

Financial Performance and Management Structure of Small, Closely Held Banks

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The views expressed in this paper are those of the authors and do not necessarily reflect the views of the Federal Deposit Insurance Corporation.



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Key Questions

- What are closely held banks, and how prevalent are they?
- How much does ownership and management coincide, and what are the implications?
- How do closely held banks differ from widely held banks in terms of: characteristics, performance, risk taking, and capital formation?
- What are the implications for management succession?



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How Might Closely Held Ownership Influence Operational Efficiency and Risk Preferences?

Operational Efficiency

Pros:

Closely held banks may be less beholden to short-term earnings pressures.

Closely held banks may be more likely to monitor managers because owners capture more of the returns to monitoring.

Cons:

Closely held banks may have more trouble raising capital to make investments.

Closely held banks may pursue goals other than profit maximization.

Risk Preferences

Pros:

Owners of closely held banks may be more risk averse given the concentration of their wealth in the bank.

Cons:



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How Might Overlap of Ownership and Control Influence Operational Efficiency and Risk Taking?

Operational Efficiency

Pros:

The incentives of owner-managers are aligned with the interests of other shareholders to maximize long-term bank value.

Cons:

Succession planning may be more difficult because the bank faces a limited talent pool.

Succession involves transferring both control and ownership, often at the same time.

Risk Preferences

Pros:

Overlap of ownership and control may cause the bank to take on less risk in some areas, depending on the concentration of the owner's wealth in the bank.

Cons:

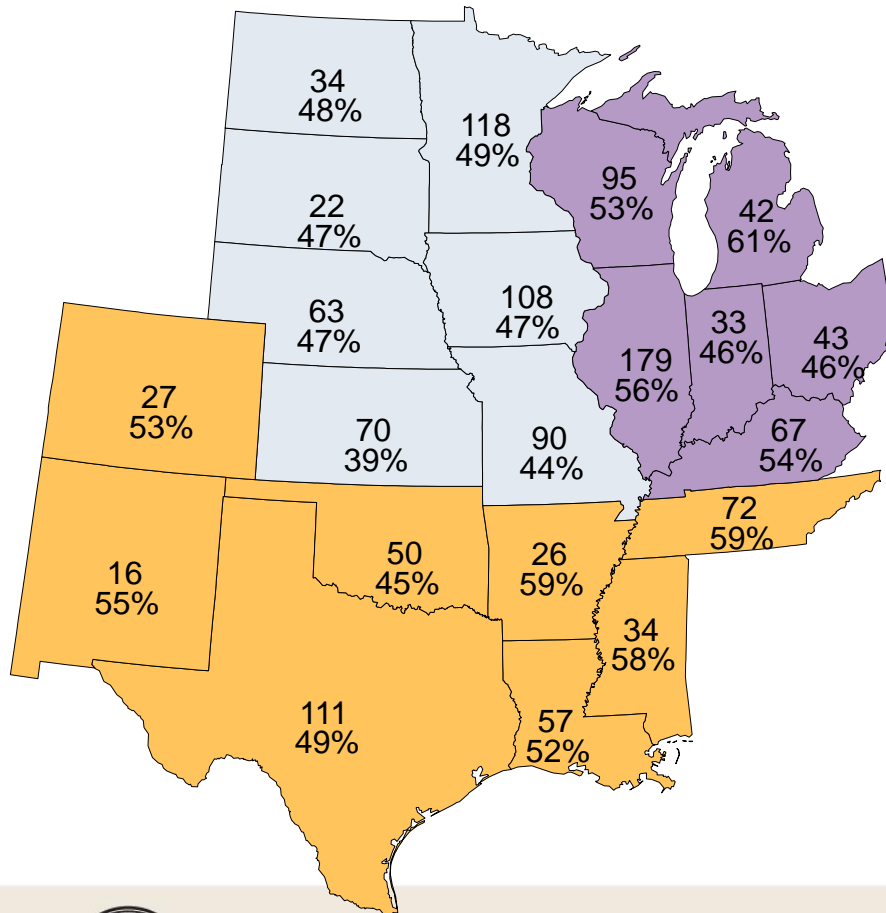


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Surveyed Banks Represent About Half of all FDIC-Supervised Community Banks in the FDIC's CHI, DAL, and KC Regions.



