Fiscal Policy
- Regulatory and Supervisory Environment
- Lehman Brothers

- American Influence on Europe
- EMU

2.2.1- Irish Economics after Independence

Many economists in Ireland around the 1950s were very critical of the economic policies implemented by the government. These policies were thought to be hindering Ireland's economic progress as evidenced by the mass emigration experienced during the time. When discussing this mass emigration Dorgan (2006, p. 2) states "there could be no clearer evidence of the failure of economic policies and opportunities and of the inadequate fulfilment of national aspirations". Dorgan mentions the sustained period of economic nationalism that Ireland employed after gaining independence from the United Kingdom and expresses the sentiment that it only succeeded in hindering Ireland's economic progress.

"By the mid-1950s it was clear that economic nationalism was not sustainable. The stagnation and emigration, and the despondency they caused, were in stark contrast to other, fast-recovering economies of postwar Europe" (Dorgan, 2006, p. 2). Dorgan explains that the policy of economic nationalism to protect indigenous industry had been proven not to work. It was thought Ireland needed to free up their economy in order to see any significant economic growth. This view is shared by Benjamin Powell who also believed it was the hands on approach of the government in the economy that caused its poor performance. Powell (2003) states "the high level of government interference in trade and other parts of the economy caused dismal economic performance".

This sentiment seemed to be echoed by the government and economists of the 1950s because we see a shift in economic policy as the end of the decade approached. Dorgan cites the 1958 economic policy paper titled 'Economic Development' as the major turning point in Ireland's economic thinking. This paper was stated to have "overturned much previous policy thinking by advocating free trade, foreign investment, productive (rather than mainly social) investment, and growth rather than fiscal restraint as the prime objective of economic management" (Dorgan, 2006, p. 2).

Economist and former government minister T.K. Whitaker was the main architect of this paper. As Ireland got into the 1960s the government abandoned its plan of protectionism and began to look at trade and exports in particular as a source of growth.

Dorgan in particular cites the shift in government economic policy from protectionism to openness as the catalyst for the change in Ireland's economic fortunes. "More open markets spurred improved economic performance in the 1960s, compared to the previous decade" (Dorgan, 2006, p.3). This view is shared by Powell (2003) who stated "trade liberalization during the 1960s fuelled Ireland's economic growth".

Dorgan goes on to explain how this new policy of economic openness appeared to gather momentum and continue into the 1970s with Ireland's admission into the European Economic Community. Joining the EEC in 1973 was seen as a very big step for this country to take in terms of trying to harness export-led growth and remove the economic shackles of protectionism. "The 1970s reversed past trends. For the first time since independence, the population increased, rising by 15 percent for the decade. National income increased at a sustained annual rate of about 4 percent." (Dorgan, 2006, p. 5). The article goes on to discuss the establishment of the IDA and its role in attracting foreign investment. The article goes on to tell of the IDA's success in attracting FDI to Ireland. "By 1975, more than 450 foreign owned industrial projects, covering a wide range of manufacturing sectors, accounted for two-thirds of Ireland's total industrial output" (Dorgan, 2006, p. 6).

The high growth of the 1960s ended and the 1970s in Ireland brought mixed fortunes as what seemed to be a promising decade marked by growth and change was damaged by unfortunate events and mismanagement of the economy. "The Irish economy maintained reasonable growth, albeit at a slower pace, in the 1970s. Inappropriate fiscal, monetary and incomes policies, together with the oil crises, then set the economy into a downward spiral". (Kelly and Everett, 2004, p. 4). This downward spiral was then said to last well within the 1980s as the old theme of the government mismanaging the economy once again emerged.

Dorgan also mentions this economic downturn in his article as well as highlighting both internal and external factors he thought had caused the downturn. “Unsolved, the underlying economic problems of the 1970s rolled over into the 1980s, producing disappointment” (Dorgan, 2006, p. 6). These factors were high inflation, high unemployment, constant budget deficits and a weak global economy. It was thought the internal hindrances were allowed to fester and grow worse rather than being dealt with. High public spending is strenuously highlighted in this article as being a major factor in Ireland’s economic problems around this time. Government intervention through increased taxes and borrowing was thought to scare off potential investment and therefore further fuel unemployment. The article indicates 1987 and the election of a new Fianna Fail government to be the beginning of Ireland’s economic resurgence. The government introduced a policy of expenditure cuts in order to erase the budget deficits. There was also an introduction of moderate wage increases as well as a reduction in income taxes thereby increasing disposable income. On the investment side of things the Industrial Development Authority was attracting FDI and the IFSC was established in Dublin as well in an effort to boost the financial services sector. “All of these things worked together and it’s stated that when the 1990s dawned Ireland had created an environment for growth” (Dorgan, 2006, p. 8).

Klaus Regling and Max Watson also believe it to be prudent government policy that caused the upturn in the economy around this time as they stated the “turnaround in the late 1980s was triggered and underpinned by a range of successful government policies. Significant fiscal consolidation measures in the late 1980s were one important factor in creating stable economic conditions, against the background of earlier structural reforms” (Regling and Watson, 2010, p. 21). Regling and Watson echo Dorgan’s sentiments in their report as they go on to mention the importance of wage restraint, specifically mentioning the trilateral wage agreements, and its roll in attracting foreign direct investment. Kelly (2009, p. 1) is yet another economist endorsing this theory as he states “during the 1990s, rising employment resulting from improved competitiveness caused Ireland to experience rapid economic growth”.

2.2.2 – The Celtic Tiger

When Ireland emerged from the economic hardships of the 1980s and moved into the 1990s there was an unanticipated period of very high growth known as “The Celtic Tiger”. In their paper about the financing of the Celtic Tiger, John Kelly and Mary Everett mention three theories that have been put forth in an attempt to explain the occurrence of this boom: expansionary fiscal contraction, delayed convergence and the regional boom theory.

When discussing expansionary fiscal contraction the authors stated the theory suggests that “a permanent fiscal contraction raises private sector expectations of lower future government spending and can lead to increased demand and consumption” (Kelly and Everett, 2004, p. 4). The term ‘fiscal contraction’ suggests a decrease in government spending, which is what Dorgan (2006) stated was what the new Fianna Fail government were trying to do upon getting elected, namely decreasing government spending and setting the budget to rights. McAleese (2000) also highlights fiscal contraction along with tax cuts as being a catalyst of the boom in his paper on the origins of the Celtic Tiger. “For a small, open economy, curbing public spending proved a far more productive way forward. It created room for tax cuts while simultaneously lowering the debt ratio. Another ploy was the introduction of a tax amnesty. Following on the high tax policy of the 1980s and the reorientation in fiscal policy, it proved hugely successful in terms of revenue generation” (McAleese, 2000, p. 47). It’s the opinion of the author that lower taxes coupled with well-managed budgets led to people having a more positive view of the government’s capabilities and this confidence led to an increase in demand and therefore the expansion of the economy.

Kelly and Everett (2004) explain that the delayed convergence theory rationalises the boom by suggesting it was nothing more than Ireland catching up with the rest of Europe. Ireland’s poor economic performance of the 1980s left it far behind the other EU member states and the subsequent boom was simply Ireland reaching these standards now that the fiscal side of things were under control. This exact sentiment is echoed by Barry (2002) who is of the opinion that “the delayed convergence perspective suggests that simply getting the various policy dimensions

right in the late 1980s allowed automatic convergence. The corollary is that such convergence could have been achieved in any earlier period if the policy environment had been similarly appropriate” (Barry 2002, p. 37). The hypothesis is that Ireland always had the capability of having a European-standard economy but policy failures prevented these standards from being achieved. Once the government implemented the proper policies it was only a matter of time before Ireland would prosper. In their paper on Ireland’s economic boom, Honohan and Walsh (2002) advocate the delayed convergence theory as well. Mentioned in this article is the common consensus around the time of 1973 that Ireland would soon experience a period of convergence in living standards. “Indeed, the situation at the end of the twentieth-century can be seen as the fulfillment of such a prediction” (Honohan & Walsh, 2002, p. 4).

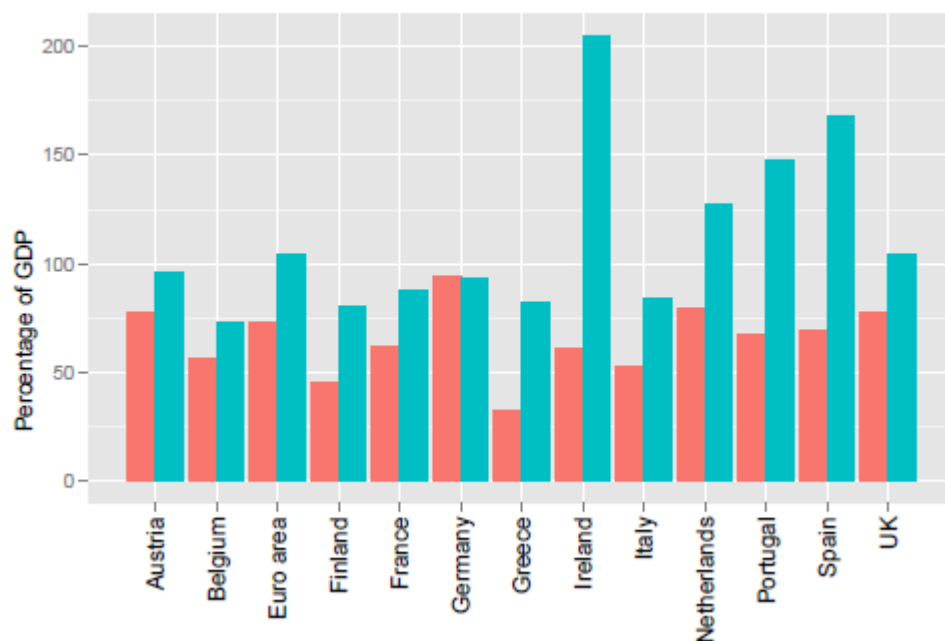
The third and final theory attempting to explain the Celtic Tiger is the regional boom hypothesis. “A regional economy can grow more dramatically than a national one, with capital and labour inflows stimulating each other” (Barry, 2002, p. 39). The belief here is that Ireland is heavily influenced by the other EU member states being a small open economy as it is. More specifically, Barry (2002) highlights Ireland’s exports as its main driver in this time and explains that it was the foreign industry set up in Ireland that accounted for the majority of these exports.

Whatever the actual reason for the emergence of the Celtic Tiger, what all the above authors agree upon is that this was a period of very high export-led growth in Ireland. The time frame of the Celtic Tiger is roughly 1994-2001. This encompasses the period of growth in Ireland that was fuelled by exports and saw Ireland emerge as a very competitive country due mainly to low corporation tax and competitive wages. After 2001 Ireland started losing its competitiveness as wage demands were soaring and the strengthening Euro led to a decrease in non-EMU exports. Growth in Ireland dipped from 2001-2003 and when it picked up again in late 2003 it was predominantly rising property prices that fuelled the economy. This fact has led to some economists labelling the period of 2003-2007 an ‘artificial boom’.

2.2.3- Artificial Boom

“The proximate cause of the boom and bust in Ireland since 2000 is well known: construction” (Kelly, 2009, p.1). In his report title ‘The Irish Credit Bubble’ Morgan Kelly immediately splits Ireland’s recent period of economic growth into two phases by highlighting a boom-bust that started in 2000. Kelly refers to the increase in the construction sector’s contribution to national income from the 1990s-2007 as evidence of the property bubble that occurred in Ireland, indicating that it went from 4-6% in the 1990s to 15% by 2006-07. He also blames this bubble for Ireland’s loss of competitiveness and the government’s surge in spending as wages were pushed up and tax revenue soared in response to the construction boom. “However, driving the construction boom was a less recognised boom, in bank lending” (Kelly, 2009, p.1).

Figure 2.1



(Source: Kelly, 2009, p. 2)

The above chart shows bank lending to households and non-financial firms as a percentage of GDP for various Eurozone economies. The red bar depicts lending to these sectors in 1997 and the green bar 2008. This rapid increase in credit seen in Ireland was said to create distortions in the economy, specifically on house prices. “Like any bubble, the rise of Irish property prices contained the seeds of its own collapse” (Kelly, 2009, p.3). These seeds were described by Kelly as being rooted in

the Irish banks' business model of heavy borrowing from wholesale markets. This model was said to have failed when foreign lenders became nervous of Irish banks.

In Patrick Honohan's report titled 'What Went Wrong in Ireland', the Central Bank Governor distinguishes between two different growth phases Ireland experienced over the last two decades. "Up to 2000 there was the true Celtic Tiger period of exceptional export-led growth with moderate wage and price inflation and healthy public finances" (Honohan, 2009b, p. 3). Governor Honohan points to the government's success in tackling public spending and negotiating wage restraint on the back of social partnership agreements as the main catalysts allowing for the emergence of The Celtic Tiger. Stressed in Governor Honohan's above statement is that this growth was export-led and the author believes this to be the crucial factor separating Ireland's two different growth phases. "By 2000, the convergence phase was over, but rapid growth continued in Ireland – though now the sources of growth shifted sharply. An unsustainable decade-long property price and construction boom had taken over from exports as the main driver of Irish growth" (Honohan, 2009b, p. 3). That this property boom was 'unsustainable' has since been echoed by many economists as the downfall of the Irish economy. Honohan then cites a dangerous shift to an over reliance on property-related taxes as a result of the construction boom. "At the same time, the negotiated wage-restraint-for-income-tax-concessions bargain continued to be renewed. Government could afford to offer these concessions because of the buoyant revenue from the construction boom and from corporate profits, on which they became increasingly reliant" (Honohan, 2009b, p. 2).

In a later section of this report, Honohan implicates the Irish Banks concerning their role in the property bubble. When discussing the sources of finance for the bubble Honohan states "long before it peaked, it looked unsustainable to most commentary. Nevertheless, from 2003 on, banks continued to ease loan conditions such as maximum loan-to-value ratios" (Honohan, 2009b, p. 4). Singled out by Honohan is Anglo-Irish Bank and the fact that their market share grew from 3 percent to 18 percent in just ten years. Honohan goes on to imply that it was pressure from Anglo in particular that caused other Irish Banks to lend recklessly in order to retain market share. When discussing how Anglo was allowed to have such an effect on other Irish Banks Honohan cites regulation and its lack of implementation. "Bank

regulation, although on the surface compliant with international standards (IMF, 2006), was complacent and permissive” (Honohan, 2009b, p. 5).

2.2.4 - Lending

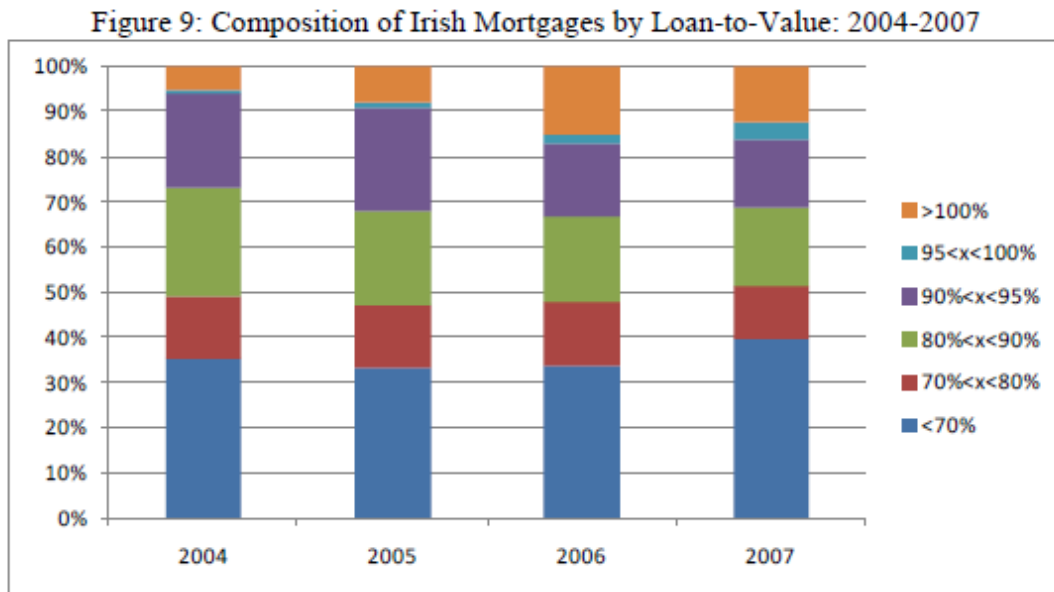
Conor et al (2010) labelled the lending that was going on in Ireland pre-2008 a ‘capital flow bonanza’. This report echoes much of the sentiment displayed in the Regling and Watson report by highlighting EMU membership as an important factor in the Irish property bubble. “A significant factor in the creation of the Irish property bubble was the relatively low interest rates following Ireland admission to the Euro currency union” (Conor et al, 2010, p. 11). As well as the effect on lending the report also says this fact made it hard for Ireland to combat the ongoing inflation. However, rather than pin this problem wholly on the EMU this report lays the blame at the door of Irish banks stating “in the case of Ireland, the capital bonanza was mediated by the Irish commercial banks” (Conor et al, 2010, p. 10). Coupled with this distortion of interest rates there was said to be a very large inflow of credit into Ireland also made easier by EMU entry and that this credit inflow had even more an effect on the housing and construction bubble than did the low interest rates.

