Discussion of “Are Bigger Banks Better? Firm-Level Evidence from Germany”
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The views expressed are those of the presenter and not necessarily those of the Bank of England, the MPC, the FPC or PRC.

Intro

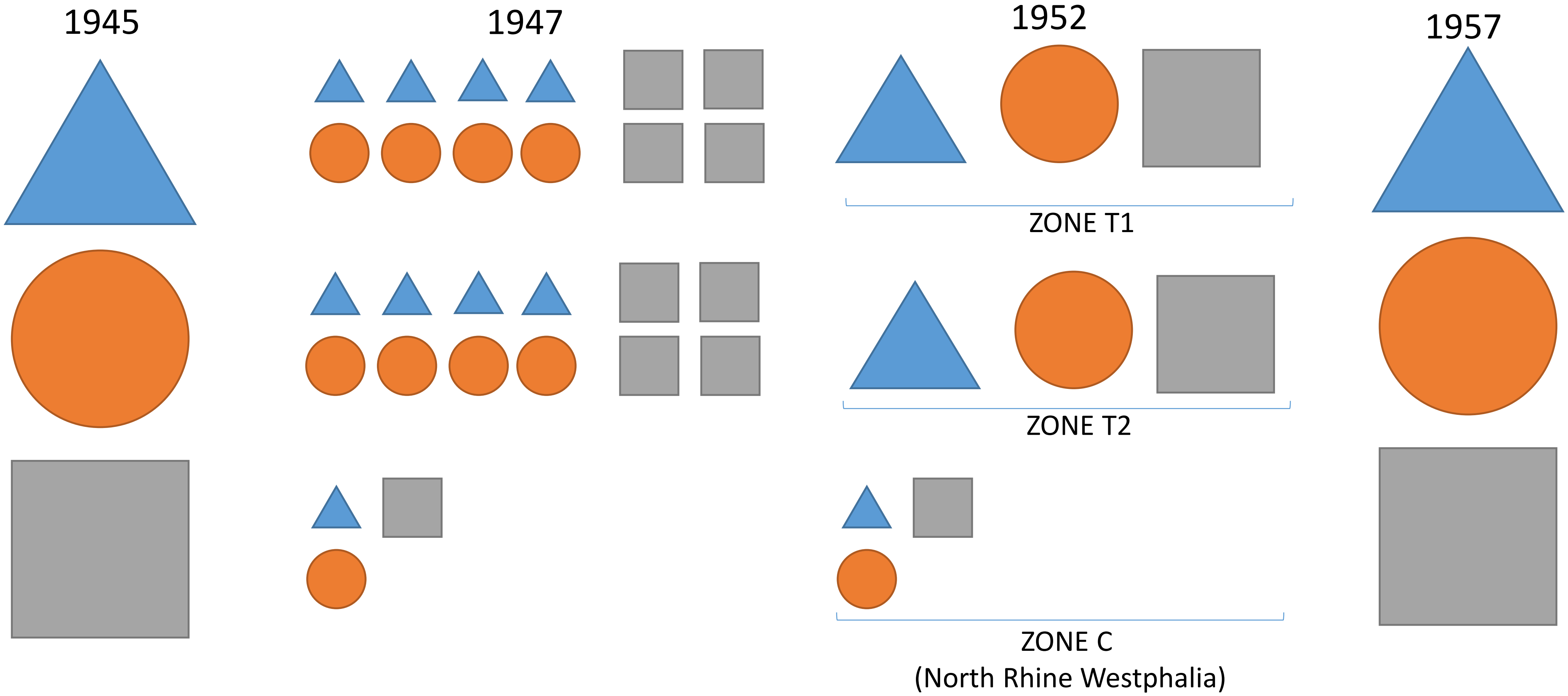
- Policy debate: should we break up big banks?
  - Moral Hazard/Financial Stability versus Efficiency.
  - Generally theoretically ambiguous.

- Existing empirical literature: cross sectional/mergers
  - Endogeneity problems.

- This paper:
  - shock to restraints on bank consolidations for geo-political reasons in post-war Germany.
  - unique historical firm level data.