FDIC Region	Number of Community Banks Surveyed	Share of FDIC-Supervised Community Banks
Chicago	459	54%
Dallas	393	52%
Kansas City	505	46%
Total	1,357	50%

Source: April 2015 FDIC Examiner Survey. Community banks are as defined per *FDIC Community Banking Study* (2012). Data as of December 2014.



Q: In your judgment, is there an identifiable *primary owner* or *ownership group* for this bank?

The primary owner or ownership group of the bank is a person or group with a substantial ownership stake that individually or collectively exerts a deciding influence over the governance of the institution.

Closely Held Banks Are Prevalent, Making Up Three-quarters of All FDIC-supervised Community Banks in These Regions

Region	Survey Responses	Identifiable Primary Owner	Percent Closely Held
Chicago	459	288	63%
Kansas City	505	424	84%
Dallas	393	301	77%
Total	1,357	1,013	75%

Source: April 2015 FDIC Examiner Survey



Ownership and Control Overlap At Most Closely Held Community Banks

Region	Survey Responses Indicating Closely Held Bank	Percent Where Key Officer Is Also A Member of the Primary Ownership Group	Percent Where Key Officer Is Not An Owner, But Can Still Be Considered An Insider	Total: Key Officer Closely Affiliated With Ownership Group
Chicago	288	44%	7%	51%
Kansas City	424	51%	6%	57%
Dallas	301	45%	17%	62%
Total	1,013	48%	10%	58%

Source: April 2015 FDIC Examiner Survey. The **key officer** of the bank is defined as the person who effectively runs the bank on a day-to-day basis, regardless of his/her formal title.



Management Succession Is An Issue for Closely Held and Widely Held Community Banks

Region	Survey Responses	Has The Bank Identified A Viable Successor?	In Your Judgment, Is The Bank Well Positioned To Recruit Qualified Management Talent From The Outside?
Chicago	288	41%	56%
Kansas City	424	57%	67%
Dallas	301	50%	62%
Total: Closely Held	1,013	50%	62%
Total: Widely Held	344	46%	69%

Source: April 2015 FDIC Examiner Survey.



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Table 7
Characteristics of Closely Held and Widely Held Banks

Characteristic	Closely Held Banks	Widely Held Banks
Assets		
Average Asset Size	\$264 million	\$334 million
Average Equity Capital as Percent of Assets	10.7%	11.0%
Geography		
Headquartered in Metropolitan County ¹	46%	57%
Headquartered in Micropolitan County	18%	22%
Headquartered in Rural County	36%	21%
Headquartered in Depopulating Rural County ²	24%	10%



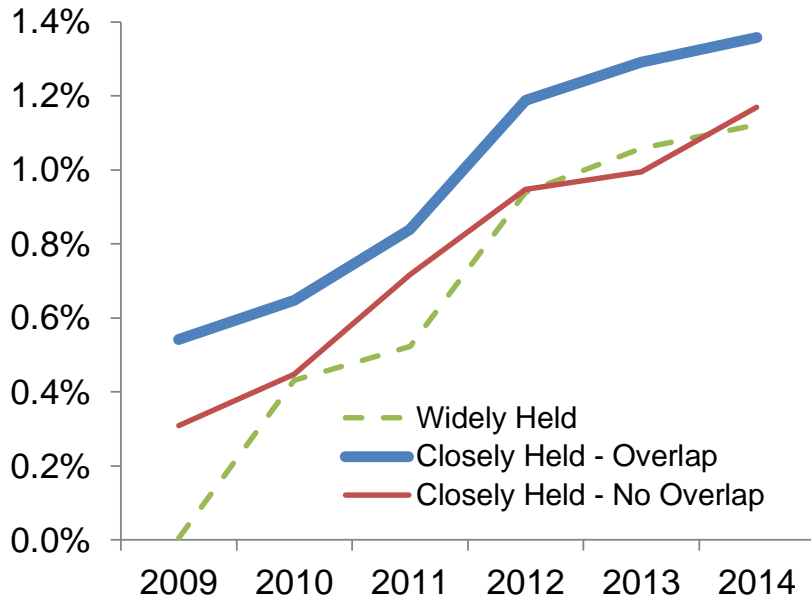
Characteristic	Closely Held Banks	Widely Held Banks
Lending Specialty		
Agricultural Lending Specialty ³	25%	13%
Commercial and Industrial Lending Specialty	2%	2%
Commercial Real Estate Lending Specialty	20%	23%
Mortgage Lending Specialty	7%	18%
Multiple Lending Specialties	12%	19%
No Lending Specialty (Diversified)	32%	24%
Other Consumer Lending Specialty	1%	1%
Age		
Charter Younger than 15 years	7%	24%
Charter Older than 100 years	43%	38%
Market Power		
Operating in 'Highly Concentrated' Deposit Market ⁴	34%	29%