Although Conor et al (2010) attribute the property bubble to the availability and cheapness of credit they state its foundations were nothing more than a “rational response to increasing demand” (Conor et al, 2010, p. 9). When discussing the original housing boom during the Celtic Tiger the report highlights net immigration and a desire to upgrade housing now that wages in Ireland allowed for such improvements. The increase in demand was said to be such that the supply could not keep pace and hence the sharp rise in property prices seen first in the late 90s. It was then by the start of the new millennium the banks were to have their effect on property prices. “This price trend was exacerbated during the later years from 2000-2006 when over-aggressive bank lending flooded the market with property developers and speculative investors” (Conor et al, 2010, p. 9).

As well as the dramatic increase in lending, Conor et al (2010) discuss the serious decrease in lending standards apparent during this time. Banks were said to have been guilty of allowing for both a decline in the credit quality of new residential

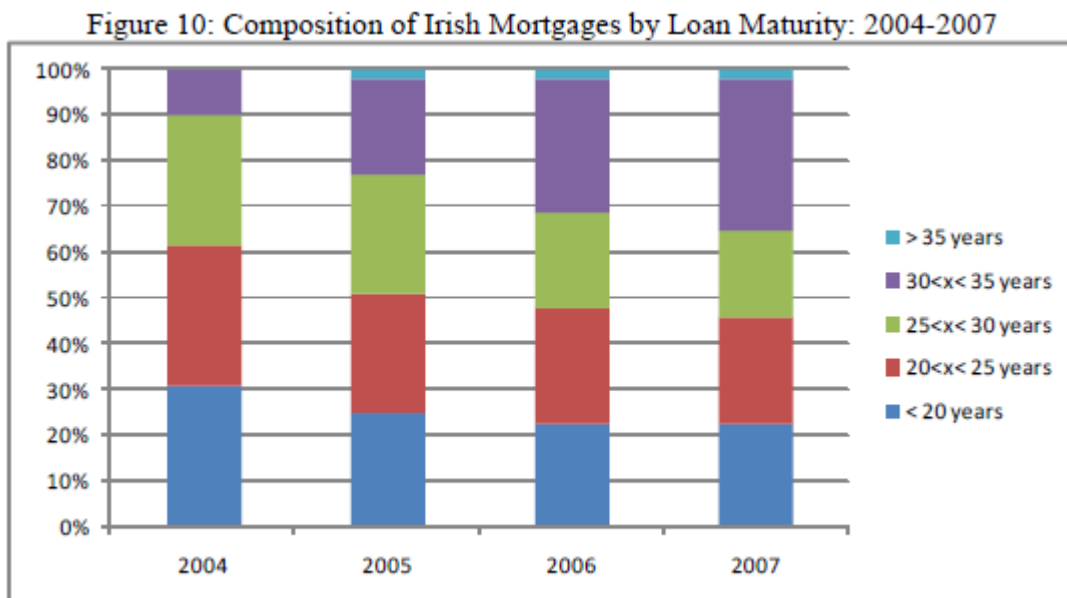
mortgages and a lengthening of mortgage maturities beyond the norm in order to attract as many new applicants as possible.

Figure 2.2



(Source: Conor et al, 2010, p. 16)

Figure 2.3



(Source: Conor et al, 2010, p. 17)

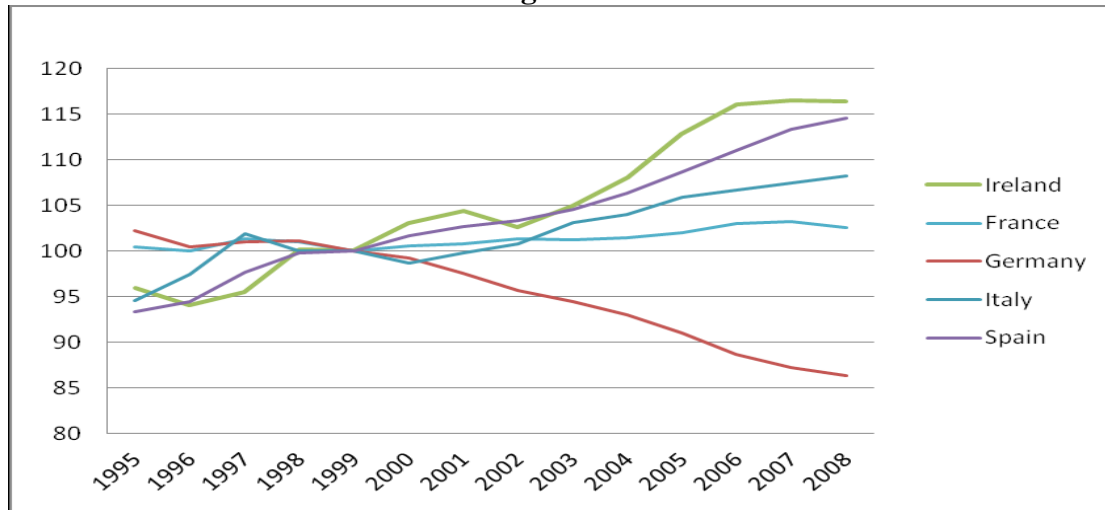
The first graph above displays an increasing willingness of banks to give 100% loan-to-value mortgages from 2004-2006 and then a slight decrease in 2007 but

apparent still in that year is that over 70% of mortgages given had LTV ratios of 90% and above. Taken from the second graph displaying mortgages by loan to maturity is an apparent 25% increase in the amount of mortgages given with a loan maturity of 30 years and over. Apart from just residential mortgages being highlighted in this report the authors also state a lack of diversification to be a problem. “With the enormous growth in property- and construction-related lending, the loan books of the Irish domestic banks were becoming increasingly undiversified” (Conor et al, 2010, p. 17). This was said to be coupled with a low income yield on commercial property as rental income did not rise as fast as property prices. This meant “investors in this sector were relying heavily on capital gains for their prospective returns” (Conor et al, 2010, p. 17).

2.2.5 - Loss of Competitiveness

Another factor highlighted in the Regling and Watson report is the acceleration of Irish wages and the resultant deterioration in competitiveness. The trilateral wage agreements mentioned earlier were still in effect but “became less relevant as workers negotiated supplementary wage increases against the background of full employment and an overheating economy” (Regling and Watson, 2010, p. 21). This loss of competitiveness is shown in the following chart that shows Ireland’s relative unit labour costs in comparison to the four main economies in the Euro zone. Evident in the chart is the particularly sharp increase in Ireland’s labour costs from 2003-2006. Another fact to be taken from the chart is that Germany and France had the most competitive wages from 2003 onwards and these are the two Euro zone countries that have emerged the most impressively from the International Financial Crisis.

Figure 2.4



(Source: Regling and Watson, 2010, p. 22)

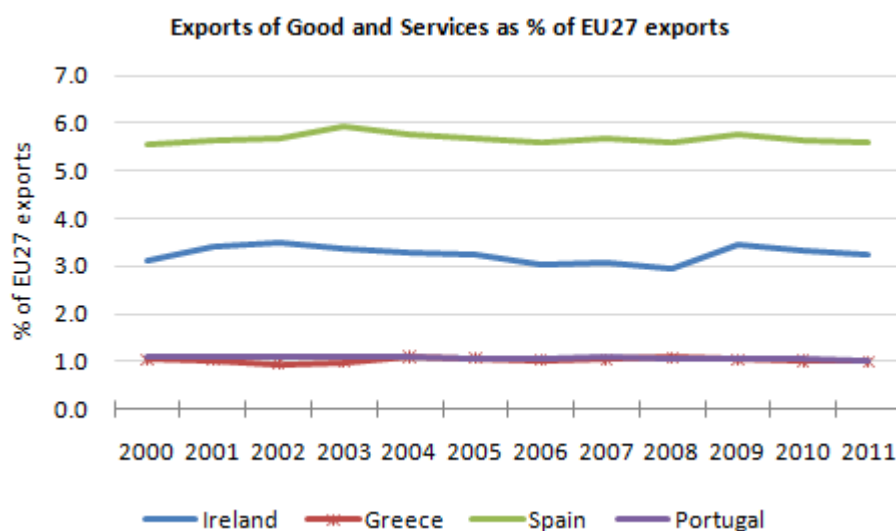
The authors go on to say that this loss of competitiveness should have been the catalyst for the slowing down of Ireland’s overheating economy but “an imprudent expansion of bank lending, accompanied by an unwise policy on tax exemptions, resulted in this natural economic cycle becoming much more extreme than should have ever have been the case” (Regling and Watson, 2010, p. 22). The implication of both the banks and the government here is a recurring theme among economists and also mentioned is the Lehman Bros collapse and how it exacerbated this situation.

Honohan (2009b) also touches on the loss of wage competitiveness as a contributor to the Irish crisis. The trilateral wage agreements are again attributed with the credit for keeping wages relatively low and helping the country to reach full employment from 1986-2000. As with the Regling and Watson report, Honohan uses Ireland’s competitors as a proxy against which to compare wages stating that Ireland’s hourly wage rates had caught up to and surpassed those in other European countries. “Sooner or later, this loss of wage competitiveness was sure to affect employment expansion, but this was masked and delayed by the construction boom” (Honohan, 2009b, p. 6).

Tom McDonnell (2011) expresses a contrasting view in his paper titled ‘Myths of the Irish Crisis: Wages and Competitiveness’. He argues that if one were to judge a country’s competitiveness by exports then Ireland didn’t experience a loss of

competitiveness. In fact McDonnell argues that, according to relevant Irish export data pertaining to the years 2000-07, a loss of competitiveness had no bearing on the economic crisis. Gros (2011) advocates this same sentiment and produces a chart showing that there was no relationship between a loss of competitiveness and exports.

Figure 2.5



(Source: Gros 2011)

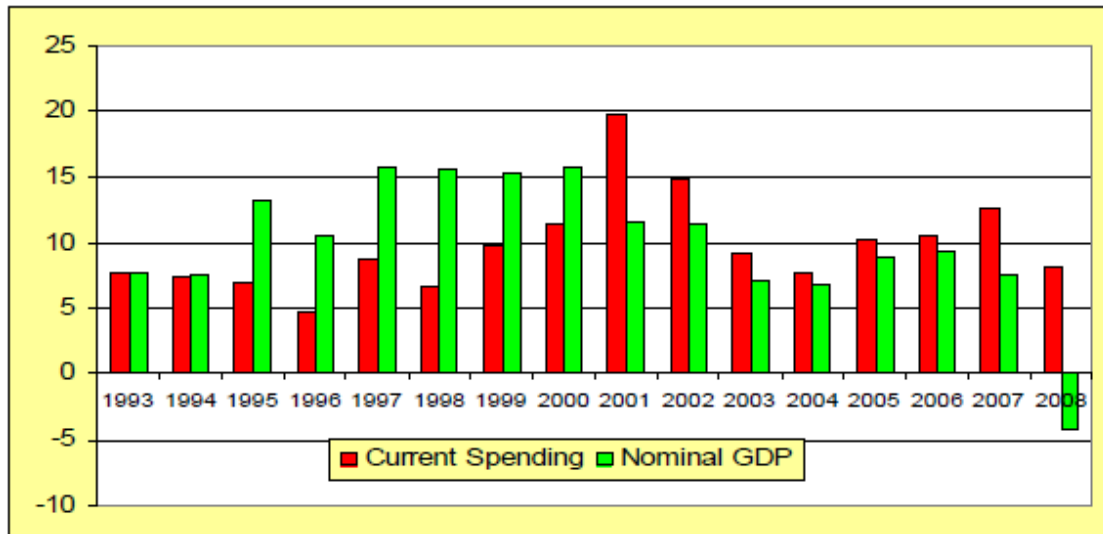
Daniel Gros states that if a loss of competitiveness did have a negative effect on exports then the above blue line (indicating Ireland) would be downwards sloping, as it would also be for Greece, Spain and Portugal if a loss of competitiveness had a negative effect on their exports.

2.2.6 - Fiscal Policy

The Irish government's fiscal stance pre-2008 was also scrutinised in the Regling and Watson Report. The section begins with the authors giving merit to the fiscal policy Ireland employed from the mid 90s to 1999. Highlighted specifically were constant fiscal surpluses up until 2006 and the creation of a Pension Reserve Fund. However, it's also stated that from 1999 onwards the cyclically adjusted fiscal surplus was actually very small. "The conclusion is that overall fiscal policies were pro-cyclical during most years up to, and including particularly, 2007 thus adding markedly to the overheating of the economy" (Regling and Watson, 2010, p. 25). The report attributes this to a mixture of public expenditure and revenue developments.

Growth in current expenditure was said to be skyrocketing and increasing far faster than nominal GDP on an annual basis.

Figure 2.6



(Source: Regling and Watson, 2010, p. 26)

The authors cite the collapse in tax revenue caused by a change in the government's reliance on sources of tax as the reason for the fiscal deficit depicted in the graph for 2008. "The composition of tax revenue had shifted gradually from stable sources of taxation, like personal income tax and VAT/excise taxes, to cyclical taxes, such as corporation tax, stamp duty and capital gains tax" (Regling and Watson, 2010, p. 26). The problem with this situation is said to be twofold. On the one hand it made it difficult to assess the fiscal stance because the cyclical taxes grew so rapidly in the run-up to the crisis. And secondly the government's switch to being over-reliant on certain types of taxes, particularly pro-cyclical property taxes, made the budget more vulnerable to a downturn. The report highlights three factors responsible for the switch in sources of tax revenue. The government's goal of achieving wage restraint using the trilateral wage agreements is said to be one factor. In order to achieve this goal the government offered income tax cuts and this worked at the time as revenue was healthy but in the end it had the effect of narrowing the tax base. The second factor mentioned is the favouritism shown by the Irish taxation system to property and home ownership. Homeowners could deduct interest rate payments on their mortgages from income tax and there was no property tax. This was said to further narrow the tax base as well as giving more incentives for people to invest in property during the bubble. The third factor cited is the various tax expenditures included in

the Irish taxation system. “According to the OECD, by 2005 the cost of “tax expenditures” had become larger than the remaining income tax receipts. As a percent of total tax revenue, tax expenditures in Ireland are more than three times larger than on average in the EU” (Regling and Watson, 2010, p. 27). This, once again, was said to have narrowed the tax base and contribute to the property bubble as some of the tax relief pertained to property.

Honohan (2009b) describes just how Ireland as a whole, and the government especially, became over reliant on the construction sector. Various tax concessions were said to have been given as the Government was taking in more than enough revenue from construction and corporate taxes. “Much of the reason for the revenue collapse lies in the systematic shift over the past two decades away from stable and reliable sources such as personal income tax, VAT and excises and towards cyclically sensitive taxes” (Honohan, 2009b, p. 3). Honohan cites these ‘cyclically sensitive taxes’ to be the likes of corporation tax and capital gains tax. Ireland has been a beneficiary of multinationals using the country as their European base so as to avail of our low 12.5% corporation tax amongst other things. Honohan believes the government allowed itself to fall into a lapse of over-reliance on these sources of revenue and therefore left the budget exposed to any potential downturn in the construction industry. However, the author does take a sympathetic stance in regards to fiscal decisions made. “The sustained output, profit and asset price boom which extended for two decades from 1988 – with only two brief hesitations in 1993 and 2001/2 – lulled policymakers into a false sense of security as to the sustainability of the revenues from cyclically sensitive taxes” (Honohan, 2009b, p. 3). It was this growth, states Honohan, which led the government to narrowing the tax base in order to take advantage of these cyclically sensitive taxes.

2.2.7 - Regulatory and Supervisory Environment

Governor of the Central Bank Patrick Honohan prepared another report on the Irish crisis that had mainly to do with regulation title ‘The Irish Banking Crisis Regulatory and Financial Stability Policy 2003-2008: A Report to the Minister for Finance by the Governor of the Central Bank’. The main focus of the report is stated to be the Central Bank of Ireland and the Financial Regulator and their regulatory

functions. Rather than focusing too much on the specific lending practices of Irish banks, this report spends more time examining government fiscal policy and the supervisory framework under which banks operated. In defence of this approach the author states “the weaknesses of Irish banks that were exposed by the near-collapse of global debt markets in late 2008 need to be viewed against the background of the overall domestic macroeconomic imbalances that had built up during most of the decade” (Honohan, 2010, p.6).

Early in the report the author talks about the establishment of the Central Bank and Financial Services Authority Ireland and the responsibilities of this body. Straight away the author highlights a fundamental flaw in the structure of the CBFSAI. “The division of responsibilities between the Governor, the CBFSAI and IFSRA (Irish Financial Services Regulatory Authority) was novel and contained the hazard of ambiguous lines of responsibility especially in the event of a systemic crisis” (Honohan, 2010, p.36). The three entities mentioned are the three separate decision making bodies that make up the CBFSAI. The section goes on to explain the complex nature of responsibility division between these three bodies and instances of seemingly overlapping responsibilities. However, the section does conclude by absolving this body to some degree by stating “though few would now defend the institutional structure invented for the organisation in 2003, it would be hard to show that its complexity materially contributed to the major failures that occurred” (Honohan, 2010, p.42).

In a later section Honohan specifically states the objective of the Financial Regulator as being “to help consumers make informed financial decisions in a safe and fair market and to foster sound dynamic institutions in Ireland, thereby contributing to financial stability” (Honohan, 2010, p.45). In the carrying out of its regulatory function the Financial Regulator is stated to have adopted a principles-based regulatory approach that is governed by nine principles that financial service providers were expected to abide by. Honohan goes on to hint that simply having principles in place is not enough and that “a key element in principles-based regulation consists of putting in place a governance architecture to ensure that banks and building societies meet specific obligations required of them” (Honohan, 2010,

p.48). The Financial Regulator was said to have attempted to implement architecture such as this through the introduction of three separate elements.

