Discussion of “Entry, Exit and Growth of US Commercial Banks” by John O.S. Wilson, John Goddard, and Hong Liu

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[1] The views expressed in this discussion do not necessarily reflect the views of the Federal Reserve Bank of Richmond or the Federal Reserve System.

What this Paper is About

- Description of banking industry structure
  - Mainly - Entry, exit, internal growth
  - The three factors that determine size distribution

- For each type of bank exit - failure of M&A
  - Reasons

Why is this Paper Interesting?

Banking structure is highly regulated

- Pre 1990s - branching and growth restrictions
- Now - regulation tied to size

Large indirect effects on bank structure and balance sheet from

- Deposit insurance, TBTF

Need to understand bank structure to evaluate

- Policies that limit bank size
- Policies that change operations (e.g., living wills)
- Policies that restrict entry
- How to improve bank supervision
    - Based on reasons for failure
- etc.

Data

- U.S. commercial banks
- 1984 – 2012

- Call Reports for balance sheet and income data
- Failures and M&A data from FDIC

- Breaks banks into size bands
- Scale by GDP deflator

Analysis of Exit

Approach

- Use a competing-risk model of being acquired and failing
- Estimate separate independent hazards
- Only consider banks that exist in 1984

Findings

- Reduce M&A - size, high capital, diversification
- Increase M&A - NPL, profitability (small banks), expenses
- Reduce failure - size
- Increase failure - recent growth (smallest banks), loan-to-asset, low cap

Test of Gibrat's Law

Gibrat's Law - growth independent of size, important

Run Cross-sectional regressions on annual data

- Use Heckman selection to control for survivorship bias
- Issue here is that error terms of the selection equation could be correlated with error terms of the growth equation
- Tested to see if lagged growth significant

Findings

- Found selection bias
- Gibrat's Law fits for small banks

Comments: Data and Exit Analysis

Data

- Commercial bank definition - uses charter, not holding company
- Account for off-balance sheet activities?
  - Big in later years - increases assets by about $400 billion in 2013
- Uses a price deflator for size bands
  - Good for services, but not assets
  - 1984 – 2012
    - GDP deflator - roughly double
    - Bank assets - roughly quadruple

Exit analysis

- Should jointly estimate failure and acquisition
- Losing lots of banks by dropping post 1984 entrants
- Should use a *de novo* dummy

Comments: Gibrat Analysis

Like that they control for selection

But Gibrat regressions run separately within each size band
Misses size effects across bands. Some of that picked up by constant terms.

Need to run a single regression for all banks, maybe weight by assets

Janicki and Prescott (2006) ran a single regression

- They didn't control for selection

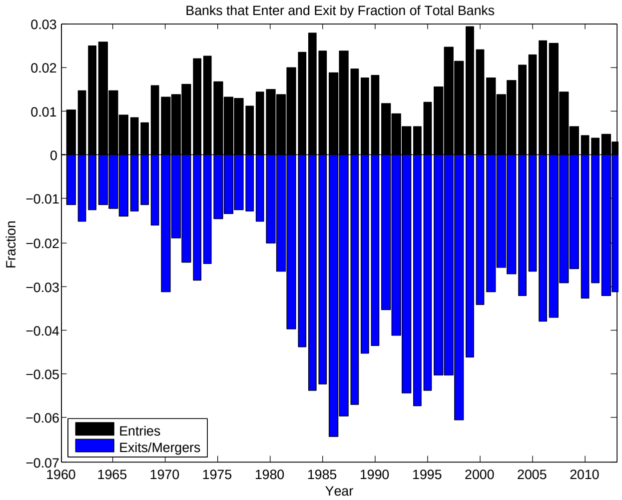
Comments: Entry

They don't emphasize, but they find NO entry in 2011 and 2012.

Great example of a question that their work can be applied to.

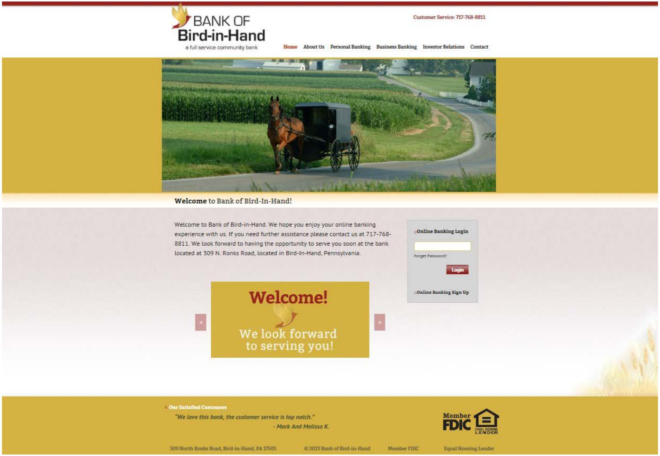
- Is no entry normal?

Is Zero Entry Ever Normal? NO



From McCord and Prescott (forthcoming). (They find some entry because they count charter conversions and separations of bank charters from holding companies as entrants.)

The One *De Novo* Bank of 2013!



Lack of Entry

Descriptive work suggests that entry patterns are not normal.

McCord and Prescott (forthcoming) - Use entry, exit, and growth dynamics like in this paper

- Show 2/3 of decline in number of banks since 2007 accounted for by lack of entry
- Show 2/3 of decline in community banks due to lack of entry
- Community bank exit rates not any different than from before crisis

Debate about reasons

- Adams and Gramlich (2014) - say it is low net interest margin
- Others - regulatory barriers

Conclusion

I like what authors are doing

Good approach for many bank structure questions