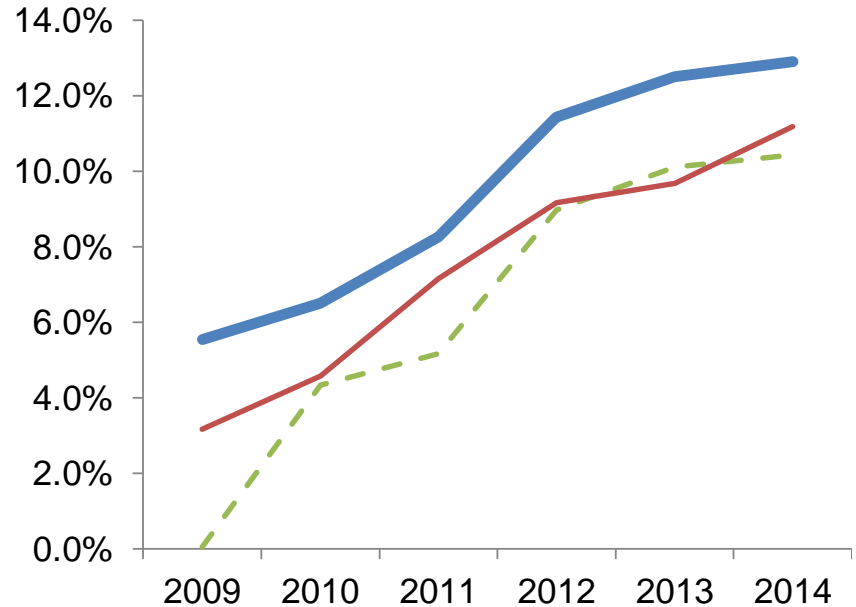


Closely Held Community Banks Where Ownership and Control Overlap Have Consistently Been More Profitable

Pre-tax Return on Assets, Percent



Pre-tax Return on Equity, Percent



Source: FDIC analysis of Call Report data on 1,357 FDIC-supervised community banks headquartered in the FDIC Kansas City, Dallas, and Chicago regions that were identified in the April 2015 FDIC Examiner Survey as having an ownership structure that could be characterized as closely held or widely held.