The first of these were Directors' Compliance Statements. The importance of these were said to be in the creation of "a culture of compliance by developing a greater sense of accountability and responsibility among company directors and by developing good systems of internal controls within companies so that directors could commit themselves to compliance in good faith" (Honohan, 2010, p.50). However, the implementation of this element never came to fruition and the reasons cited included an expected loss of competitiveness and an inconsistency with the principles-based approach. The introduction of 'fit and proper requirements' was another element proposed by the Financial Regulator. These requirements were said to have already existed but only on an individual institutional level and it was the aim of the Financial Regulator to standardise and modernise them. This effort was successful in part as the requirements were implemented but not on a statutory basis for all firms. The third element proposed by the Financial Regulator was the implementation of a corporate governance code as set out in its 2005 paper 'Corporate Governance Guidelines for Credit Institutions and Insurance Undertakings'. A group of 12 credit institutions were issued this paper and asked for their views on it and IFSC-based foreign institutions received it positively while that wasn't the case for domestic institutions. This fact led to the implementation of the paper being delayed several times until it was scrapped altogether and a paper on corporate governance dealing with reinsurance was issued instead. When summing up that two of the three proposed elements of the governance architecture were not implemented, Honohan states "one of the reasons why one of the three initiatives was abandoned related to competitiveness concerns. While such concerns were part of the mandate of the Authority, they were given too much weight in the decision not to proceed with the introduction of these key features" (Honohan, 2010, p.55).

A later section of the report deals with macro-prudential regulation and the financial stability report process. These reports were created "to analyse and assess the overall health of the financial system" (Honohan, 2010, p.76). These reports were to be comprised by a combination of Central Bank and Financial Regulator staff but a lack of proper staff resources led to the reports being compiled by mainly Central

Bank staff. The lack of Financial Regulator staff expertise coupled with the availability of relatively raw data “appear to have inhibited the extensive usage of the data in report preparation” (Honohan, 2010, p.79). Another fault in these reports was said to be that they didn’t give enough consideration to conveying the breakdown of key red-flag indicators, such as balance sheet growth and outstanding credit, between different institutions but rather they just gave averages. In highlighting why this is a problem Honohan (2010, p. 80) states “as a rule, financial stability issues arise from the tail of the distribution, not from the averages”.

“Market participants and regulators need to conduct risk management by mitigating, hedging and holding buffers so that even relatively unlikely events can be absorbed. The purpose of the financial stress tests was to explore explicitly such adverse scenarios” (Honohan, 2010, p.86). Described next are both the ‘bottom up’ and ‘top down’ stress tests. The former is said to be where the banks are asked to implement theoretical pessimistic scenarios and calculate the effect it would have on their standard financial indicators. The latter tests don’t involve the banks but rather rely on staff to calculate the effect on banks’ positions of negative economic changes. Inherent weaknesses in these reports were highlighted, particularly the fact that “the ‘bottom up’ tests relied on the banks’ own judgements as regards the impact of shocks on their loan portfolios, including the extent of realisable collateral in a sharp downturn” (Honohan, 2010, p.87). The lack of severity in regards to the economic conditions applied in the stress tests is also highlighted and the report specifically refers to a need for a sharper fall in property prices to have been applied. As with the financial stability reports the use of averages rather than a break down between institutions is stated as a weakness of these tests as well.

In summing up the credibility of the financial stability reports as a whole, Honohan deems their approach to be appropriate and remarks that the approach adopted was similar to that of other central banks and presented the standard health indicators. However, the problem was that “the key message was that these risks – to the extent it was believed that they might materialise – were manageable and not a major cause for concern” (Honohan, 2010, p.93). The conclusions section then expresses concern that the financial stability reports didn’t pay enough attention to the

effect that having fast balance sheet growth as a priority can have on lending standards, that an analysis of commercial property prices was only introduced as late as 2007 and that these reports had no quantitative evidence for predicting a 'soft landing' for the housing market.

The last section of Honohan's report that actually deals with the run-up to the crisis is concerned with the powers the CBFSAI had in regards to controlling the activities of credit institutions. Of four measures available only two were said to have been used and these were increased capital requirements and moral suasion. This means the body disregarded the other two powers at its disposal, which are direct controls on lending and sectoral limits.

"Moral suasion consists of the central bank/regulatory authority exercising their powers of persuasion – either publicly or privately – to convince financial institutions to modify their behaviour in some desired fashion" (Honohan, 2010, p.98). This was said to have been a preferred methods because it had no direct interference with lending. It was commonly seen used in the financial stability reports mentioned above but it never went as far as to actually call for a change in credit institutions lending practices. This tactic was also seen used in letters from the CBFSAI to the Minister for Finance expressing view on house price inflation and over-reliance on the construction sector.

"The FR was not passive in responding to the renewed system-wide expansion of property-related credit. From at least mid-2005 the idea of a capital surcharge on the riskier property-related loans came to the fore" (Honohan, 2010, p.100). Honohan here comments positively on the efforts made in regards to slowing property-related lending and cites internal documentation related to unprecedented demand for housing credit, IMF opinions saying house prices in Ireland were too high and increased competition between lenders as evidence of this effort. This is where it is said the use of the second measure of increased capital requirements was evident, specifically in a 2005 internal memo proposing an increase in capital requirements for new high loan-to-value mortgages. The Financial Regulator also issued a paper in 2006 proposing an increase in weighting given to speculative commercial lending and after industry debate this measure was introduced. However, it is Honohan's belief that this was too

late as he states “by the end of 2006 the residential property market had peaked, and few big speculative property deals were concluded after mid-2007, well before the effective date of the capital surcharge affecting them. Furthermore, the measures were in reality also rather modest in their likely impact. It was too little too late” (Honohan, 2010, p.102).

2.2.8 - Lehman Brothers

In an article titled ‘Case Study: The Collapse of Lehman Brothers’, a brief description is given detailing the collapse of one of America’s largest investment banks. Lehman’s stock is stated to have sustained its first sharp fall as a result of the failure of two Bear Stearns’ hedge funds in August 2007. However, rather than deter the company from activity, Lehman Bros went on to participate heavily in the mortgage market and “in 2007, Lehman underwrote more mortgage-backed securities than any other firm, accumulating an \$85-billion portfolio, or four times its shareholders’ equity” (Investopedia, 2009). The company’s vulnerability is said to be down to this risky portfolio coupled with its high degree of leverage and Lehman’s share price eventually fell by 48% following the near-collapse of Bear Stearns on 17th March 2008. Lehman took some confidence-restoring initiatives in the wake of this such as raising \$4bn through the issue of preferred stock and another \$6bn from investors but this was said to be too late to repair the damage that had been wrought. “The stock plunged 77% in the first week of September 2008, amid plummeting equity markets worldwide, as investors questioned CEO Richard Fuld’s plan to keep the firm independent” (Investopedia, 2009). Lehman Brothers eventually declared bankruptcy on September 15 after failure to secure a takeover deal with Barclays PLC and Bank of America. This collapse was said to ‘roil’ global financial markets for weeks and many questioned the American government’s decision to let the collapse happen.

Klaus Regling and Max Watson heavily implicate the various rating agencies in the transmission of the global financial crisis. Their report highlights the readiness of the agencies to rate complex securities based on re-packaged assets Triple-A. Also scrutinised here were the issues that the features of the securities were hard to assess and in certain cases the rating agencies would be party to the design of these products

that they would then go on to rate. “Such ratings became crucially important in the transmission of the global crisis through their part in a chain of events” (Regling and Watson, 2010, p. 16). With healthy ratings being applied to these securities the report mentions the exuberance with which banks in the EU would buy them and hold them off balance sheet in special purpose vehicles. As uncertainty arose about the value of the underlying debts it became apparent that banks’ balance sheets were impaired, but the extent to which was unclear. “Only after the failure of Lehman Bros, however, did these balance sheet concerns trigger a drying-up and balkanisation of liquidity in different markets compartments – an event that no risk assessments or stress tests had imagined in an ever more integrated financial world. It was at this stage that the full force of the crisis was felt by countries (including Ireland) where banks were heavily exposed to wholesale money markets but did not hold many toxic assets” (Regling and Watson, 2010, p. 16). The authors clearly believe it was the collapse of Lehman Bros that was the catalyst for bringing about the start of the crisis. Also implied here is that the much criticised stress tests had no way of knowing such a shock to liquidity was on the horizon, and therefore couldn’t take such an event into account. However, whilst the authors have laid the liquidity crisis at the door of the Lehman Bros collapse, they indicate a belief that banks would have encountered severe difficulties in the near future anyway. When discussing the deficiencies in Ireland’s financial regulation and supervision Regling and Watson (2010, p. 18) state “experience shows that these generic concerns and changes of approach among regulators and supervisors allowed a serious build-up of vulnerabilities in some cases, which would have spelled problems for bank balance sheets even without the extreme shock to liquidity that followed the Lehman Bros episode.”

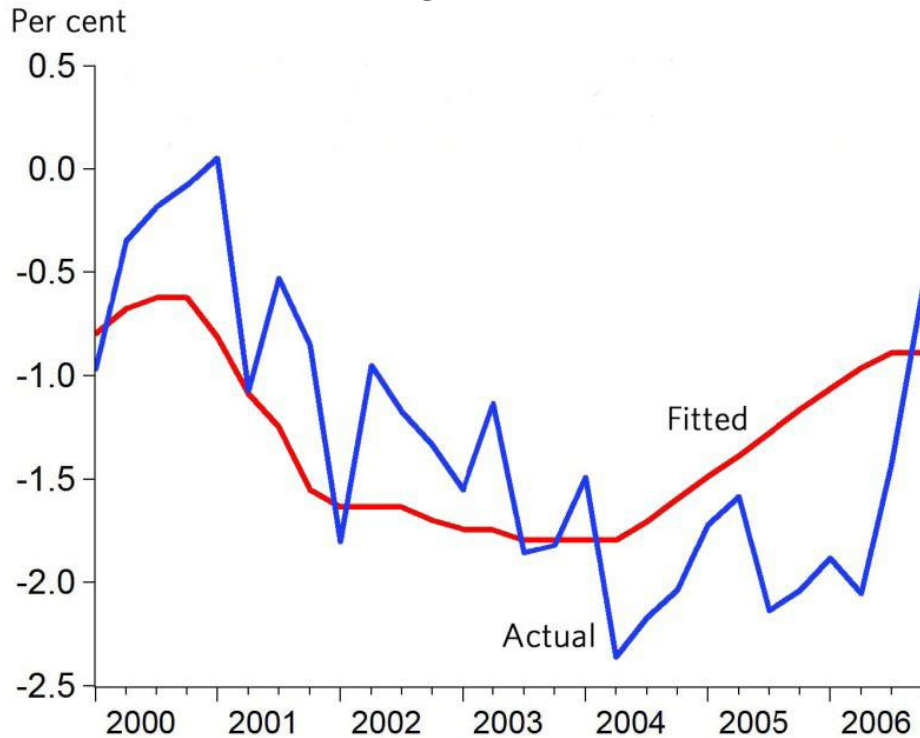
Conor et al (2010) implicate both global and domestic factors when discussing the emergence of the Irish financial crisis. The United States financial crisis was described as being caused by an ignorance of the liquidity and credit risk of new financial products. It was the accumulation of mortgage defaults in America by mid-2007 that is said to be the first sign that something was wrong. In regards to the spread of the American crisis to other countries, the report highlights the subsequent collapse of Lehman Bros as the trigger that caused the drying up of global liquidity and that “the drying up of liquidity exposed the fragility of the Irish financial sector” (Conor et al, 2010, p. 4). This was said to make it difficult for Irish banks to secure

more foreign borrowings to fund business activity. However the report also goes on to state that this was only one factor in a myriad of problems for the Irish banks that were “compounded by the rapidly deteriorating credit quality of their loan books, due to adverse conditions in the domestic property market” (Conor et al, 2010, p. 4). Here the report implies it was the Irish banking sector, and more specifically its over-exposure to a property bubble, which led to the financial sector’s vulnerability in the first place.

2.2.9 - American Influence on Europe

In his report titled ‘The Financial Crisis and the Policy Responses: An Empirical Analysis of What Went Wrong’ John B. Taylor discusses how the low interest rates set by the European Central Bank in the years preceding the crisis may have been influenced by Federal Reserve monetary policy. The reason behind this study was to find out “whether these low interest rates at other central banks were influenced by the decisions in the United States or whether they represented an interaction among central banks that caused global short interest rates to be lower than they otherwise would have been” (Taylor, 2008, p. 6). The study began with Taylor examining the deviations of ECB interest rates from the rates that would have been applied had the ECB followed a monetary policy known as the ‘Taylor Rule’. This is a rule that dictates how interest rates should be set in response to inflation and GDP amongst other variables. Once the deviations were calculated Taylor ran a regression to determine whether the residuals were influenced by the interest rate decisions of the Federal Reserve in America during the years 2000-06. Taylor (2008, p.6) stated “the estimated coefficient was .21 and that it was statistically significant”.

Figure 2.7



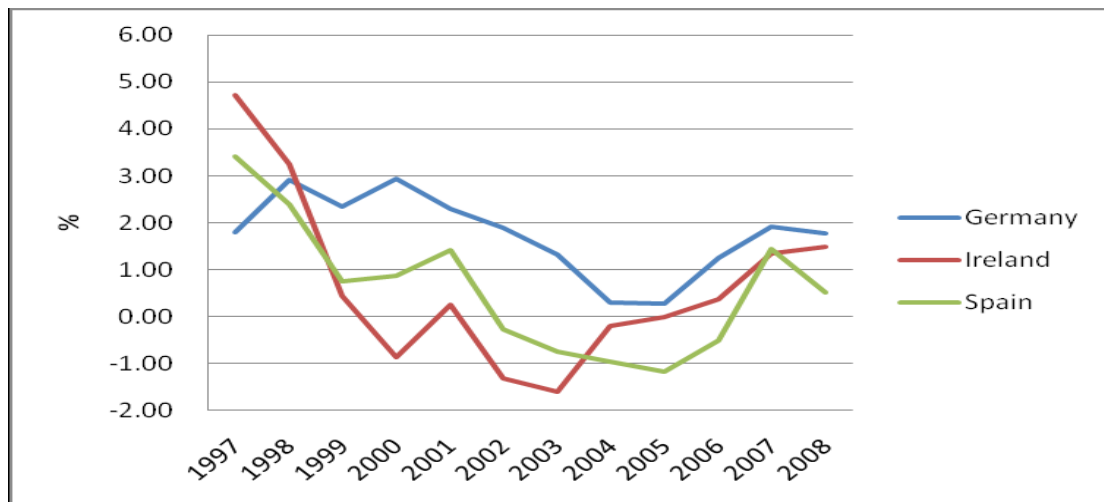
(Source: Taylor, 2008, p.6)

The above chart depicts the link between ECB interest rate decisions and the corresponding decisions of the Federal Reserve. The jagged line is stated to be the deviations of the ECB interest rate from those prescribed by the Taylor rule mentioned above. Noted here by Taylor is that the ECB interest rate was sometimes up to 2 percentage points lower than it should have been during this period had it followed the Taylor rule. The smoother line labelled 'fitted' is said to show that "a good fraction of the deviation can be explained by the federal funds rate in the United States" (Taylor, 2008, p. 6).

2.2.10 - EMU Membership

A factor highlighted in the Regling and Watson report is the cheap money that was available in the years preceding the crisis. "Certain aspects of EMU membership certainly reinforced vulnerabilities in the economy. Short-term interest rates fell by two thirds from the early- and mid-90s to the period 2002-07. Long-term interest rates halved. Real interest rates were negative from 1999 to 2005 after having been strongly positive earlier" (Regling and Watson, 2010, p. 24).

Figure 2.8



(Source: Regling and Watson, 2010, p. 24)

The above chart depicts the 3-month interbank interest rates deflated by the harmonised index of consumer prices. The authors directly credit these low interest rates with having contributed to the credit boom and property bubble and that these interest rates were as a result of EMU membership.

“It was not just the availability of finance that has changed but its cost has also been reduced by the move to monetary union and also by financial liberalisation in the 1990s and the early years of this decade” (Conefrey, T. & Fitzgerald, J., 2009, p. 14). In their report titled ‘Managing Housing Bubbles in Regional Economies under EMU: Ireland and Spain’ Thomas Conefrey and John Fitzgerald discuss how the advent of the Economic and Monetary Union made credit cheaper and also increased its availability to EMU members, specifically Ireland and Spain. A wider pool of money was said to have been made available as banks within the EMU could lend to foreign markets without the worry of exchange rate risk.

When referring specifically to the ‘Irish case’ the report mentions that until the end of the 1970s mortgages were provided by financial institutions known as ‘building societies’ and that these institutions were financed mainly by household deposits. This was an era of banking that had a lack of an interbank market. Interest rates were said to depend on the availability of domestic savings and the rationing of credit was determined by a bank’s personal deposits and the demand for mortgages.

“Over the last decade the housing booms in both Ireland and Spain relied on the availability of a ready supply of bank credit in the form of mortgages” (Conefrey & Fitzgerald, 2009, p. 17). The liberalisation of the banking system due to EMU entry was said to have given the Irish housing boom the ready supply of credit it needed to grow as banks were not reliant on just a domestic deposit base. The authors indicate that had banks behaved as they had in the 1970s then the practice of rationing mortgages may have continued. “Instead, with the advent of EMU (and prior to the financial crisis), the domestic banking systems in both Ireland and Spain were able to raise substantial additional resources without any exchange risk and this provided the financing for a very large continuing investment in new building in both economies” (Conefrey & Fitzgerald, 2009, p. 18).

