

Discussion of
“Entry, Exit and Growth of US Commercial
Banks”
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November 21, 2014
Southern Finance Association

¹The 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

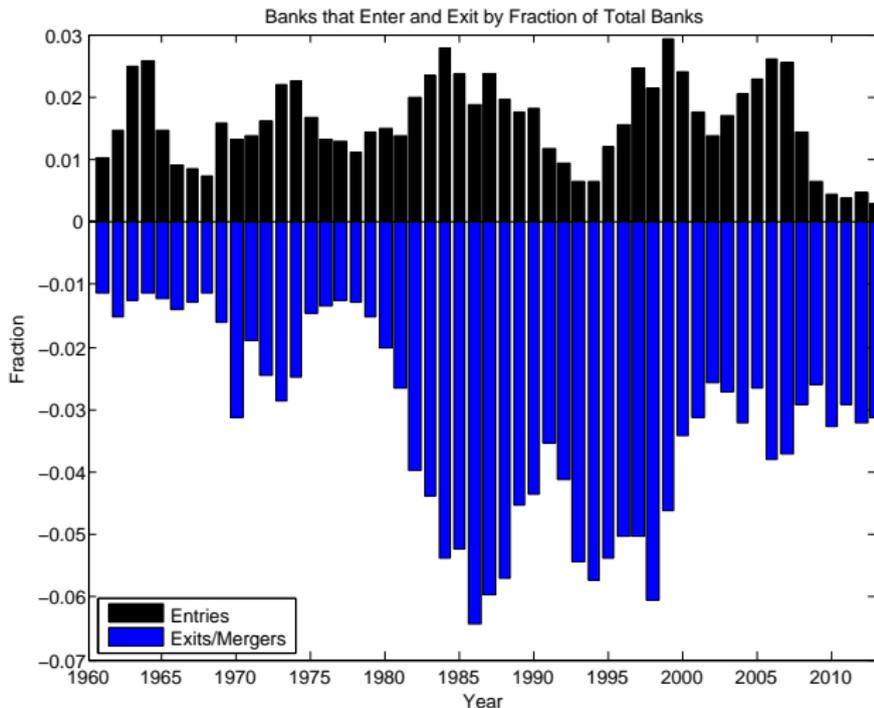
Comments: Entry

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!

The screenshot shows the homepage of the Bank of Bird-in-Hand. At the top left is the bank's logo, which includes a stylized bird icon and the text "BANK OF Bird-in-Hand" with the tagline "a full service community bank" below it. To the right of the logo is the phone number "Customer Service: 717-760-8811". Below the logo is a navigation menu with links for "Home", "About Us", "Personal Banking", "Business Banking", "Investor Solutions", and "Contact".

The main content area features a large photograph of a horse-drawn carriage on a paved road that curves through a green field with rows of corn. Below the photo is a yellow banner with the text "Welcome to Bank of Bird-In-Hand!".

Below the banner is a white box containing the text: "Welcome to Bank of Bird-in-Hand. We hope you enjoy your online banking experience with us. If you need further assistance please contact us at 717-760-8811. We look forward to having the opportunity to serve you soon at the bank located at 309 N. Ronks Road, located in Bird-in-Hand, Pennsylvania." To the right of this text is a login box titled "Online Banking Login" with a "Forgot Password?" link, a password input field, a "Login" button, and a link for "Online Banking Sign Up".

Below the white box is a yellow box with the text "Welcome!" and "We look forward to serving you!" accompanied by a small bird icon. This box is flanked by two small red square buttons with white arrows.

The footer is a dark yellow bar. On the left, it says "Our Satisfied Customers" and includes a quote: "We love this bank, the customer service is top notch." attributed to "Mark And Melissa K.". On the right, it features the "Member FDIC" logo and the Equal Housing Lender logo. At the bottom of the footer, the address "309 North Ronks Road, Bird-in-Hand, PA 17005" and copyright information "© 2013 Bank of Bird-in-Hand Member FDIC Equal Housing Lender" are displayed.

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