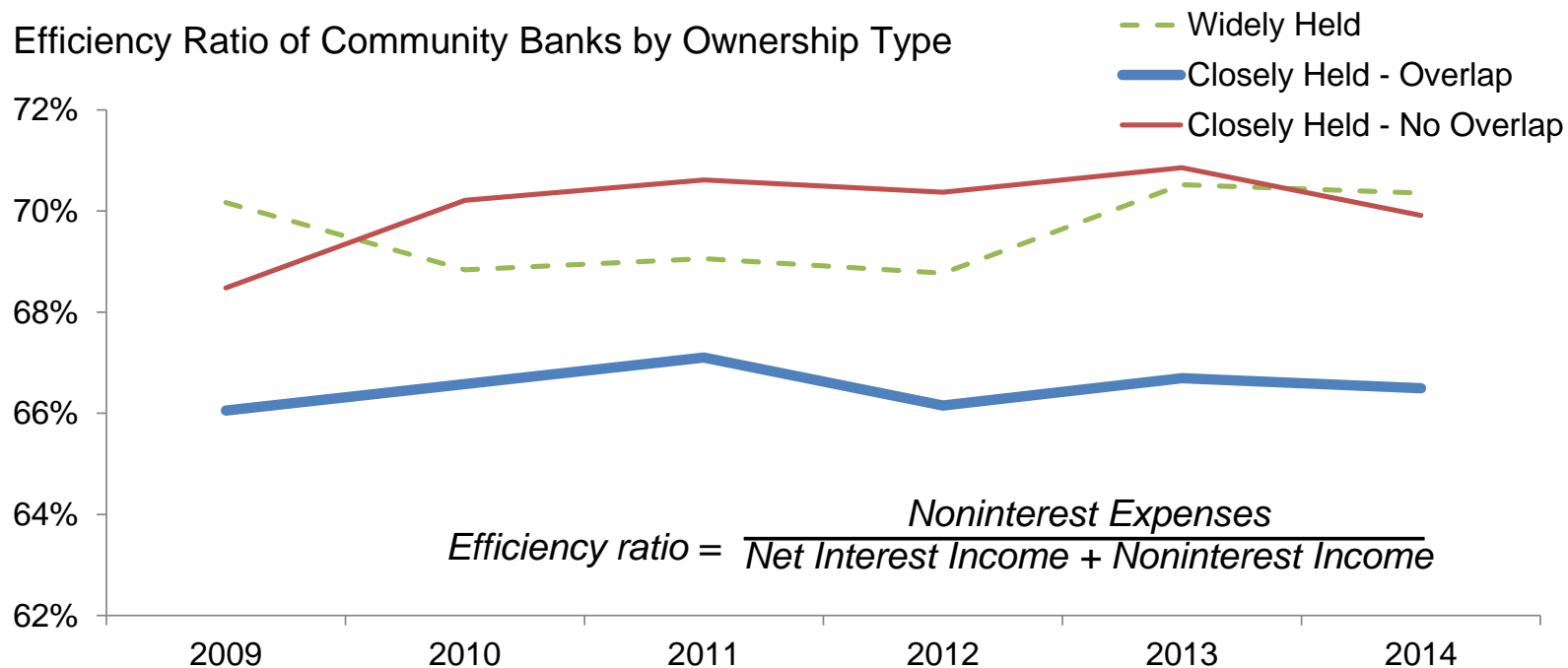


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Closely Held Community Banks Where Ownership and Control Overlap Report Lower Efficiency Ratios



Source: FDIC Analysis of Call Report data on 1,357 FDIC-supervised community banks headquartered in the FDIC Kansas City, Dallas, and Chicago Regions that were identified in April 2015 FDIC Examiner Survey by closely held or widely held ownership structure.