As well as enabling easier access to a larger pool of funds, the reports highlights that the EMU also made the cost of funds cheaper. “For much of the private sector borrowing in the local currency in Ireland, Spain and elsewhere a significant exchange risk premium was payable prior to EMU as a cost of having an independent currency” (Conefrey & Fitzgerald, 2009, p. 17). This increase in the cost of funds for banks is something that would traditionally have been passed on to the consumer and the report hints that such a rise in interest rates would have seriously hampered the housing boom and may even have cut it off at an early stage. While the introduction of the EMU was said to decrease the cost of capital for all members, the report indicates Ireland as being a marked case due to the high inflation in consumer prices during the first ten years of EMU. This made real interest rates lower than those in countries such as Germany and France and was said to further encourage investment in housing.

Honohan (2009b) echoes the beliefs of Conefrey and Fitzgerald and states “seeds of the crisis were sown around the time the single currency began at the beginning of 1999” (Honohan, 2009b, p. 6). Low interest rates and the elimination of exchange rate risk are again the elements of EMU that are said to have contributed to the property boom. However, a new issue discussed in this report is the growth in size of the EU and how the resultant strong inward migration into Ireland added more fuel enabling the boom to continue for longer. The large wholesale foreign borrowing done by Irish banks to fund the property boom was described as an ‘effortless undertaking’ because of the aforementioned removal of currency risk. “Only when credit risk became an issue after September 2008 did the financial markets belatedly

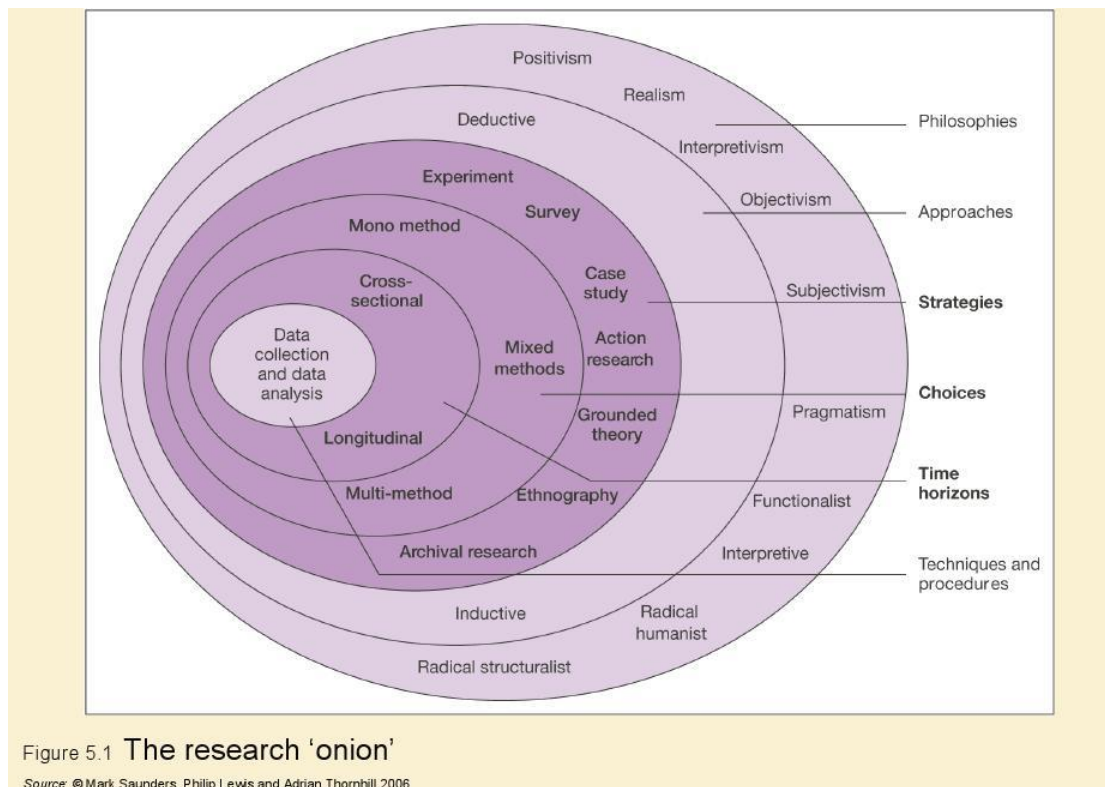
sound a warning sign” (Honohan, 2009b, p. 7). However, Honohan does offer a form of defence for EMU in expressing a belief that all of the mentioned problems could theoretically have happened outside of EMU. In evidence of this, Honohan points to the fact that a number of non-EMU countries experienced similar problems to that of Ireland. “But the policy antennae had not been re-tuned in Ireland, and corrective action that could and should have been taken (fiscal policy, bank regulation, centralized wage negotiations) were neglected as a result” (Honohan, 2009, p. 7).

Chapter 3 – Research Methodology

3.1 – Introduction

The following section will explain to the reader the process underwent and the methodologies adopted by the researcher in the completion of this dissertation. The researcher will use the research onion as depicted by Saunders, Lewis, and Thornhill (2009) as the basis of this section.

Figure 3.1



(Saunders, Lewis, and Thornhill, 2009, p. 108)

Saunders, Lewis, and Thornhill (2009) use an onion as a metaphor to describe the different philosophies adopted by a researcher when undergoing research. We start at the outside layer, or the more general philosophies, and work inwards to the more specific areas of approaches, strategies, choices, time horizons and finally techniques and procedures.

This section will be broken into two main sub-categories titled 'Quantitative Research Methodology' and 'Qualitative Research Methodology'. Each sub-category

will be organised into different chapters giving a detailed description of how the researcher approached each element of the research.

Research can be defined as “the systematic collection and interpretation of information with a clear purpose, to find things out” (Saunders, Lewis, and Thornhill, 2009, p. 600). For the completion of this dissertation the researcher will undertake both quantitative and qualitative research and through these two approaches will hope to provide a suitable basis for testing the research hypothesis. For each of the two types of research the researcher will describe the research philosophy, “defined as an over-arching term relating to the development of knowledge and the nature of that knowledge” (Saunders, Lewis, and Thornhill, 2009, p. 107)

Methodology can be defined as “the theory of how research should be undertaken, including the theoretical and philosophical assumptions upon which research is based and the implications of these for the method or methods adopted (Saunders, Lewis, and Thornhill, 2009, p. 595). The researcher will give a "detailed description of the different methodologies adopted when undertaking both the quantitative and qualitative elements of the research. These methodologies will be selected from those contained within the first two layers of the research onion pictured above.

3.2 – Quantitative Research Methodology

3.2.1 – Quantitative Research Philosophy

The research philosophy that best fits in with the quantitative element of this research is the epistemological philosophy of positivism.

“Epistemology is the study or a theory of the nature and grounds of knowledge especially with reference to its limits and validity. Epistemological assumptions underpin any approach to research” (Remenyi et al. 1998, p. 282). Saunders, Lewis, and Thornhill (2009, p.112) define epistemology as “concerning what constitutes acceptable knowledge in a field of study”. The ‘resources’ researcher would claim to be external to the process of data collection in the sense that there is little that can be

done to alter the substance of the data collected (Saunders, Lewis, and Thornhill, 2009, p. 114). In terms of relationship between knowledge and the way it is developed the researcher would best be described as a 'resources' researcher. The researcher would place much more emphasis on the collection and analysis of facts and phenomena that can be seen and quantified and generally data that is objective in nature. Conversely, subjective data that may be dictated to a degree by feelings and attitudes are given less importance.

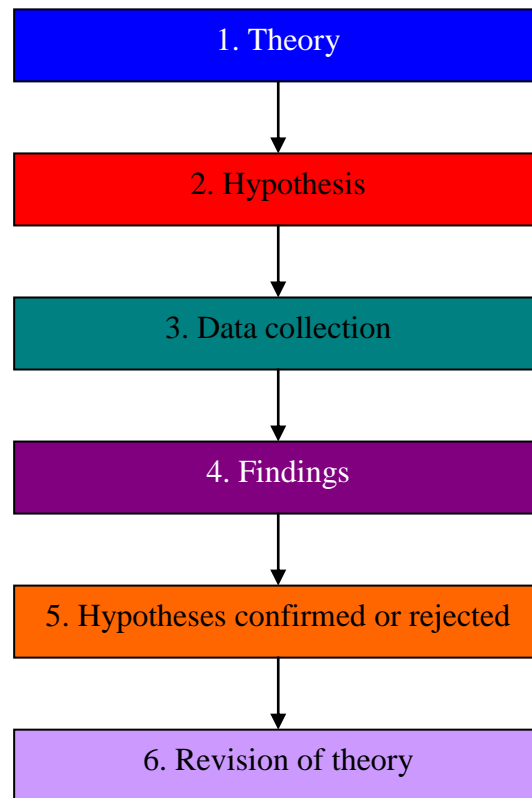
“Positivism is the assumption that the researcher is independent of and neither affects nor is affected by the subject of the research” (Remenyi et al. 1998, p. 33). This philosophy holds true for the researcher, as the quantitative element of the research will be the analysis of company financial statements. This approach affirms the researchers status as a 'resources' researcher in that the data cannot be altered in any way but only analysed objectively. This will fall under the definition of secondary quantitative research, as these financial statements have already been prepared. The narratives of these statements will be mostly disregarded and only the statistical elements of the reports will be used. “In this sort of approach the emphasis will be on quantifiable observations that lend themselves to statistical analysis” (Saunders, Lewis, and Thornhill, 2009, p. 112).

3.2.2 – Quantitative Research Approach

The second layer of the research onion depicts the different sort of approaches a researcher can take. A deductive approach will be taken in regards to the quantitative element of this research. “This approach involves the development of a theory that is subjected to a rigorous test” (Saunders, Lewis, and Thornhill, 2009, p. 124). The theory, as stated above, is that reckless investment by Irish financial institutions will be found to have been the main cause for the severity of the current economic recession as opposed to global influences. Saunders, Lewis, and Thornhill (2009, p.124) state that “deduction can be used to explain causal relationships between variables”. The researcher will use the deductive strategy to measure the relationship between Bank's business practices in Ireland pre-2008 and the subsequent banking and economic crisis.

To test this theory the researcher will follow the deductive process depicted by Bryman and Bell (2011):

Figure 3.2



(Bryman and Bell, 2011, p.11)

Applying the above structure to my research will involve working from the more general to the more specific. In the case of this particular process, the researcher will begin at stage 2 of the above chart as a hypothesis has already been fully developed. Data collection will then commence through the use of company financial statements and through analysis of this data the researcher will present the findings. I have developed my theory and through observation of various data I will prove or disprove said theory.

3.2.3 – Quantitative Research Strategy

Saunders, Lewis, and Thornhill (2009, p.587) define archival research as a “research strategy that analyses administrative records and documents as principal source of data because they are the product of day-to-day activity”. As I’m concerning myself with recorded data that has already been collected and categorized my research strategy will fall under this category. Using the financial statements of individual Irish and Canadian Banks I will conduct a ratio analysis of key activity. The ratios that will be calculated are net interest margin, cost-income ratio, return on assets and return on equity. All four of these ratios are profitability ratios. A trend analysis will also be carried out using the data from these same financial statements. This is a technique used to spot patterns in a series of data. In the case of this research it will be used to analyse any harmful trends existent on the financial statements of Irish banks over the years 2004-2007. More specifically, it will be used to spot any trends that might indicate overheating within the banks. 2004 will be used as the base year and the percentage increase in each figure will be calculated for the years 2005-2007 in relation to the base year. For both of these analyses, three Canadian banks will then be examined in the exact same manner for use as a proxy by which to compare the results obtained on the Irish banks. The basis for using Canadian banks as a proxy is Canada was along very similar lines of economic development as Ireland pre-2008 and has since emerged from the International Financial Crisis in much healthier economic condition.

The financial institutions included in the research will be three of the Irish banks that were included in the government deposit guarantee scheme; Bank of Ireland, Allied Irish Bank and Anglo Irish Bank. The Canadian Banks chosen for the ratio analysis are the Royal bank of Canada, Nova Scotia Bank (Scotia Bank) and Toronto-Dominion Bank (TD). These are the three largest banks in Canada just as the BOI, AIB and Anglo were the three largest banks in Ireland pre-2008. The researcher believes using the activities of financial institutions from another country as a scale will give a new insight into just what was going on within Irish banks pre-2008.

3.2.4 – Research Choice

The research choice used for this research was that of mixed-method. This is a general term for approach when both quantitative and qualitative data collection techniques and analysis procedures are both used in a research design (Saunders, Lewis, and Thornhill, 2009, p. 595). My mixed method research can be described as parallel as I will be using both quantitative and qualitative data collection techniques simultaneously. According to Bryman and Bell (2011, p. 630) this indicates the researcher adopting a technical version towards the research as only in this version is quantitative and qualitative research deemed compatible. This section describing research choice will also hold true for qualitative research methodology, which will be described below.

3.2.5 – Quantitative Research Time Horizon

A longitudinal study is the study of a particular phenomenon over an extended period of time (Saunders, Lewis, and Thornhill, 2009, p. 594). This can be classified as a longitudinal study as I will be collecting data at the outset and I will be making repeated observations of the same items over time. These observations will be made using the above-mentioned financial institutions' financial reports pertaining to the years 2004-2006. For instance, I will be comparing a company's revenue and net profit figures for each of three different years. The term longitudinal is used to describe a study that extends over a substantial period of time and involves studying changes over time (Remenyi et al. 1998, p. 47). The purpose of using a 3-year time horizon over which to conduct ratio analysis using the company's financial statements is to highlight any trends of business activity that may have helped cause the crisis. The researcher feels this will give ample data upon which the research hypothesis can be tested thoroughly.

3.2.6 – Quantitative Research Techniques and Procedures

All annual reports used for the ratio and trend analysis have been downloaded in PDF format from the websites of the respective banks. The researcher will concern himself mainly with the financial statements contained within these reports i.e. the

balance sheet and income statement. The researcher will first complete all ratio calculations for the six banks included in the study and then proceed to compile a trend analysis to further aid in the testing of the stated theory. As stated above this analysis will take place over the course of three years from 2004 to 2006 inclusive.

3.3 – Qualitative Research Methodology

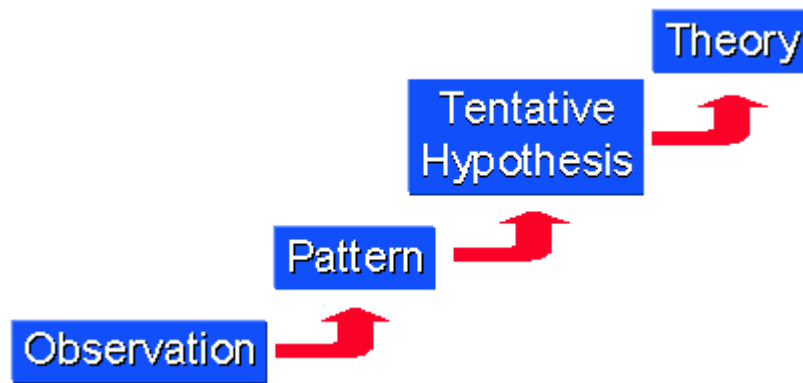
3.3.1 – Qualitative Research Philosophy

The research philosophy that best fits in with the qualitative element of this research is the epistemological philosophy of interpretivism. This emphasises the difference between conducting research among people rather than objects (Saunders, Lewis, and Thornhill, 2009, p. 116). This philosophy holds true for the researcher in this case as the qualitative research will entail conducting interviews as well as drafting questionnaires and sending them to two separate groups of candidates; Journalists / Economists and Bankers. In this case the researcher will adopt the roll of the ‘feelings’ researcher. This is in complete contrast to the quantitative element of the research, as importance here will be given to subjective comments dictated by the feelings and attitudes of questionnaire recipients. For this to be effective the researcher will have to adopt an empathetic stance and enter the social world of the research subjects and understand their world from their point of view (Saunders, Lewis, and Thornhill, 2009, p. 116). The researcher has full faith in his capability to do this effectively and elicit the appropriate responses from the candidates that would help to answer the research question.

3.3.2 – Qualitative Research Approach

An inductive approach to research involves the development of a theory as a result of the observation of empirical data (Saunders, Lewis, and Thornhill, 2009, p. 593). I will be working from the ground up making observations with a view to developing a theory so the approach is inductive in nature. In this case the theory will follow the data analysis, which is in complete contrast with the quantitative element on the research in which the data analysis follows the theory. The following is a graphical representation of following the inductive approach to building a theory.

Figure 3.3



(Graph obtained from <http://www.socialresearchmethods.net/kb/Assets/images/induct.gif>)

Observations will be made using the completed questionnaires and the information gathered during interviews. Through analysis of the data collected the researcher will attempt to spot any patterns in the respondent's comments that could then be used in the forming of a hypothesis and, ultimately, a theory.

