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”

- > $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
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

<table>
<thead>
<tr>
<th>Period</th>
<th>% of banks that survived</th>
<th>traditional bank survival advantage</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>traditional banks</td>
<td>nontraditional banks</td>
</tr>
<tr>
<td>1997-2012</td>
<td>48.2%</td>
<td>40.4%</td>
</tr>
<tr>
<td>1997-2006</td>
<td>57.5%</td>
<td>49.5%</td>
</tr>
<tr>
<td>2006-2012</td>
<td>88.8%</td>
<td>70.5%</td>
</tr>
</tbody>
</table>
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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