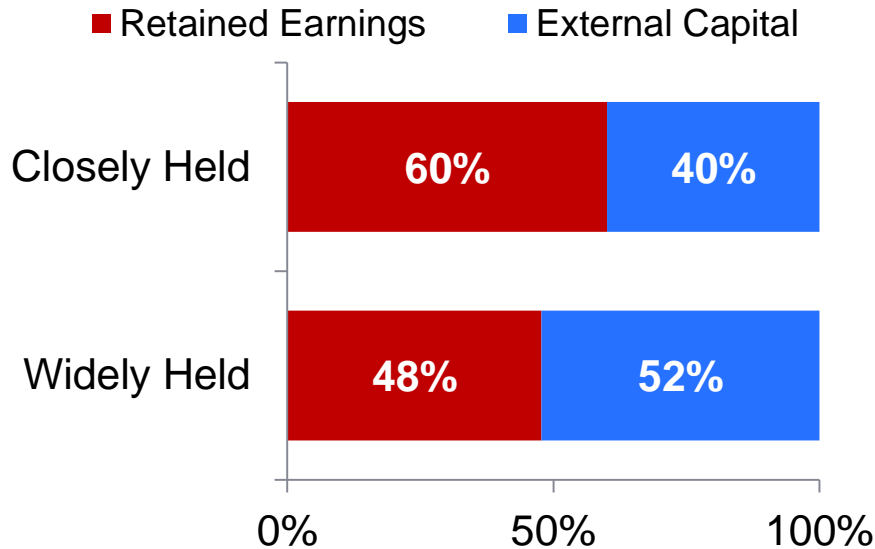


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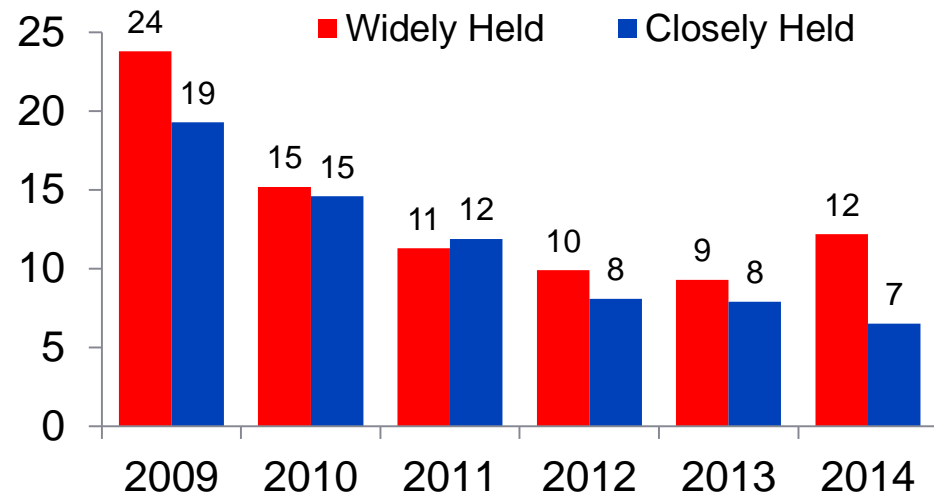
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Closely Held Community Banks Raise More Capital Through Retained Earnings, But Still Have Access to External Sources

Percent of Gross Capital Raised by Source, 2009 to 2014



Percent of Existing Community Banks Raising External Capital, By Ownership Type



Source: FDIC Call Report data on 1,357 FDIC-supervised community banks headquartered in the FDIC Kansas City, Dallas, and Chicago regions identified in April 2015 FDIC Examiner Survey as closely held or widely held. Note: Excludes institutions in first year of existence.



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Regression Analysis Shows That Closely Held Banks Do Not Underperform Widely Held Banks

Specification	Independent Variable				
	Pre-tax Return on Assets	Pre-tax Return on Equity	Loans to Assets	Loans to Risk Based Capital	Risk Weighted Assets to Total Assets
	1	2	3	4	5
Outcome average	0.084	6.31	0.62	6.02	0.66
Closely Held = 1	-0.0234 (0.0690)	0.164 (0.5280)	-0.00986 (0.0060)	0.068 (0.1290)	-0.00147 (0.0069)
Overlap = 1	0.117** (0.0427)	1.327*** (0.4590)	0.00696 (0.0084)	0.0639 (0.1660)	0.00445 (0.0062)
Age	0.000125 (0.0011)	0.0105 (0.0117)	-0.000336*** (0.0001)	-0.00415** (0.0017)	-0.000378*** (0.0001)
Total Assets (\$ million)	0.314*** (0.0401)	3.298*** (0.5010)	0.0185** (0.0074)	0.371** (0.1380)	0.0354*** (0.0061)
Metro HQ	-0.260*** (0.0518)	-2.422*** (0.3460)	0.0210** (0.0095)	0.366*** (0.0885)	0.0157 (0.0098)
Micro HQ	0.00821 (0.0767)	0.202 (0.7260)	0.0149* (0.0086)	0.312** (0.1240)	0.0154** (0.0068)
Market Power	0.0000516** (0.0000)	0.000450** (0.0002)	-1.61E-06 (0.0000)	-3.37E-05 (0.0000)	-0.00000053 (0.0000)
Ag Specialization	0.409*** (0.1190)	4.476*** (1.5120)	-0.0190* (0.0106)	-0.0493 (0.1760)	-0.00734 (0.0117)
C&I Specialization	0.172 (0.1970)	2.662 (1.9980)	0.011 (0.0164)	0.575* (0.3160)	-0.0212 (0.0223)
	-0.046	0.653	-0.00586	0.126	-0.113***

(See Table B1 for complete regression results.)





Conclusions

- Closely held institutions make up three-quarters of community banks in our sample; ownership and management overlap at most of them.
- Closely held community banks where ownership and management overlap have outperformed the other groups in recent years.
- This suggests that the advantages of closely held ownership structure and management overlap outweigh the disadvantages.
- However, this solution to the agency problem may prove difficult to replicate when it comes time to implement a succession plan.



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