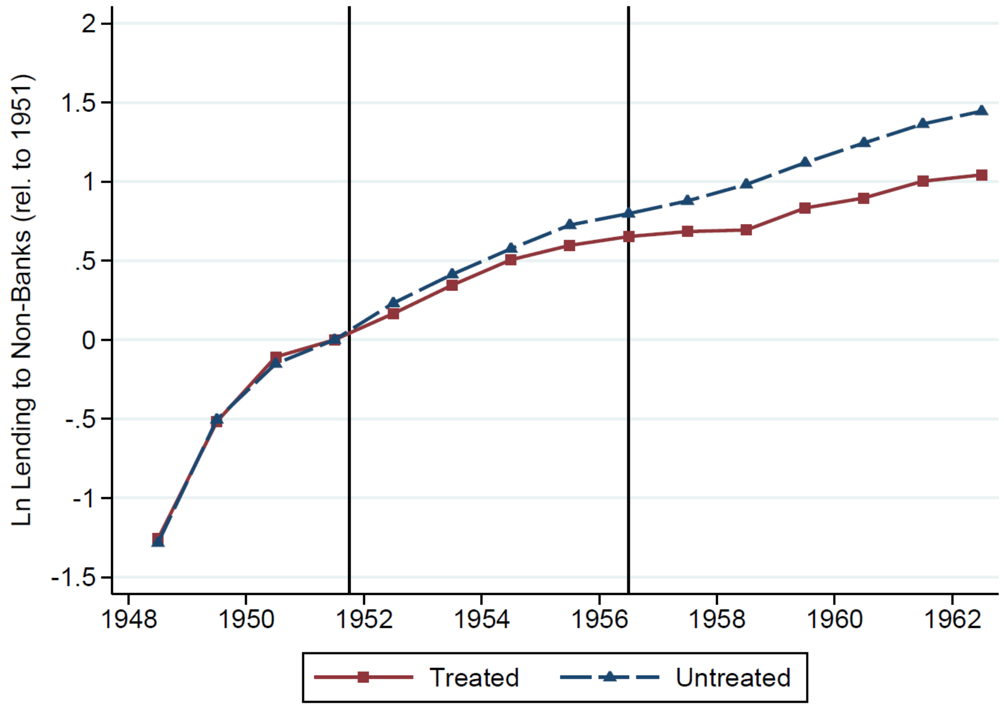
- Plan for discussion: (i) summary. (ii) remarks on the empirics. (iii) understanding the forces at work.

Building blocks of Post-war German Banking Reform

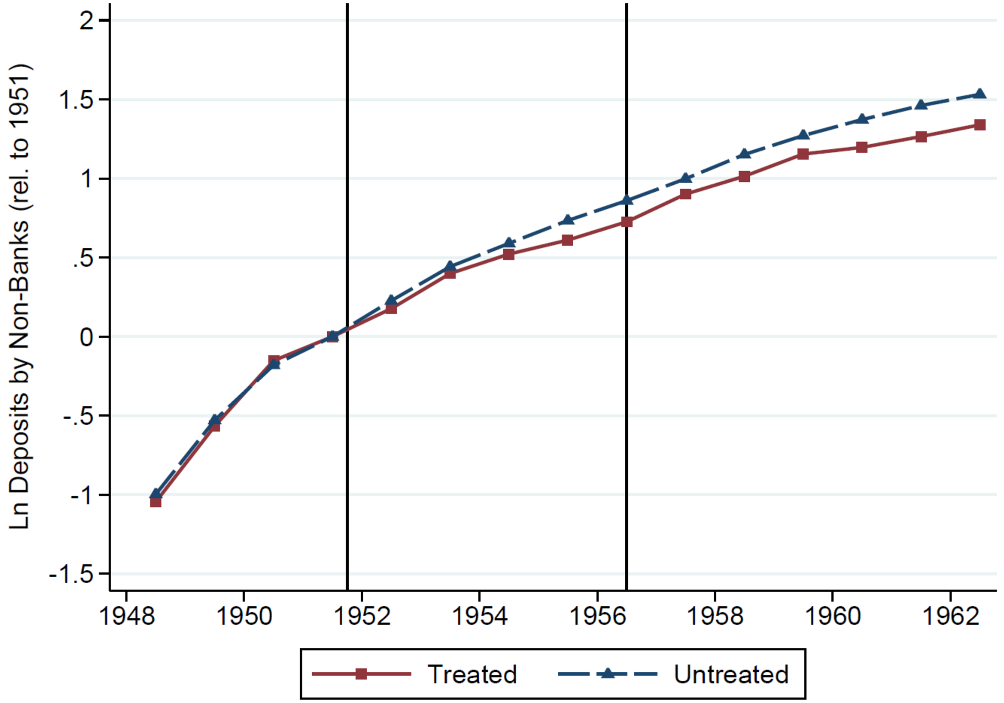

1945
1947
1952
1957
ZONE T1
ZONE T2
ZONE C
(North Rhine Westphalia)

Other (Commercial) Banks

A: Lending to non-banks



B: Deposits by non-banks



Zero/-ve effect on:

- treated firms
- treated municipalities.

Treated banks formed fewer relationships with:

- less to opaque firms
- more to risky firms.

Empirical set up

Parallel Trends

- Immediate post-war and economic miracle
- Break up in 1947
- Small commercial banks potentially different (and concentrated in particularly regions).

The “focused” sample goes a long way to deal with these issues.

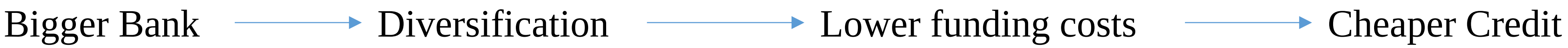
But effective sample size is:

- 3 control and 6 treatment (1952, focused)
- 9 control and 3 control (1957)
- Not fully convinced by your inference strategy to address this.
- Even so, error bands span estimates of economically significant +ve & -ve effects.