3.3.3 - Qualitative Research Strategy

For the qualitative element of the research the researcher will adopt a mix of the case study and grounded theory strategies. The case study strategy will be adopted in an attempt to develop a valid grounded theory as to the microeconomic and macroeconomic background in which the 2008 Irish Financial Crisis took place. The case study research strategy involves the empirical investigation of a particular contemporary phenomenon within its real-life context, using multiple sources of evidence (Saunders, Lewis, and Thornhill, 2009, p. 588). The contemporary phenomenon being investigated in this case is the 2008 Irish Financial Crisis and the multiple sources of evidence are the various questionnaire recipients and interviewees. This strategy is apt as it is a useful tool in the answering of 'why' and 'how' certain things happen, which is the essence of this dissertation topic. Through the implementation of the case study the researcher hopes to amass sufficient data to allow for the generation of a grounded theory. This is a research strategy in which theory is developed from data generated by a series of observations or interviews principally involving an inductive approach (Saunders, Lewis, and Thornhill, 2009, p.

592). This strategy accurately describes what the researcher is setting out to do and fits in perfectly with the chart depicted under ‘qualitative research approach’. The emphasis with grounded theories is to develop and build theories rather than taking the approach of having a theory predefined and then using data analysis to prove or disprove the theory. As stated before the researcher will adopt an indifferent view to the qualitative element of this research so as to gain an unbiased view of the background in which the Irish Financial Crisis took place. This mentality is key in the case of this strategy and this point is emphasized by Remenyi et al (1998) who regard grounded theory to be inductive and to involve theory-discovery methodology. The common sentiment from both the above descriptions of grounded theory is the development of a theory from the analysis of data. It is the hopes of the researcher to obtain enough primary qualitative data to allow for the building of an intelligent grounded theory.

3.3.4 - Qualitative Research Time Horizon

A cross-sectional study focuses on a particular phenomenon at a particular time (Saunders, Lewis, and Thornhill, 2009, p. 155). A questionnaire is a type of cross-sectional study as it is used to collect data on how a certain group of people feel about a certain phenomenon. In this case the questionnaires will be directed at two specific groups of recipients; journalists / economists and bankers. The questions contained in the questionnaires will hopefully elicit responses from the recipients that the researcher can then analyse for useful data that will enable the formation of a theory. Whereas the quantitative research will be focused on data spanning a couple of years this will be a snapshot of people’s opinions now to be used in order to draw conclusions on the 2008 Irish Financial Crisis.

3.3.5 - Qualitative Research Techniques and Procedures

For the purpose of this study the researcher has created two separate questionnaires designated for two different groups of recipients. The first questionnaire is designated for economic journalists or economists and is compiled of 16 questions. These questions focus on areas such as global events that could have affected the crisis, the Irish financial regulatory structure pre-2008, internal risk

management methods used by Irish banks and the Irish Property Bubble. With this questionnaire the researcher was allowed to ask very pointed and frank questions as there was no fear of insulting any of the recipients. The recipients, without naming anyone in particular, were predominantly professionals from the Economic and Social Research Institute (ESRI) and The Central Bank of Ireland as well as several university lecturers. The second questionnaire is designed for people who worked in Irish banks in the lead up to the crisis. The recipients, again without naming anyone in particular, were people working for AIB, BOI and Anglo as these are the three Irish banks I will be conducting the ratio analysis on. The questionnaire contains 12 questions that will cover topics on areas such as bonus incentives, performance targets, corporate governance framework and institutional lending practices. In the case of this questionnaire the researcher had to soften the questions so as not to unintentionally insult any of the recipients or be perceived as having preconceptions already in place. In saying that, the researcher is still confident of being able to elicit the responses necessary for adequate data collection. The researcher will proposition each questionnaire recipient with an interview at their leisure. The two questionnaires will be used as a template for the interviews and this will give the interviewees a chance to further expand on any of the issues raised in the questionnaires that they feel more can be added to. A copy of each questionnaire will be provided in the appendices section of this dissertation.

Chapter 4 – Data Analysis / Findings

4.1 - Introduction

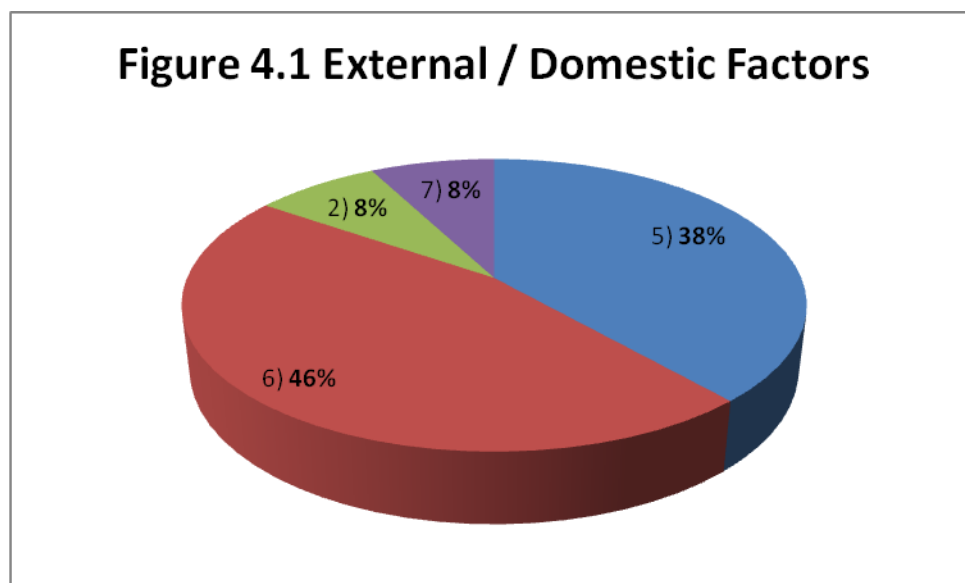
This chapter will present the findings of my primary and secondary research. The first subchapter will be devoted to presenting and discussing the findings of the questionnaires sent out to various recipients as well as the interviews conducted using these questionnaires. The findings of questionnaire / interview 1 will be presented in the first section. This was the questionnaire sent out to economists, economic journalists and university lecturers in the field of economics. Thirteen recipients completed and returned this questionnaire as well as two of the respondents also being interviewed. As stated in the research methodology section, the questionnaire has been broken down into four different categories and these will provide the basis for subsections. These categories are external vs. internal factors, regulation and governance, Economic and Monetary Union and finally risk management. Each question within these sections and answers obtained will then be discussed individually. The next section will discuss the findings of questionnaire / interview 2. This is the questionnaire sent to various employees of Irish banks that would have been working in the banks up to and through the Irish Financial Crisis. As expected, respondents were very hard to come by in this instance mainly due to concerns over confidentiality. However, I did manage to receive one completed questionnaire as well as conduct a single interview. The four subsections here are incentives & targets, competition, decision-making and risk management & corporate governance. Both questionnaires have been included in the appendices.

The next subchapter will be devoted to discussing the findings of the secondary research undertaken. This will consist of the trend analysis compiled using the financial statements of three Irish banks and three Canadian Banks pertaining to the years 2004, 2005, 2006 and 2007. As stated in the research methodology the purpose of this trend analysis is to uncover any patterns evident within the Irish banks' business practices that could indicate overheating. The analysis will include several figures taken off both the income statement and the balance sheets of the six included banks.

4.2.1 Primary Research – Questionnaire 1

Section 1 – External vs. Internal Factors

Question 1 invited respondents to highlight on a scale from 1-7 how much of the Irish Financial crisis they felt was caused by domestic factors as opposed to external factors. Out of the thirteen respondents five chose answer 5, six chose answer 6 and one respondent each chose answers 2 and 7 respectively. The results are displayed in the pie chart below.



The largest percentage of respondents went with answer 6 showing that 46.2% thought that 80% of the Irish Financial Crisis was caused by home grown factors whilst 20% can be attributed to external factors. A combined 92.3% of respondents went with answers 5, 6 and 7 showing an overwhelming sentiment that the crisis was indeed predominantly home grown with only one respondent of the opinion that external factors had more of an effect.

Question 2 asked the recipients to discuss how much of an effect they felt the collapse of Lehman Bros and the subsequent drying up of liquidity had on the crisis. Although this question didn't employ a scale format, 84.6% of respondents displayed the sentiment that the Lehman collapse had middling to little effect. Eight out of

thirteen respondents seemed to think the Lehman collapse acted as a trigger event for underlying problems in the balance sheets of Irish banks. One particular respondent wrote, “It was a trigger, in that it froze the interbank market, but the underlying problems in Ireland were unrelated to Lehman-type activities”. The same sort of opinion was voiced by one interviewee who stated, “It made the fall much sharper but something was going to go wrong eventually, imbalances were already there in Irish banks”. This interviewee went on to say these imbalances were property related. Only one respondent replied with the opinion that the Lehman collapse had a “huge” affect yet still went on to state “Although it is likely there still would have been a hard crash as Morgan Kelly predicted”.

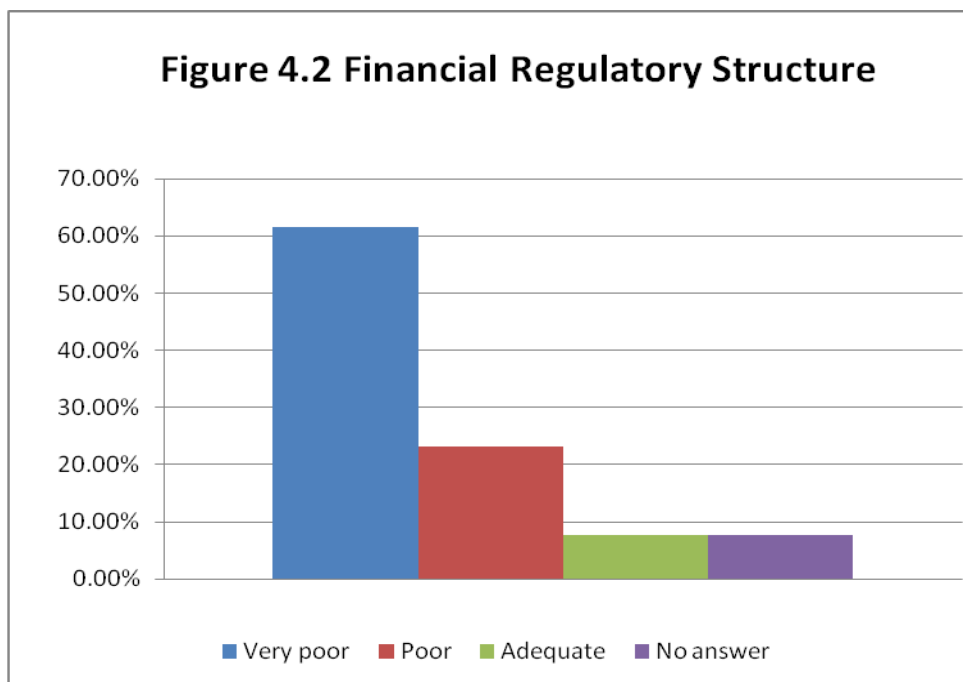
Question 3 asked recipients to state whether they thought Irish banks would still have needed a government bailout had the collapse of Lehman Bros not occurred. 11 out of 13 respondents replied with a ‘yes’ while several went on to explain their choice. Three of these respondents implicated the property bubble specifically and that its collapse would have led to the need for a bailout anyway while another three respondents referred simply to bad lending decisions leading to a need for a bailout. Although no one replied with ‘no’, there were two respondents who were noncommittal stating it was too hard to assess whether or not the bailout would have been needed had it not been for the collapse of Lehman Bros. One respondent in particular replied with “Maybe, still would have been in serious difficulty”.

Question 4 asked the recipients to state what, if any, other factors they believe exacerbated the crisis. A wide variety of events and factors were cited but the only two that were repeated were too low interest rates and bad Irish exports. Three respondents cited the fact that interest rates were too low with one respondent stating, “Interest rates were appropriate for slow-growing economies such as Germany, but not for a country such as Ireland, which was experiencing high growth rates”. Another respondent went as far as to state, “Low interest rates and a feeling of stability engendered by joining the Euro was the main cause of the financial crisis”. Other factors cited included a lack of confidence, a lack of understanding of the problem, a drop in corporate deposits in Irish banks, pro-cyclical policies and too easy access to liquidity.

The responses obtained in this section were discussed at length in the literature review and therefore hardly any were a surprise. Question one was meant to set the theme for the entire questionnaire and was aimed straight at answering the research question itself. Questions 2 & 3 sought to clarify opinion on the effect the Lehman Bros collapse had on the crisis. I thought these questions important to ask as Lehman Bros is cited by many as the start of the International Financial Crisis and is also thought to have had an effect on the Irish crisis. The final question was then meant to uncover any other factors I may have missed that the respondents thought important to mention. On the whole, the responses obtained in this section correlated largely with literatures consulted during the literature review. Lehmann's was considered to have surprisingly little effect and for the most part the recipients are very ready to apportion most blame for the crisis to domestic factors.

Section 2 – Regulation & Governance

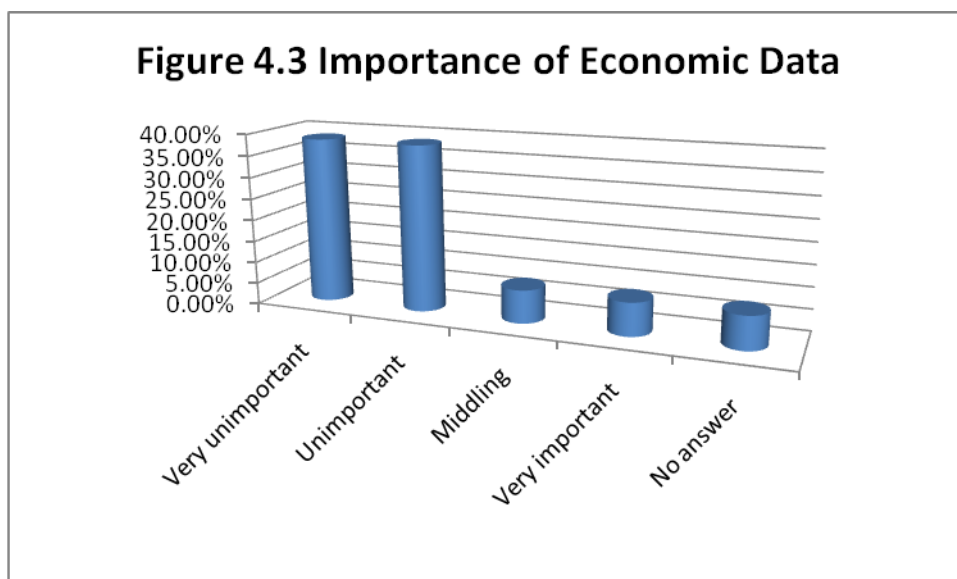
Question 5 once again employed the scale format and asked recipients to rate Ireland's financial regulatory structure pre-2008. Of the thirteen respondents three chose 'poor', eight chose 'very poor', one chose 'adequate' and one chose not to respond to this particular question. The results are displayed in the chart below.



A combined 84.6% of respondents stated they thought the financial regulatory structure to be either poor or very poor. This is in line with literatures reviewed and particularly the report done by Patrick Honohan to the Minister for finance. Although this was a scale format question one respondent chose to elaborate stating, “It was worse than very poor but given the choice, very poor”. The only response other than 1 or 2 obtained was a 3. This respondent also elaborated on their choice stating, “The structure was adequate, it was the implementation and enforcement of financial regulation that was the problem”.

Question 6 asked recipients to describe their opinion of the quality of the economic data provided by The Financial Regulator and The Central Bank of Ireland. Opinion was divided in this instance as four respondents chose not to answer, four expressed the opinion that the data was adequate or better and five respondents rated the data negatively. Of the respondents that deemed the data adequate most went on to say it was the interpretation of the data that was the problem. One interviewee stated, “There was enough information in the data provided to allow for a better assessment of financial stability risks than took place in practice in the years preceding the crisis”. Of the respondents who thought the data lacking some expressed opinions that there was motive behind such perceived failures. One respondent simply stated that the authorities “clearly avoided the problem” while another stated, “Politics didn’t want negative reports”. Other respondents when describing the quality of the data also used the terms “useless” and “poor”.

Question 7 was another scale format question and asked the recipients to describe what level of importance they thought Irish banks gave to the data released by The Financial Regulator and The Central Bank of Ireland. The results are displayed in the chart.



A combined 76.9% of respondents expressed the opinion that banks thought the data either very unimportant or unimportant. One respondent who chose ‘unimportant’ on the scale went on to elaborate on their choice stating, “The Central Bank and Financial Regulator were in constant contact with the banks stating their concerns based on the Financial Stability Reports while the Governor would write to the banks”. One respondent thought the banks gave the data middling concern while two chose not to answer this question.

Question 8 was aimed at the Irish government and its role in the crisis. I asked recipients to state whether or not they felt the government should be apportioned some of the blame that has been levelled at the Irish banks. The answers given were one-sided for the most part with eleven respondents deciding the government should be apportioned some blame, one respondent chose not to answer and one decided the government shouldn’t shoulder any blame at all. This particular respondent stated, “Persons charged with the responsibility for running banks should bear full responsibility for their behaviour”. Of the respondents with the view that the government should bear blame most cited inappropriate fiscal policy as the area in which the government was at fault. One such response read, “Absolutely yes, the government managed and analysed its fiscal situation and tax revenue determinants terribly and ended up with the worst imaginable fiscal situation except for the savings in national pension reserve fund”.

