Is the Traditional Banking Model a Survivor?

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Community bank survival: One definition, one fact, and one finding

Definition: A bank ***survives*** by neither failing (financial exit) nor being acquired (strategic exit).

Fact: The population of banks with assets between $500 million and $10 billion ***has increased*** over time.

Finding: Within this size group, a traditional banking strategy substantially ***increases a bank's probability of surviving***.

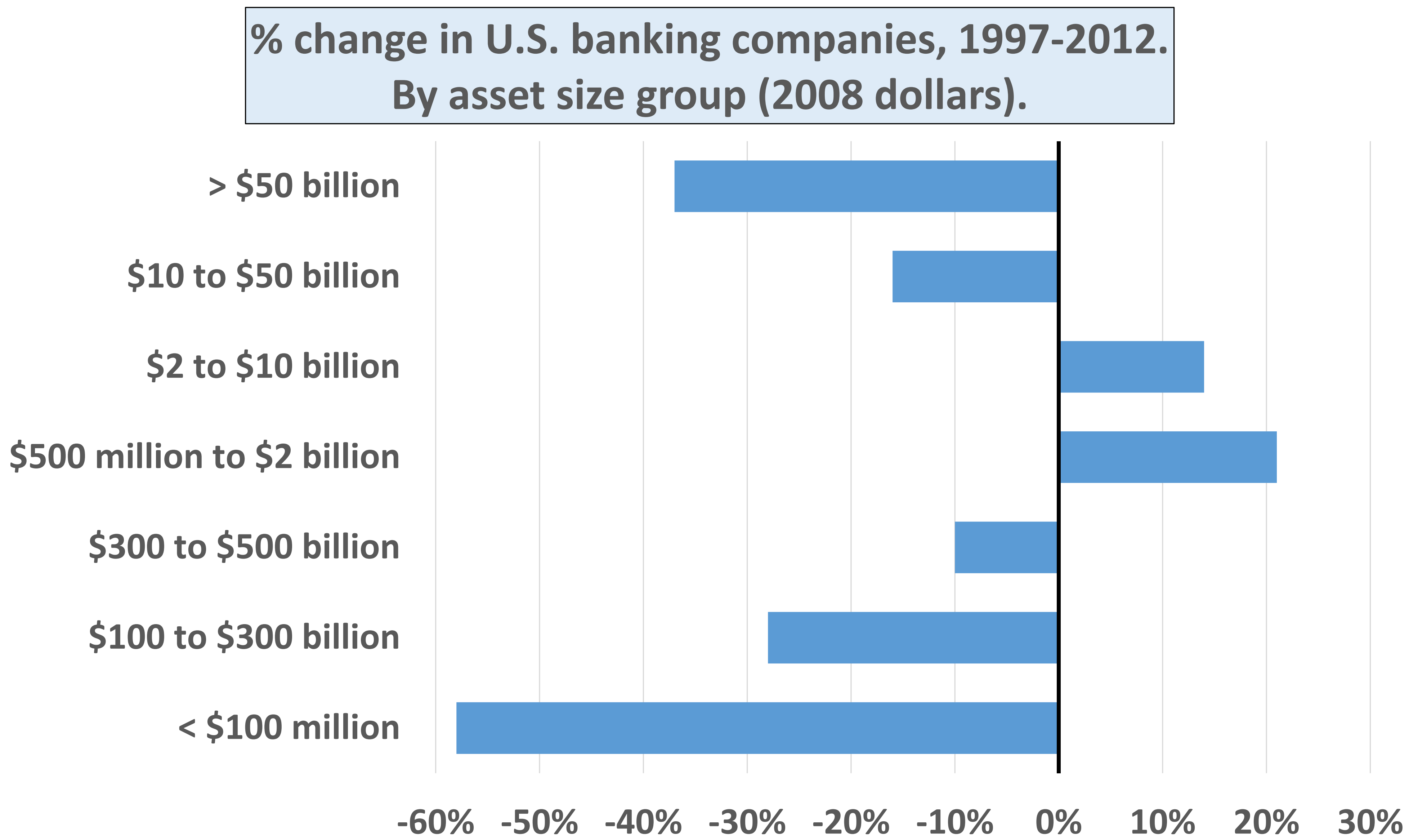
Bank survival

To survive, a bank must remain solvent (not fail).

- 477 U.S. banks have failed or been acquired with government assistance since 1997.
- “financial exit”

To survive, a solvent bank must also remain operating under its own power (not be acquired).

- 5,675 healthy U.S. banks have been acquired since 1997.
- “strategic exit”


% change in U.S. banking companies, 1997-2012.
By asset size group (2008 dollars).
> $50 billion
$10 to $50 billion
$2 to $10 billion
$500 million to $2 billion
$300 to $500 billion
$100 to $300 billion
< $100 million
-60%
-50%
-40%
-30%
-20%
-10%
0%
10%
20%
30%

The traditional banking model

- We know it when we see it…but it is very difficult to quantify.
- Analyze U.S. banks with assets from $500 million to $10 billion.

➢ **Traditional bank:** At least 3 of these ratios are above median:

  - branches/assets
  - core deposits/assets
  - traditional income/assets
  - relationship loans/assets

➢ **Nontraditional bank:** No more than 1 ratio is above median.

- *Which type of bank was more likely to survive?*

Evidence from the raw data

	% of banks that survived		traditional bank survival advantage
	traditional banks	nontraditional banks	
1997-2012	48.2%	40.4%	19.2% more likely
1997-2006	57.5%	49.5%	16.3% more likely
2006-2012	88.8%	70.5%	22.5% more likely

An econometric model

- **Traditional banking index (TBI)** = % of 4 ratios above the median.
  - TBI = 100% (fully traditional)
  - TBI = 75% (marginally traditional)
  - TBI = 50%
  - TBI = 25% (marginally nontraditional)
  - TBI = 0% (fully nontraditional)
- **We estimate a panel probit model of bank survival:**
  - Year fixed effects, cluster on banks.
  - Controls: Bank size, lending mix, local economy, market competitiveness, and Heckman selection first-stage.

Results from econometric model

- How does the value of the TBI influence the probability that a bank survived from 1997 through 2012?

- "Marginally traditional" banks were ***13 percentage points more likely to survive*** than "marginally nontraditional" banks.

- The traditional banking advantage is strongest for banks between $500 million and $2 billion.
- The advantage disappears for banks between $2 billion and $10 billion.

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