Diversification and Risk-Taking

Much of human history can be written in terms of the search for and production of safe assets.

-- *Gorton (2017)*



Bigger Bank → Diversification → Lower funding costs → Cheaper Credit

Takeaway from the paper: this mechanism is quantitatively weak.

Is there a particular reason why?

- Is there a cross holding structure within banking groups or some guarantees?
- What is the state’s role in providing insurance?
- Any info on funding costs?

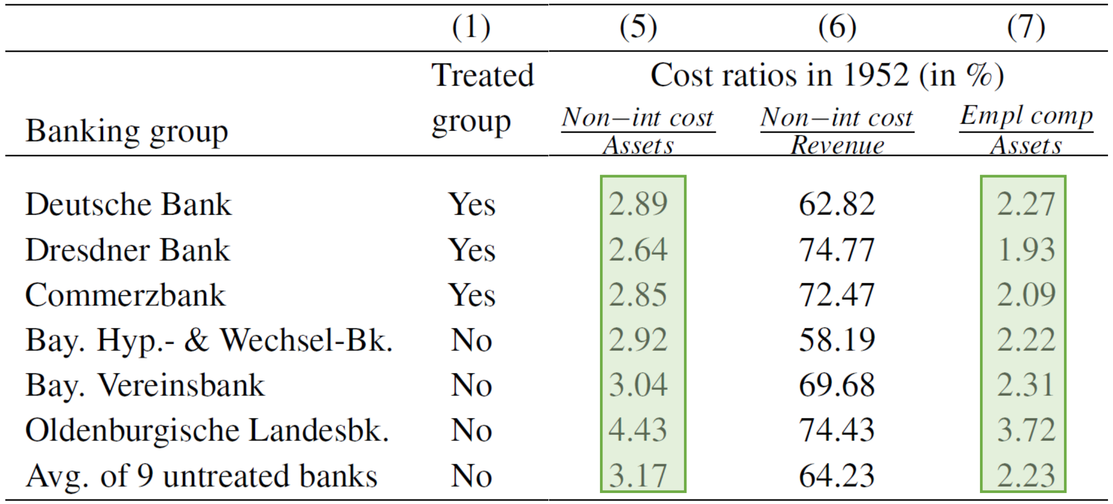
Also: Not obvious TBTF explains the results:

- Can lead to misallocation
- But also excessive credit provision.

Internal Capital Markets and Efficiency

Fall in cost of operations:

- No evidence in the data.
- But treated banks were more efficient to start with (would be nice to see ‘47 too).



	(1)	(5)	(6)	(7)
	Treated	Cost ratios in 1952 (in %)		
Banking group	group	$\frac{Non-int\ cost}{Assets}$	$\frac{Non-int\ cost}{Revenue}$	$\frac{Empl\ comp}{Assets}$
Deutsche Bank	Yes	2.89	62.82	2.27
Dresdner Bank	Yes	2.64	74.77	1.93
Commerzbank	Yes	2.85	72.47	2.09
Bay. Hyp.- & Wechsel-Bk.	No	2.92	58.19	2.22
Bay. Vereinsbank	No	3.04	69.68	2.31
Oldenburgische Landesbk.	No	4.43	74.43	3.72
Avg. of 9 untreated banks	No	3.17	64.23	2.23

Internal Capital Markets

- Idea: larger deposit base better at allocating capital.
- Great empirical exercise: firms in deficit regions don’t benefit.
- How do things look on a consolidated basis?
- Why are treated banks more successful at attracting deposits than growing lending?

Factors Pushing in the Other Direction

- Adjustment costs
  - Treated banks broken up and put back together again.
  - Efficiency costs => results on the cost base.
  - Smaller banks to gain market share. Would flip the setting on its head.
  - Not sure permanent effect rules this out.

- Competition
  - Reform was an increase in market power.
  - Not discussed much in the paper.
  - Response of stock and non-stock firms should rule this out.

Firms, Risk Taking and Opacity

- Big banks are less good at making loans:
  - Less efficient at processing soft information
  - Risk-taking incentives (TBTF or managerial).

- Paper shows:
  - Opaque firms suffered from reform (smaller, younger, less tangible)
  - Treated banks went towards risky firms (higher leveraged).

- Remarks:
  - Not convinced you can separate the two.
  - For risk taking: why not look at doubling down?
  - Does this survive more conservative clustering?
  - Why does the average bank not respond?

- Result: for a “creditworthy” borrower, having a big bank makes no difference.

Misc. Comments

- I didn’t find the model particularly helpful.
  - Identification problem is clear.
  - Didn’t elucidate on the only significant result on opacity.

- Some more discussion of external validity (relative to today) would be useful.

- Firm selection
  - Should we not expect more differences between stock and non-stock firms?
  - majority of firms are multi-banked, how about single banked firms?

In a nutshell: Important policy question, unique data and with an identification strategy at the frontier.