Question 9 asked recipients if they were aware of any blatant disregard of standard lending principles within Irish banks. Seven respondents indicated they were aware to some degree of the lack of lending principles, three chose not to answer and three stated they had no knowledge beforehand of any disregard of lending principles. Of the seven respondents that replied 'yes', three used the same term that they only had 'anecdotal' knowledge of the degree to which lending principles had fallen. One other respondent's answer read, "They were blatantly obvious by 2005. When this was pointed out in an ESRI publication in December 2005 this made headlines in all of the papers and the editorial of the Irish Independent referred to the ESRI as the Grinch that stole Christmas for warning about the dangers". This was an interesting response as I wasn't aware of just how blasé the public sentiment was concerning the country's economic future. What makes this even more surprising is that the lending practices within Irish banks didn't appear to be a secret judging by the responses received here. Other responses were repeated with several referring specifically to the high loan-to-value ratios.

Question 10 referred to the Regling and Watson reports' assessment that deficient implementation rather than defective guidelines were the reason for lax lending procedures and asked respondents if they agree with this assessment. Surprisingly six respondents chose not to answer this question with most claiming they hadn't sufficient knowledge in order to give a proper answer. Of the seven other respondents, two replied 'no' and five replied 'yes'. Most who replied 'yes' referred to 'light touch regulation', a term that was coined in the time following the emergence of the crisis. Of the two who replied 'no', one respondent explained their choice by saying, "No – guidelines in their current form are defective, this in tandem with defective implementation led to lax procedures, but as a starting point the guidelines are not robust enough".

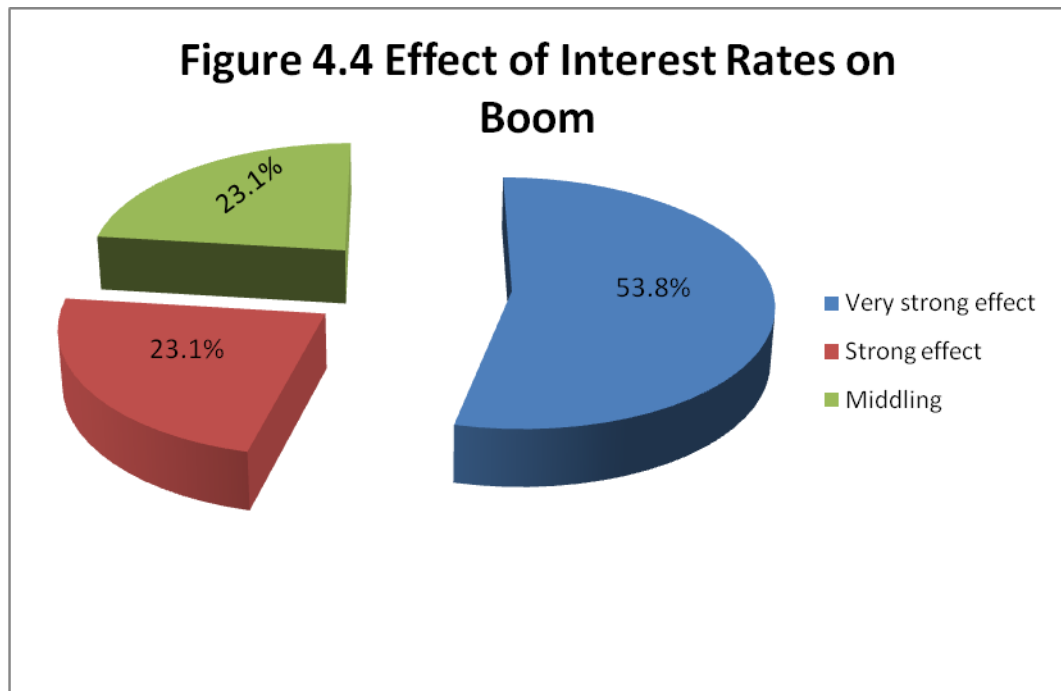
Ireland's financial regulation has come under severe scrutiny in the years since the crisis emerged and it was probably the most common theme uncovered during the research done for the literature review chapter of this dissertation. The role the Irish government played has also been a much debated topic. Therefore I thought it imperative to ask the questions contained in this section of the questionnaire. As with the first section, the answers obtained here correlate for the most part with the

information uncovered during the literature review. Regulation was deemed for the most part to be below par whilst banks' use of this data was also thought to be lacking. One surprise here was the divided opinion on question 10. While researching literature a common sentiment was the deficient implementation of governance guidelines.

Section 3 – Economic and Monetary Union

Question 11 also referred to the Regling and Watson report, but in this case to the report's assessment that funding exposure had a large adverse effect on the crisis. In light of this the question asks whether or not the recipients deem EMU on the whole to be beneficial for Ireland or not. Opinion on this was very split as every respondent answered this question; seven replied 'yes' and the other six replied 'no'. Most who answered yes deemed it to be a lack of understanding of the effects of EMU entry rather than the entry itself. One respondent replied "Yes. Don't blame EMU blame government for decisions which were clearly very unwise. When this was pointed out to them their answer tended to be abuse". Another respondent echoed this sentiment stating, "Inappropriate policy responses meant that such access exacerbated the scale of the crisis. Recall that the UK has a crisis as well and yet was not part of the euro". Of the respondents that answered 'no' a common theme was that EMU caused wages to rise so much and thus the country lost some of its competitiveness.

Question 12 used the scale format to determine how much an effect recipients thought the very low nominal interest rates caused by EMU had on the credit and property boom.



As can be seen from the chart a combined 76.9% of respondents thought the rates to have a strong or very strong effect on the housing boom. One respondent elaborated stating, “As the factors driving demand were heavily influenced by availability of credit as opposed to lower cost of credit by basic factors such as income an employment growth and confident expectations”.

From the responses obtained in this section we can determine that EMU entry definitely had a hand in the crisis yet is still not universally thought to have been detrimental to Ireland on the whole. Although the questions pertained to EMU many respondents chose to highlight the government’s failure in handling its consequences rather than the consequences themselves. In terms of question 12 one respondent wrote “absent proper policy making in Ireland it had a big effect. However, it would have had no serious adverse impact (and probably a beneficial effect) if domestic policy makers had acted sensibly”. I thought these questions important to ask as EMU was another recurrent theme in literatures researched. Again, responses obtained were largely in line with literatures.

Section 4 – Risk Management / Celtic Tiger

Question 13 asked recipients if they found the internal risk management of Irish banks to have contained any weaknesses. Five respondents chose not to answer this question and the other seven all replied ‘yes’. Several elaborated on their answer and one in particular stated, “Yes they were engaging in international short term borrowing and then lending long term for Irish mortgages and property development”. Another respondent replied with “absolutely in that they took a very optimistic view of any downside risk”. Other common themes in answers were the 100% loan-to-value mortgages being given to first time buyers and lacklustre stress tests.

Question 14 asked recipients how effective / informative they thought the system-side stress tests had been. Four respondents didn’t answer this question and one respondent thought the Irish stress tests were good but the EU-wide ones were very poor. The other eight respondents thought the tests were ineffective to varying degrees. One reply read “stress tests clearly did not identify the risks which were later crystallised and were not effective in warning of the dangers to the financial system”. For the most part the major sentiment, and a commonly used term, was that stress tests ‘were not strict enough’.

Question 15 asked if recipients were aware of any economists or other bodies voicing concern of an impending collapse in the economy in the years preceding the crisis. Most stated they were aware of several voices of concern and the name of Professor Morgan Kelly of UCD was the most frequently mentioned. Economist David McWilliams was also mentioned as having voiced concern specifically about Ireland’s property market. The Economic and Social Research Institute was the only agency that was mentioned and in particular their 2005 Medium-term Review.

Question 16 asked recipients to state what they thought were the main differences between Ireland’s growth phase known as ‘The Celtic Tiger’ and the period of growth from 2002-2006. In terms of The Celtic Tiger, which lasted from roughly 1993 to 2000, most respondent’s highlight exports and competitiveness as a driver of growth. One reply read “first phase was based on fundamentals, i.e. competitive, demand for outputs, etc”. Property was the most frequently mentioned

factor when describing the drivers of Ireland's growth phase from 2002-2006. One respondent stated, "Post 2000 there was easy money from property and this distracted many companies from their core business into property". Another reply read "from 2002-2006 the economy expanded as a result of credit growth and wealth effects from house price increases, which were again predicated on credit growth".

Its apparent from these responses that risk management was thought to be lacking on the verge of non-existent. For internal risk management not one respondent had anything at all positive to say. Too high loan-to-value ratios were highlighted and the foreign borrowing done by Irish banks was also condemned. Stress tests were also found to be lacking. The ineffectiveness of stress test was also uncovered. An interesting response here was the respondent who championed the Irish stress tests but condemned the EU-wide tests. However, this was still one opinion against many. The fact that there were ample voices of concern over Ireland's economy in the years preceding the crisis came as a surprise. This shows that the evidence of a problem was there for those who chose to see it. Finally the factors of growth that underlined Ireland's two distinct growth phases were highlighted. The importance given to exports as a driver of growth can be seen in these responses as can the danger of switching to a cyclical source of growth such as a property boom.

4.2.2 Primary Research – Questionnaire 2

Section 1 – Incentives & Targets

Question 1 asked recipients to give a brief description of how incentive packages were laid out in their institution pre-2008. Both the respondent and the interviewee indicated incentives were performance driven with the interviewee further elaborating that "performance was revenue driven". The respondent also mentioned goals were based on key results areas (KRA's) and everything fell under group and divisional performance.

Question 2 follows on from the first one and asks recipients what were the normal performance targets and timelines associated with these targets. Both stated that performance targets were judged annually although the interviewee went on to

say that they could be on a 6-month basis if something ‘exceptional’ happened. The respondent indicated that “the annual goals were financial, new business, credit risk management and other”.

The responses obtained in this section were fairly innocuous. I thought it an important section to include as there has been much talk of incentive packages being too focused on the short-term. However, annual performance targets are the norm as is driving revenue. The respondent also specifically mentions credit risk management as being incorporated within annual goals.

Section 2 – Competition

Question 3 asked recipients if competitors’ strategies and business decisions would be given much regard within their own institutions. The questionnaire respondent replied bluntly with “not really”. The interviewee on the other hand stated that competitors’ strategies did matter and specifically stated, “Yes. We had to react. Anglo were lending to such a degree that we had to keep up or make no money”.

Question 4 was a scale format question that asked recipients to rate the level of importance given to and/or maintaining market share. The respondent answered ‘a lot’ while the interviewee answered ‘main priority’. The interviewee elaborated and explained the reason this is so important is because “banks are publicly quoted and analysts compare banks based on market share growth”.

Again the responses obtained in this section don’t highlight any real breaches of standard business practice. Questions 3&4 were used in tandem to assess how competition affected the banking industry. To maintain and grow market share is a top priority for a company in any sector. A danger here can be seen in the interviewee’s response to question 2 and the implication of Anglo as a bank that needed chasing. The worry here of course is that if one bank gets out of control then there is the risk of contagion. Literatures reviewed have revealed that this was indeed the case.

Section 3 – Decision Making

Question 5 used the scale format and asked recipients to rate how much the current economic outlook factored into the decision making of the institution. Both the respondent and the interviewee rated economic outlook as ‘very important’ when making decisions. The interviewee also informed me that not only did the bank heed the reports of outside economists but also they had their own team of internal economists also compiling forecasts. I was also informed that both of these sets of economists reported a ‘soft landing’ for the banks just before the crisis hit.

Question 6 was another scale-format question and asked recipients to indicate what level of financial resources within their institutions were allocated to the property sector. The questionnaire respondent chose not to answer this question while the interviewee indicated his institution allocated between 40-60% of financial resources to the property sector. Further to this the interviewee added that property was an easy way for employees to meet targets because “it was an easily available deal”.

Question 7 asked recipients what the specific guidelines were within their institutions with regards to loan-to-value ratios. The questionnaire respondent indicated the ratios varied by customer i.e. consumer, business, corporate etc. However the respondent didn’t elaborate on what the guidelines were within these categories. The interviewee indicated that guidelines got somewhat blurred. The exact response read “the practice was to lend to 80% of the value of an asset but the asset was inflated. Standards were in place but it was a rising market and then all assets collapsed in value”.

Question 8 once again used the scale format to determine how much influence the economic data released by The Financial Regulator and The Central bank of Ireland had on banks’ business making decisions. The questionnaire respondent answered ‘influential’ while the interviewee answered ‘very little’. Neither respondent chose to elaborate on their answer.

After all the scrutiny the various business practice decisions made by banks came under in the wake of the crisis, I thought it was important to attempt to get the perspective of those that were working within the banks during that time. Question 5 revealed that economic outlook factored heavily in the decision making of banks. This was perhaps to their detriment as the interviewee's response tells of reports of 'soft landings' for banks and this would not have done much to reign in lending. As only the interviewee answered question 6 only so much weight can be given to the response that their bank allocated 40-60% of financial resources to the property sector. However it also cannot be ignored that this is largely in line with information uncovered while completing the literature review section of this dissertation. Also notable in that response is the revelation that employees would use property to meet targets because it was an easily available deal. What I can take from the interviewee's response to question 7 is that guidelines in regards to loan-to-value ratios definitely got blurred which would most likely have affected business practice negatively. No solid opinion can be elicited from the two contrasting answers given in response to question 8 without elaboration by either of the respondents.

Section 4 – Risk Management & Corporate Governance

Question 9 invited recipients to describe what sort of internal risk management was employed by their institution. The questionnaire respondent's reply read "variety of policies and procedures in place. Lending discretion centralised for the large part. There was ongoing review of credit profile of individual borrowers, economic factors and industry sectors. Sophisticated risk models were also deployed". On the other hand the interviewee indicated they had only an internal credit process but that it wasn't audited.

Question 10 asked recipients if internal stress testing was prevalent in their institutions in the years preceding the crisis. The interviewee chose not to answer this question while the questionnaire respondent replied with a simple 'yes'.

Question 11 used a scale format and asked recipients to rate their institutions corporate governance framework pre-2008. Both respondents rated theirs as 'good'

and the interviewee expanded on their own response by stating, “Credit process still went through Credit Committees”.

Question 12 asked recipients if there was any concern voiced within their institutions about the high level of wholesale borrowing that was being done by Irish banks to finance lending. The questionnaire respondent replied ‘yes’ but didn’t expand on this. In contrast to this the interviewee stated that no one voiced any concern. They indicated that this was down to the fact that no one foresaw the liquidity crisis as there was such ample availability of it at the time.

As with the other sections of this questionnaire the questions were picked based on issues uncovered while researching literatures. Risk management, or the lack thereof, was possibly the most prominent issue and therefore its inclusion as a section in this questionnaire was important. The responses obtained from question 9 leave a certain amount of ambiguity in terms of the entire banking system in that the answers were contrasting. What I can take from this is that individual institutions had differing degrees of severity with regards to their internal risk management. In terms of internal stress testing the response obtained from question 10 indicates that it was existent in one institution at least but its effectiveness remains unclear. The two replies to question 11 can lead one to believe that corporate governance within the banking system as a whole was adequate at least. Responses to question 12 were again contrasting suggesting that employees within different institutions, and therefore the institutions themselves, looked on wholesale foreign borrowing with different sentiment.

4.3.1 Secondary Research – Trend Analysis

In Governor Patrick Honohan’s report for The Economic and Social review titled ‘Resolving Ireland’s Banking Crisis’, he notes that balance sheet growth of 20% in any year is a traditional red flag warning used by financial regulators. It is a sign that a company is overheating and is doing more trading than is healthy. It is also noted in this report that this kind of activity can generate systemic risk, especially when several companies within the same industry behave in this manner. A trend analysis will therefore be used in an attempt to highlight this behaviour within the

Irish banking system. If, upon comparing trends in Irish banks to that of Canadian banks, I can spot serious differences in practices that correlate with movements in the base countries' key economic indicators then this should help to answer the research question. Below are tables depicting the full trend analysis for both sets of banks. An appendix is included that details any differences between Irish and Canadian financial statements inn terms of what the figures are called.

