The profit efficiency of small US commercial banks

Aigbe Akhigbe,1, James E. McNulty b,*

a Moyer Chair in Finance, University of Akron, Akron, OH 44325, USA
b Department of Finance, College of Business, Florida Atlantic University, Boca Raton, FL 33431, USA

Received 20 January 2000; accepted 1 August 2001

Abstract

This study investigates the profit efficiency (PROFEFF) of small banks (those under $500 million in total assets) for 1990–96. Assuming that small banks and large banks use the same production technology, we find, consistent with Berger and Mester [J. Bank. Finance 21 (1997) 875], that small banks are more profit efficient than large banks. Small banks in non-metropolitan statistical areas (non-MSA) areas are consistently more profit efficient than small banks in MSAs. Cross-sectional analysis of the correlates of the PROFEFF estimates suggests that structure–performance factors, relationship–development factors, and expense-preference behavior play an important role in explaining the PROFEFF of small US commercial banks. © 2002 Published by Elsevier Science B.V.

JEL classification: G2; D2; G21; G28; E58; E61; F33
Keywords: Profit efficiency; Commercial banking; Expense preference; Structure–performance; Loan relationships

1. Introduction

Financial economists have long been interested in the financial performance of small banks. This issue is especially important in the current era of bank consolidation. As the industry consolidates, there are concerns that small commercial banks...
may not survive; these banks have traditionally performed the important function of allocating credit to small businesses, an important source of job creation.

One difficulty in evaluating small bank performance relative to other banks is that it is affected by inherent differences in asset composition, liability composition, expenses, non-interest income, capital ratios, competition and access to credit information. The profit efficiency (PROFEFF) analysis used in this paper produces a sophisticated measure of financial performance which takes many of these differences into account. The PROFEFF measure is estimated and then regressed on variables which reflect differences in asset and liability composition, competition, location, organizational structure and other factors. This analysis provides a comprehensive picture of the differences between small banks and other banks for the period 1990–96. We define small banks as those with less than $500 million in total assets.

In addition to the application of PROFEFF analysis, this approach is different because previous studies of small bank performance generally consider all small banks as one group. Fortythree percent of small banks are located in metropolitan statistical areas (MSAs) and 57% are located in non-MSA areas. Since both types of small banks are important parts of the banking community, it is important to understand the differences in financial performance between the two sets of small banks.

Assuming that small banks and large banks use the same production frontier, we find that small banks are more profit efficient than large banks, which is consistent with Berger and Mester (1997). Small MSA banks are the least profit efficient of the three types of banks considered. Our results suggest that small bank PROFEFF is reduced by expense-preference (EP) behavior and increased by factors related to market structure and lender–borrower relationship–development (RD).

2. Literature review and hypotheses

At least five theories have been advanced to explain why small bank financial performance may differ from that of other banks. Empirical tests have found some support for most of these theories, but these tests have generally not been conducted using a PROFEFF framework. We do not attempt formal tests of the hypotheses, but we use these hypotheses to characterize our results and to interpret these results.

The oldest theory, the structure–performance (SP) hypothesis (e.g., Gilbert, 1984; Hannan, 1991a, b) suggests that, other things being equal, small banks in small communities can charge higher rates on loans and pay lower rates on deposits than other banks because there is less competition in small banking markets. This hypothesis is consistent with higher PROFEFF at small non-MSA banks.

The EP hypothesis (e.g., Arnould, 1985; Berger and Hannan, 1998; Hannan and Mavinga, 1980; Purroy and Salas, 2000; Rhoades, 1980) suggests that, ceteris pari-
دریافت فوری متن کامل مقاله

امکان دانلود نسخه تمام متن مقالات انگلیسی
امکان دانلود نسخه ترجمه شده مقالات
پذیرش سفارش ترجمه تخصصی
امکان جستجو در آرشیو جامعی از صدها موضوع و هزاران مقاله
امکان دانلود رایگان ۲ صفحه اول هر مقاله
امکان پرداخت اینترنتی با کلیه کارت های عضو شتاب
دانلود فوری مقاله پس از پرداخت آنلاین
پشتیبانی کامل خرید با بهره مندی از سیستم هوشمند رهگیری سفارشات