Table 4.1 - Irish Trend Analysis							
AIB	2004	2005	2006	2007	2005	2006	2007
Net Interest Income	2072	2530	2999	3418	122.10%	144.74%	164.96%
Operating Expenses	1869	2011	2314	2521	107.60%	123.81%	134.88%
Profit	1158	1433	2298	2066	123.75%	198.45%	178.41%
Liabilites	85727	111483	148614	166684	132.80%	158.14%	177.78%
Securities in Issue	10330	16684	28531	41866	161.51%	276.20%	405.29%
Total loans and Advances	63187	86404	120015	137068	136.74%	189.94%	216.92%
Customer Accounts	34727	42666	74875	81308	122.86%	215.61%	234.13%
BOI	2004	2005	2006	2007	2005	2006	2007
Net Interest Income	1744	1898	2307	2757	108.83%	132.28%	158.08%
Operating Expenses	1654	1924	2020	2159	116.32%	122.13%	130.53%
Profit	935	1073	1221	1652	114.76%	130.59%	176.68%
Liabilites	101967	121469	156981	182055	119.13%	153.95%	178.54%
Securities in Issue	12917	20539	36914	59523	159.00%	285.78%	460.81%
Total loans and Advances	75293	87700	113434	132258	116.48%	150.66%	175.66%
Customer Accounts	54395	60265	61710	72277	110.79%	113.45%	132.87%
Anglo	2004	2005	2006	2007	2005	2006	2007
Net Interest Income	523.5	720	1069	1566	137.54%	204.20%	299.14%
Operating Expenses	219.1	291.8	328	393	133.18%	149.70%	179.37%
Profit	379.4	491	658	1008	129.41%	173.43%	265.68%
Liabilites	29799.5	42672.2	70598	92587	143.20%	237.07%	310.70%
Securities in Issue	6944.5	9405.1	15060	23588	135.43%	216.86%	339.66%
Total loans and Advances	29571.2	40352.6	61566	78000	136.46%	208.20%	263.77%
Customer Accounts	19546	25159.7	36858	52686	128.72%	188.57%	269.55%

Table ?? - Canadian Trend Analysis							
RBC	2004	2005	2006	2007	2005	2006	2007
Net Interest Income	6398	6770	6796	7532	105.81%	106.22%	117.32%
Operating Expenses	10833	11388	11495	12473	105.12%	106.11%	115.39%
Profit	2772	3349	4668	5404	120.81%	168.40%	194.95%
Liabilites	408318	449.674	514657	575907	110.13%	126.06%	141.04%
Securities in Issue	25005	32391	38252	44689	129.54%	152.98%	178.72%
Total loans and Advances	170916	190416	208530	237936	111.41%	122.00%	139.21%
Customer Accounts	111256	111618	114040	116557	100.33%	102.50%	104.76%
Scotia	2004	2005	2006	2007	2005	2006	2007
Net Interest Income	5701	5871	6408	7098	102.98%	112.40%	124.50%
Operating Expenses	5862	6043	6443	6994	103.09%	109.91%	119.31%
Profit	2892	3184	3549	3994	110.10%	122.72%	138.10%
Liabilites	264227	297943	361459	392706	112.76%	136.80%	148.62%
Securities in Issue	27013	33608	46866	44176	124.41%	173.49%	163.54%
Total loans and Advances	171768	191005	202774	227147	111.20%	118.05%	132.24%
Customer Accounts	79020	83953	93450	100823	106.24%	118.26%	127.59%
TD	2004	2005	2006	2007	2005	2006	2007
Net Interest Income	5773	6008	6371	6924	104.07%	110.36%	119.94%
Operating Expenses	8007	8782	8815	8975	109.68%	110.09%	112.09%
Profit	2232	2229	4581	3977	99.87%	205.24%	178.18%
Liabilites	298359	349344	373282	400720	117.09%	125.11%	134.31%
Securities in Issue	27517	35690	45768	40769	129.70%	166.33%	148.16%
Total loans and Advances	123924	152243	160608	175915	122.85%	129.60%	141.95%
Customer Accounts	111360	131783	146636	147561	118.34%	131.68%	132.51%

The first figure analysed was the ‘net interest income’ figure found in a company’s income statement. This is the difference between interest paid out on liabilities and interest taken in on assets and is typically the main component going towards a bank’s profit at year-end. Immediately noticeable is the much higher growth-rate in regards this figure amongst Irish banks. Chief amongst them is Anglo Irish Bank, who saw NII increase to 299.24% of base year by 2007. This shows Anglo’s NII to have almost tripled compared to the NII of Allied Irish Bank and Bank of Ireland having both increased by roughly 60% during the same period. The largest growth that can be seen in NII amongst Canadian banks is with Scotia who saw NII

grow to 124.5% of base year during this period. Average increase in this figure from base year to 2007 amongst Irish banks was 207.39% compared to 120.59% for Canadian banks. What can be taken from these figures is that growth rates amongst banks, at least in terms of NII, were much higher in Ireland than they were in Canada from 2004-2007. Another important fact evident from these figures is that Anglo was very much the market leader in this area amongst Irish banks.

Secondly I looked at trends in the banks' 'operating expenses'. This figure is also taken off income statement and is the ongoing costs of running a company. An increase or decrease can usually mirror a company's growth or lack thereof. The figures between the two sets of banks in this case are not in as stark a contrast as is the case with NII. Anglo again is the major grower of the Irish banks with operating expenses increasing 79.37% by 2007 while BOI and AIB see growth of 30.53% and 34.88% respectively. Average increase on base year amongst Canadian banks in this case is 115.6% with Scotia's 19.31% growth not even coming near that of BOI. A pattern is already starting to emerge here in terms of Anglo being the market leader amongst Irish banks, as well as the general pattern of Irish banks growing much faster than Canadian banks in multiple areas.

'Profit' was the last figure to be analysed from the income statement. The analysis of this figure is to be used to compound on the results obtained with the previous two figures. The analyses of all three are imperative in order to gauge the banks' growth, as profit on its own doesn't tell the full story. Immediately noticeable once again is Anglo's profit growth has far outdistanced that of the other five banks seeing it grow to 265.68% of base year. In contrast to the previous two analyses BOI and AIB experience profit growth much in line with the three Canadian banks. Indeed, with the exclusion of Anglo, profit growth on base year averages 177.54% between BOI and AIB compared to 170.41% for the Canadian banks.

'Liabilities' is the first figure taken from the balance sheet for analysis. Liabilities are what a company owes and in the case of a bank the most notable are customer deposits. Apparent here is the re-emergence of the earlier trend of Irish banks' far outstripping Canadian banks in growth. Once again Anglo is the market leader, experiencing growth in liabilities to 310.7% of base year but AIB and BOI

also both far outstrip the growth experienced by Canadian banks. Average growth in this area amongst Irish banks was 222.34% of base year whereas the correlating figure amongst Canadian banks was 141.32%. If concerned just with liabilities, these results would indicate balance sheet growth, as a policy, amongst Irish banks is far more aggressive than that of Canadian banks.

‘Debt securities in issue’ was the next balance sheet figure to be analysed. These securities include bonds and medium term notes, commercial paper and other such securities. It’s in this area where we see the starkest contrast between Irish and Canadian banks in terms of growth. We also see a deviation amongst Irish banks from the trend of Anglo being the market leader. The amount of securities in issue by BOI grew to 460.81% of base year from 2004-2007 showing a remarkable increase in a need for outside funds. Average growth on base year in this area amongst Irish banks was 401.92% showing a quadrupling of securities in issue between Ireland’s three largest banks between 2004 and 2007. All three Irish banks experienced greater than 20% growth year-on-year in this area. Conversely the growth experienced in this area amongst Canadian banks averaged 163.47%. This shows a very large difference in the need for outside funding between Irish and Canadian banks as well as highlighting the fact that deposits in Irish banks weren’t enough to fund business activity.

The next balance sheet figure to be analysed was ‘loans and advances to customers’. Analysis of this figure enables a comparison of banks’ main activity, lending. Here Anglo reasserts itself as the market leader as its growth far outstrips that of BOI and AIB. Anglo experienced greater than 20% growth year-on-year leading to an increase on base year of 263.77%. The average growth in loans on base year amongst Irish banks was 218.78% compared with 137.8% for Canadian banks. Based on these figures it can be assumed that Irish banks had a far more aggressive growth strategy than Canadian banks from 2004-2007.

The last figure to be analysed for this trend analysis is ‘customer accounts’. This analysis is used in conjunction with that of ‘loans and advances to customers’ as it is very helpful in directly gauging a bank’s growth. Customer accounts include current accounts, deposit accounts, time deposits, securities sold under agreement to repurchase and other short-term borrowings. This is a bank’s main source of funds for

distributing credit and is measured on the balance sheet in overall value of accounts. As is the case with loans and advances to customers the growth rate in this area amongst Irish banks far exceeds that of Canadian banks. Anglo is once again the market leader seeing customer accounts grow to 269.55% of base year, experiencing greater than 20% growth year-on-year. AIB almost matches Anglo in this area seeing growth of 234.13% on base year. Average growth amongst Irish banks on base year is 212.18% showing customer accounts to have more than doubled over the course of three years in Ireland's three largest banks. Compared to this average growth on base year amongst Canadian banks was 121.62%. The comparably moderate growth experienced in Canada is characterised by RBC who saw just customer accounts grow to 104.76% of base year.

The growth-rate amongst Irish banks was dramatically higher than Canadian banks in virtually every aspect of the trend analysis. Below is a table of key economic indicators for Ireland and Canada from 2004 – 2010 (all information was obtained from www.indexmundi.com).

Table 4.3 - Economic Information							
Ireland	2004	2005	2006	2007	2008	2009	2010
Unemployment rate	4.30%	4.30%	4.30%	4.60%	6.10%	11.80%	13.70%
GDP (PP in \$US)	\$31.9k	\$41.1k	\$44.5k	\$46.6k	\$45.3k	\$37.7k	\$37.7k
Inflation	2.20%	2.40%	3.90%	4.90%	4.10%	-4.50%	-1.60%
Public Debt (%GDP)	31.20%	26.70%	22.80%	24.90%	41.80%	64.80%	94.20%
Canada	2004	2005	2006	2007	2008	2009	2010
Unemployment rate	7%	6.80%	6.40%	6%	6.20%	8.30%	8%
GDP (PP in \$US)	\$31.5k	\$33.9k	\$35.6k	\$38.6k	\$39.1k	\$38.1k	\$39.4k
Inflation	1.90%	2.20%	2%	2.10%	1.20%	0.30%	1.60%
Public Debt (%GDP)	74.10%	69.60%	65.40%	64.20%	63.80%	82.50%	84%

As we can see from the table of economic information, the level of expansion seen in the two separate sets of banks is somewhat mirrored by the growth of key economic indicators of the two base countries from 2004 - 2007. Ireland expanded rapidly as an economy from 2004 – 2007 and then we see the start of the recession in 2008 as public debt as a percentage of GDP spiked upwards and unemployment went up for

the first time in over three years. This trend continues up until 2010. Compared to this Canada appears much more stable. We don't see earnings spike to the levels experienced in Ireland nor does the unemployment rate get as low as 4.3% but there's no massive shock to the economy either. Unemployment over the seven years ranges between 6 - 8% compared to Ireland's range of 4.3 - 13.7%. Gross Domestic Product per person ranges from \$31.5k - \$39.4k compared to Ireland's \$31.9k - \$46.6k. Although the public debt of the two countries isn't dissimilar, Ireland's figure more than doubles from 2008-2010, a much sharper increase than that experienced in Canada. Of course there are many other factors that can affect a country's KEI but the actions of its three main financial institutions and the resultant health of these institutions would undoubtedly have some sort of affect. What this analysis plainly shows is a much more stable growth strategy employed by Canadian banks from 2004 – 2007 and parallel to this a much more stable Canadian economy post 2007 after the International Financial Crisis hit. Compared to this the hyper growth of Irish banks evident from 2004 – 2007 and the dire state of the economy post 2007 as these institutions collapsed and had to be bailed out. One indicator that can be directly attributed to the actions of the Irish banks is Irish public debt post 2008 as the government bailed out Irish banks.

4.3.2 Secondary research – Ratio Analysis

Whereas the trend analysis examined specific components of the banks' financial statements individually, the figures used for calculating financial ratios encompass more. The four profitability ratios that will be calculated for this analysis are net interest margin, cost-income ratio, return on assets and return on equity. These are the main profitability ratios in the case of banks and are used to measure the efficiency with which banks are run. A full list of ratio calculations will be included in the appendices.

Table 4.4 - Ratios					
AIB	2004	2005	2006	2007	Average
Net Interest Margin	1.99%	1.90%	1.89%	1.77%	1.89%
Cost-Income Ratio	57.78%	55.14%	53.49%	51.79%	54.55%
Return on Assets	1.39%	1.28%	1.65%	1.41%	1.43%
Return on Equity	18.76%	19.99%	26.70%	21.02%	21.62%
BOI	2004	2005	2006	2007	Average
Net Interest Margin	1.64%	1.50%	1.42%	1.46%	1.51%
Cost-Income Ratio	55.54%	60.64%	54.94%	51.70%	55.71%
Return on Assets	1.10%	1.04%	0.98%	1.04%	1.04%
Return on Equity	20.95%	21.48%	24.32%	24.57%	22.83%
Anglo	2004	2005	2006	2007	Average
Net Interest Margin	1.52%	1.49%	1.46%	1.62%	1.52%
Cost-Income Ratio	30.30%	29.87%	26.45%	22.32%	27.24%
Return on Assets	1.47%	1.42%	1.16%	1.29%	1.34%
Return on Equity	30.60%	23.25%	24.52%	24.88%	25.81%
RBC	2004	2005	2006	2007	Average
Net Interest Margin	1.49%	1.44%	1.26%	1.25%	1.36%
Cost-Income Ratio	63.52%	60.94%	56.88%	57.56%	59.73%
Return on Assets	0.93%	1%	1.16%	1.17%	1.07%
Return on Equity	15.21%	16.87%	21.10%	22.11%	18.82%
Scotia	2004	2005	2006	2007	Average
Net Interest Margin	2.10%	1.87%	1.69%	1.72%	1.85%
Cost-Income Ratio	59.85%	59.42%	58.62%	57.23%	58.78%
Return on Assets	1.35%	1.31%	1.20%	1.27%	1.28%
Return on Equity	18.98%	19.80%	20.23%	21.24%	20.06%
TD	2004	2005	2006	2007	Average
Net Interest Margin	1.91%	1.65%	1.62%	1.64%	1.71%
Cost-Income Ratio	71.40%	74.16%	68.74%	65.82%	70.03%
Return on Assets	1.03%	0.84%	1.41%	1.10%	1.10%
Return on Equity	15.97%	14.05%	23.33%	18.58%	17.98%

Net interest margin is the first ratio that was calculated. This ratio measures the bank's spread per unit of assets. The higher this ratio is the better it is for the bank and a typical healthy ratio would be roughly 1.3%. All six banks meet and exceed this criterion in almost every year with the exception of RBC in 2006 and 2007. Straight away we see the NIM for both Irish and Canadian banks are very analogous. Both sets of banks average a NIM of 1.64% for the four years indicating a healthy use of assets for creating income. With literally no difference in NIM between the two sets of banks it can be said that Irish banks used their assets just as effectively as Canadian banks in the creation of a spread and therefore income.

Cost-income ratio was the next to be calculated. This measures a bank's non-interest expenses as a percentage of total operating income and is thought to be a direct measure of how efficient a bank is. In the case of this ratio, lower is better. Immediately noticeable is that Anglo appears to be the most efficient bank by far of any of the six with a cost-income ratio of 27.24%. What this tells us is for every €1 earned by Anglo only 27c is spent on non-interest expenses. Even with the exclusion of Anglo, Irish banks average cost-income ratio over the four years was 55.13% compared to 62.84% for Canadian banks. BOI and AIB, from 2004 to 2007, spent on average 7.71% less of operating income on non-interest expenses than Canadian banks making them more efficient.

Return on assets is a ratio that indicates how much profit is generated in comparison to the available asset base. It does this by measuring net profit before tax as a percentage of total assets. The higher this ratio the better for the bank and a healthy ratio is around 1%. With the exception of BOI in 2006 and RBC in 2004 every bank consistently displays a healthy return of above 1% in this ratio. Irish banks are again the stronger of the two with an average ratio of 1.27% across the four years compared to 1.15% for Canadian banks. AIB in this case is the best performer with an average ROA of 1.43% indicating they generate €1.43 profit after tax for every €100 of assets.

Return on equity is the last ratio to be calculated for this analysis. This measures a bank's efficiency at generating profits from shareholders' equity. The

higher this ratio the better for the bank and the benchmark is around 10%. As has been the case through most of this analysis, Irish banks are again clearly the more efficient. Average ROE over the four years for Irish banks was 23.42% compared to 18.95% for Canadian banks. Anglo was again the market leader amongst Irish banks with an average ROE of 25.81%.

The results obtained here are surprisingly very innocuous. Irish banks appear to have been run in a far more efficient manner than Canadian banks over this period. Indeed, apart from the heavy amount of resources Irish banks were pouring into the property sector, as evidenced by facts uncovered when researching literature as well as data from questionnaire 2, Irish banks appear to have been very well run.

Chapter 5 – Conclusion

The purpose of this dissertation was to analyse the practices of Irish banks from 2004-2007 in an attempt to evaluate whether the 2008 Irish Financial Crisis was predominantly home-grown or more the result of uncontrollable external factors. This has been one of the most well researched phenomena of the last few years and I needed to therefore come up with a new angle of approaching the research. Consequently I incorporated three Canadian banks into my trend analysis for use as a proxy against which to compare the actions of the Irish banks over the same time period. As there is such a wide range of pre-existent knowledge in this area I thought it imperative to adopt two separate methods of research:

1. Primary Research – Questionnaires
2. Secondary Research – Trend Analysis

Two questionnaires were designed to elicit meaningful responses from two separate target groups. The first questionnaire was designed for economists, economic journalists and university lecturers whereas the second questionnaire was designed for bankers, and more specifically those working within the banking system before and during the crisis. While there were sufficient respondents to questionnaire 1, as well as two interviews, only one respondent replied to questionnaire 2 plus one other interview. It must be stated that this obviously detracts from the weight that can be given to the results of questionnaire 2. The literature review chapter helped greatly to better target my questions for the two separate target groups.

The analysis of questionnaire 1 as well as the conclusions from the interviews indicates an overwhelming sentiment that the crisis was indeed home-grown with 92% of respondent believing the crisis was somewhere between 60-100% home-grown. This was hardly surprising given the information uncovered during the literature review but only gave a very blunt assessment of the overall view of events. Based on this research the collapse of Lehman Bros can be said to have had little effect throwing further weight behind the sentiment that the crisis was home-grown, as the collapse of Lehman and the subsequent drying up of liquidity was thought to be the most influential external factor on the crisis. Irish financial regulation and its implementation were clearly very lacking as opinion came back as poor verging on non-existent, which is interesting considering opinion was divided between good and

bad concerning the data provided by the regulatory bodies themselves. These bodies, The Financial Regulator and The Central Bank of Ireland, are also clearly guilty of lacklustre system-wide stress tests. The Irish banks themselves are clearly guilty to a degree as they are heavily implicated by respondents who believed not only did the banks disregard all available financial data when making decisions but were also thought to be guilty by the majority of respondents of a plain breach of lending code. Not only this, but their internal risk management systems certainly seemed to have been below par. Such sentiment indicates the banks should shoulder quite a large portion of the blame. The Irish government should also clearly be held accountable with almost 85% of respondents expressing this sentiment and only a sole respondent believing otherwise. In terms of external factors other than Lehman Bros a strong case can be made that EMU had a significant effect on the crisis. Only a very slight majority of respondents thought EMU to be beneficial on the whole while a large majority of respondents thought low interest rates as a result of EMU had a strong effect on the housing boom. At the very least it can be said EMU, and the resultant interest rates that were outside Ireland's control, had a notable impact on the crisis.

Analysis of the limited information compiled from questionnaire 2 can only be described as inconclusive. The questions were chosen as a result of an extensive literature review and were meant to examine areas that had come under scrutiny after the crisis had emerged; incentives and associated timelines, loan-to-value ratios, property lending and corporate governance were all targeted with this questionnaire. Corporate governance within the banks would appear to have been good as well as adequate risk management procedures being in place e.g. loans still went through credit committees. In contrast to this though is the interviewee's admission that his bank allocated between 40-60% to the property sector. These are the dangerous levels highlighted by Governor Patrick Honohan and can certainly be said to have attributed to the property bubble and therefore the crisis. It can also be labelled simply bad business practice as several literatures reviewed have revealed that for a company to devote that many resources to one sector is too risky.

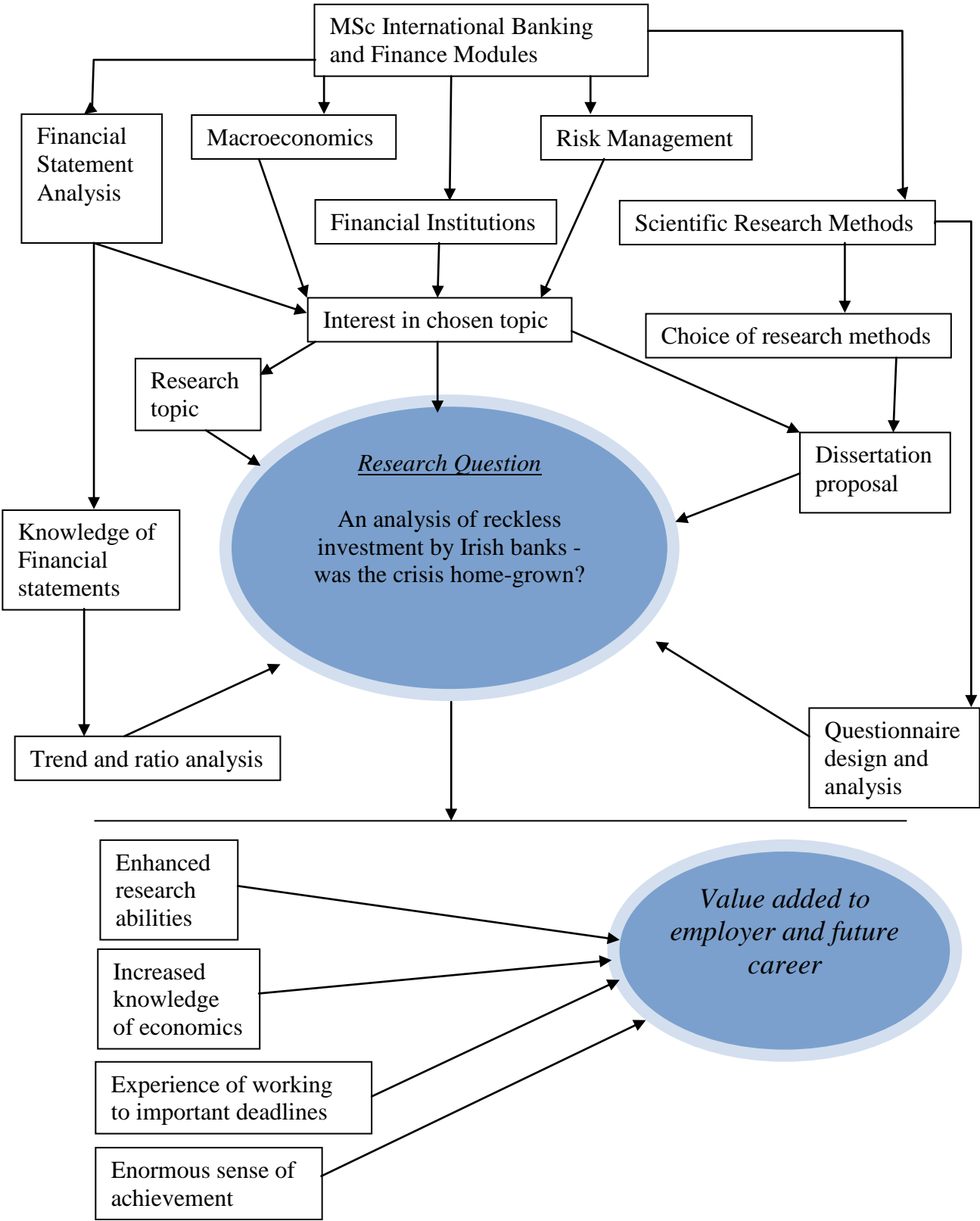
The trend analysis reaffirmed what Governor Honohan uncovered in that Irish banks were indeed growing parts of their balance sheet by 20%+ in multiple years. Anglo has unsurprisingly been confirmed as the worst offender. This sharp growth is

mirrored by the growth of the Irish economy and as the banks collapsed in 2008 we see a parallel collapse in several key economic indicators for Ireland. When this was compared to the stability shown by Canadian banks and the parallel stability of the Canadian economy post-international crisis the only conclusion to be drawn is that the actions of Irish banks were responsible for the collapse of Ireland's economy.

In conclusion I believe it was the investment practices of Irish banks, and in particular that of Anglo that were the main cause of the 2008 Irish Financial Crisis. Anglo led the way in property lending and it was up to the other Irish banks to either keep up or lose market share. There is certainly no doubting the overaggressive, reckless nature with which Irish banks grew their balance sheets and over-invested in property. Not only did this fuel a property bubble and create an artificial boom that led to Ireland's economy getting severely overheated but it also led to the tax payer having to shoulder the burden of an enormous amount of debt for many years to come. However I now realize this research question to be quite limited and even naïve. Yes, to be specific it was the actions of Irish banks in the years preceding the crisis that ultimately led to the economy collapsing when the bank-funded property bubble burst, but the banks were but the forefront of a network of negligence and misguided decisions. The ratios calculated show that apart from the risk-ignoring practice of investing so heavily in property that the banks were actually quite efficient and well run. It is not within the nature of banks to cease the supply of credit when there are those willing to repay it. The Irish government, EMU and the financial regulatory bodies of this country acted as enablers for the property bubble to grow and for the banks to lend in the manner they did. Therefore I end with this; The 2008 Irish Financial crisis was predominantly home-grown and it was the investment practices of Irish banks that were the main cause. However it is the authorities that allowed this to happen and it is the authorities, I believe, that should shoulder the majority of responsibility.

Chapter 6 – Self Reflection

(Figure 6.1 – Cognitive map of learning and performance)



The completion of this dissertation has been without question the most trying experience of my academic life. The above cognitive map depicts the process undergone and every factor that had an affect on the completion of this dissertation.

The top half relates solely to the process of actually completing the dissertation from start to finish. The five modules that were the most influential in topic choice form the roots of the cognitive map. These were the modules I was most interested in and also were the modules that incorporated a lot of the 2008 Irish Financial Crisis into the curriculum, with the exception of Scientific Research Methods. In order to conduct the proposed ratio and trend analyses my Financial Statement Analysis module was crucial. This class not only gave me the understanding of financial statements I needed but also introduced me to the two methods. Macroeconomics, Financial Institutions and Risk Management all focused heavily on the financial crisis and gave me an excellent understanding of it, as well as a keen interest in its causes. Scientific Research Methods armed me with the research tools necessary to complete such an intense study. This module was crucial for the completion of the research methodology section of this dissertation and also gave me an understanding of questionnaire design.

The map shows the synthesis of the knowledge gained through these four modules into an initial interest in the chosen topic. With the topic in mind and research methods selected I was able to complete my dissertation proposal. It was then a matter of researching the topic thoroughly and conducting the chosen methods of analysis to come up with a conclusion as to the research question.

The bottom section of the cognitive map summarizes how this research has affected my growth as a person and a professional. Each task undertaken in the completion of this dissertation, from questionnaire design to analysing financial statements and reviewing countless literature, has added to my capacity to perform in the professional world. My research abilities have increased measurably and I now have further experience of having to work to very important deadlines. Both the Masters degree and the completion of the dissertation itself have added to my general knowledge of economics. All this will only benefit my employer as I now have a more complete skill set and the confidence with which to use it.

As stated above, this was the most daunting academic project I have ever completed. In terms of value added to myself I would say first and foremost is an enormous sense of achievement. Several months of research have been devoted to this study and it marks the end of my educational life for the foreseeable future. This was dissertation was also completed while working a full-time job and this adds to the sense of achievement. I have more knowledge now of what I am capable of than I've ever had before and the knowledge of having completed such a monumental report has given me increased confidence in my abilities.

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Appendix 1 (Questionnaires)

Questionnaire for Economists / Journalists

All questions relate to the period pre-2008. Please fill in your answers in the space below each question.

Section 1 – External vs. Internal Factors

- 1) Using the following scale, describe whether you feel the current Irish financial crisis was predominantly homegrown or the result of uncontrollable international circumstances?
 - 1) 100% External
 - 2) 80% External & 20% Homegrown
 - 3) 60% External & 40% Homegrown
 - 4) 50-50
 - 5) 40% External & 60% Homegrown
 - 6) 20% External & 80% Homegrown
 - 7) 100% Homegrown

- 2) How much of an affect do you think the collapse of Lehmann Bros and the subsequent drying up of liquidity had on the Irish financial crisis?

- 3) In your opinion, if the collapse of Lehmann Bros hadn't occurred would Irish banks have still needed a government bailout?

- 4) What, if any, other external factors do you feel exacerbated the Irish financial crisis?

Section 2 - Regulation & Governance

- 5) Using the following scale, how would you rate Ireland's financial regulatory structure pre-2008?
 - 1) Very poor
 - 2) Poor

- 3) Adequate
 - 4) Good
 - 5) Very good
-
- 6) How effective did you find regulatory bodies such as The Financial Regulator and The Central Bank of Ireland to be in regards to providing the country with economic data in the years preceding the crisis?
 - 7) Using the following scale, what sort of importance would you say Irish banks gave to the economic data provided by these institutions?
 - 1) Very unimportant
 - 2) Unimportant
 - 3) Middling
 - 4) Important
 - 5) Very important
 - 8) In your opinion, should the Irish government be apportioned some of the blame that is levelled at banks for their business practices? How do you feel government fiscal policy affected the crisis?
 - 9) Where you aware of any blatant disregard of standard lending principles within Irish banks?
 - 10) Regling and Watson cited 'deficient implementation' of corporate governance rather than 'defective guidelines' as the reason for what was perceived as lax lending procedures. Would you agree with this assessment?

Section 3 - EMU

- 11) Klaus Regling and Max Watson cited funding exposure as one of the main factors contributing to the collapse of the banking system in their report on Ireland's banking crisis. Heavy foreign borrowing was said to have been made

easier because of EMU entry. On the whole, do you feel the introduction of the EMU was beneficial for Ireland's economy or not? Explain briefly.

- 12) Using the following scale, how much of an affect did the lowering of nominal interest rates as a result of EMU entry have on the credit and property boom experienced in Ireland pre-2008?
- 1) Very small affect
 - 2) Small affect
 - 3) Middling
 - 4) Strong affect
 - 5) Very strong affect

Section 4 - Risk Management

- 13) Did you find the internal risk management of Irish Banks to contain any weaknesses? If so what were they?
- 14) In regard to system-wide stress tests, how effective / informative did you find these to be?
- 15) Were warnings given from any economists or others of an impending collapse in the economy in the years preceding the crisis? If so briefly explain.
- 16) What do you believe were the main differences between Ireland's growth phase titled 'The Celtic Tiger' and the period of growth from 2002 – 2006?

Questionnaire for Bankers

All questions relate to the period pre-2008. Please fill in your answers in the space below each question.

Section 1 - Incentives & Targets

- 1) Give a brief description of how incentive packages were laid out in your institution pre-2008.
- 2) What were the normal performance targets and timelines associated with these targets?

Section 2 - Competition

- 3) In relation to your main competitors, were their strategies and business decisions given much regard within your institution when making your own decisions? If so briefly explain.
- 4) With reference to the following scale, what level of importance was given to maintaining and/or growing market share?
 - 1) Very little
 - 2) Little
 - 3) Some
 - 4) A lot
 - 5) Main priority

Section 3 - Decision Making

- 5) In regards to the health of the Irish economy, how did economic outlook factor into the decision making of the institution?
 - 1) Not at all
 - 2) Not very important

- 3) Somewhat important
 - 4) Important
 - 5) Very important
- 6) Within your institution what level of financial resources were allocated to the property sector?
- 1) 0-20%
 - 2) 20-40%
 - 3) 40-60%
 - 4) 60-80%
 - 5) 80-100
- 7) Were there specific guidelines within your institution in regards to loan-to-value ratios? If so, what were they?
- 8) The Financial Regulator and the Central Bank of Ireland are Ireland's two main sources of economic data that financial institutions use to aid them in making business decisions. What sort of influence would these reports have had on lending decisions?
- 1) None
 - 2) Very little
 - 3) Middling
 - 4) Influential
 - 5) Very influential

Section 4 - Risk Management & Corporate Governance

- 9) What sort of internal risk management was employed in your institution?
- 10) Was internal stress testing prevalent in the years preceding the crisis?
- 11) With reference to the following scale, how do you rate your institutions corporate governance framework pre-2008?
- 1) Very poor

- 2) Poor
- 3) Mediocre
- 4) Good
- 5) Very Good

12) Was there concern voiced from any areas within your institution about the high level of wholesale borrowing being done to finance lending?

Appendix 2 (Secondary Research Workings)

Ratio Formulas:

Net Interest Margin: $\frac{\text{Interest income} - \text{interest expense}}{\text{Total assets}}$

Cost-Income Ratio: $\frac{\text{Non interest expenses}}{\text{Total Operating income}}$

Return on Assets: $\frac{\text{Net profit before tax}}{\text{Total assets}} \times 100\%$

Return on Equity: $\frac{\text{Net profit available for distribution}}{\text{Total equity}}$

Ratio Workings:

				2004		
	RBC	Scotia	TD	BOI	AIB	Anglo
Net Interest Margin	6684/447682	5865/279212	5943/311027	1744/106431	2036/102240	523.5/34339.8
Cost-Income Ratio	11020/17350	5862/9795	8007/11212	1654/2978	1886/3264	219.1/723.2
Return on Assets	4152/447682	3769/279212	3205/311027	1170/106431	1418/102240	504.1/34339.8
Return on Equity	2794/18375	2892/15235	2232/13978	935/4464	1047/5581	379.4/1239.8
				2005		
Net Interest Margin	6770/469521	5871/314025	6008/365210	1898/126464	2530/133214	720/48263.36
Cost-Income Ratio	11433/18760	6043/10170	8782/11842	1924/3173	2011/3647	291.8/977
Return on Assets	4702/469521	4127/314025	3060/365210	1321/126464	1706/133214	685.2/48263.6
Return on Equity	3349/19847	3184/16082	2229/15866	1073/4995	1433/7169	491/2112.1
				2006		
Net Interest Margin	6762/536780	6408/379006	6371/392914	2307/162354	2999/158526	1069/73290
Cost-Income Ratio	11495/20208	6443/10992	8727/12695	2020/3677	2314/4326	328/1240
Return on Assets	6204/536780	4549/379006	5527/392914	1599/162354	2615/158526	850/73290
Return on Equity	4668/22123	3549/17547	4581/19632	1296/5328	2298/8605	658/2684
				2007		
Net Interest Margin	7532/600346	7098/411510	6924/422124	2757/188813	3148/177862	1566/96652
Cost-Income Ratio	12473/21671	6994/12220	8975/13636	2159/4176	2521/4868	393/1761
Return on Assets	7025/600346	5226/411510	4661/422124	1958/188813	2508/177862	1243/96652
Return on Equity	5404/24439	3994/18804	3977/21404	1652/6724	2066/9827	1008/4052

Use of Canadian and Irish financial statements:

Trend analysis:

‘Operating expenses’ is ‘non interest expense’ on Canadian income statements.

‘Profit’ figure is ‘profit for the period’ on Irish income statements and ‘net income available to common shareholders’ on Canadian statements.

‘Securities in issue’ is ‘obligations related to securities sold short’ on Canadian balance sheets.

‘Total loans and advances’ is ‘loans and receivables to banks’ + ‘loans and receivables to customers’ on Irish balance sheets and just ‘loans’ on Canadian balance sheets.

‘Customer accounts’ is ‘personal deposits’ on Canadian balance sheets.