Small Banks and FinTech Lending

Comments

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  - **Shadow banks: 24% to 30%**
  - **Fintech lenders: 2% to 7%**
  - Small banks: stable share at 17%

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  - Small banks (<$10 Billion): stable share at 17%
- **Small banks reallocate mortgage lending**

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- Small banks’ reallocation ***shares***
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- Small banks’ reallocation ***levels***
  - **three** times as responsive as **shadow bank lenders**
  - **eight** times as responsive as **fintech lenders**

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- **Capital market incentives** for small bank lending

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“What Is Fueling the Fintech Lending Revolution?”

- Small banks have comparative advantages in relationship lending.
- Small banks are “disappearing.”
- **Large bank retreat** in small business lending
- As well as **declining numbers of small banks**
- May lead to **fintech opportunities**.

"What Is Fueling the Fintech Lending Revolution?"

- Consumer loans made by **Prosper** and identified as **small business loans**
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- **Small bank**: less than $2 billion in assets
- **Small bank share**: percent of county bank branches owned by a small bank (0.583)

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- Fintech loan volume is **negatively** related to the ***number of small bank branches*** and **positively** related to the ***number of large bank branches***.

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- Same findings for *small bank loan volume*

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- Fintech lending (Prosper) has grown faster where. . .
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- Are there capital market incentives at work?

Capital Market Incentives

- **Why are small banks disappearing?**

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- Is fintech lending competitive?

Why are small banks disappearing?

- Hughes, Jagtiani, Mester, and Moon, *Journal of Banking and Finance*, 2019
- Top-tier bank holding companies
- At year-end 2003, 2013, 2016

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- Accounting performance: **ROA** and **Best-Practice ROA** increase with bank asset size.

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Why are small banks disappearing?

- Accounting performance: ROA and Best-Practice ROA increase with bank asset size.
- ROA Shortfall, the difference between the Best-Practice ROA and observed ROA, is lower at large community banks than at small community banks.
- **Large community banks and midsize banks show better potential performance per unit of risk than small community banks**.

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- **Large community banks** are more efficient at achieving their **potential market value of assets** than **small community banks**.
- Compared to community banks, **midsize banks and larger banks are more efficient at achieving their potential market value**
- Thus, there appear to be **incentives for small banks to grow larger**.

Does the Capital Market Reward Small Business Lending?

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Does the Capital Market Reward Small Business Lending?

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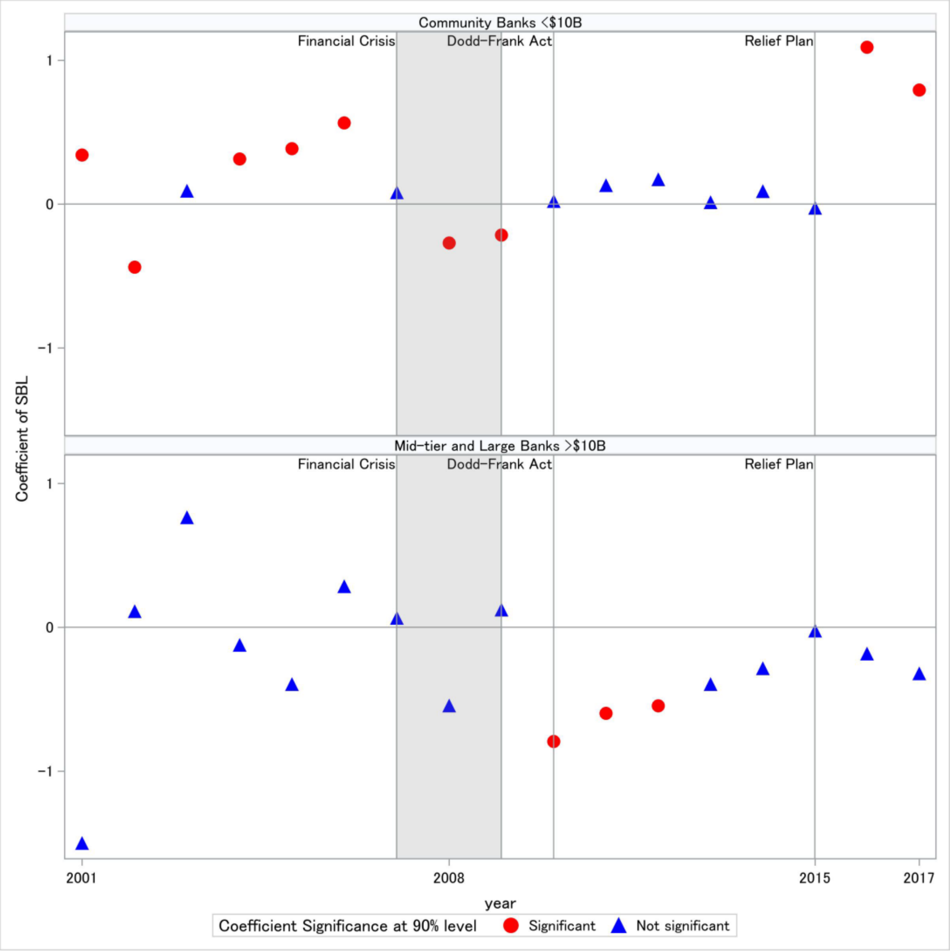
- Unlike small community banks, **large community banks** have financial incentives to increase **lending to small businesses**.
- Thus, concern that **small business lending** would be adversely affected if **small community banks** find it beneficial to **increase their scale** is not supported by our results.

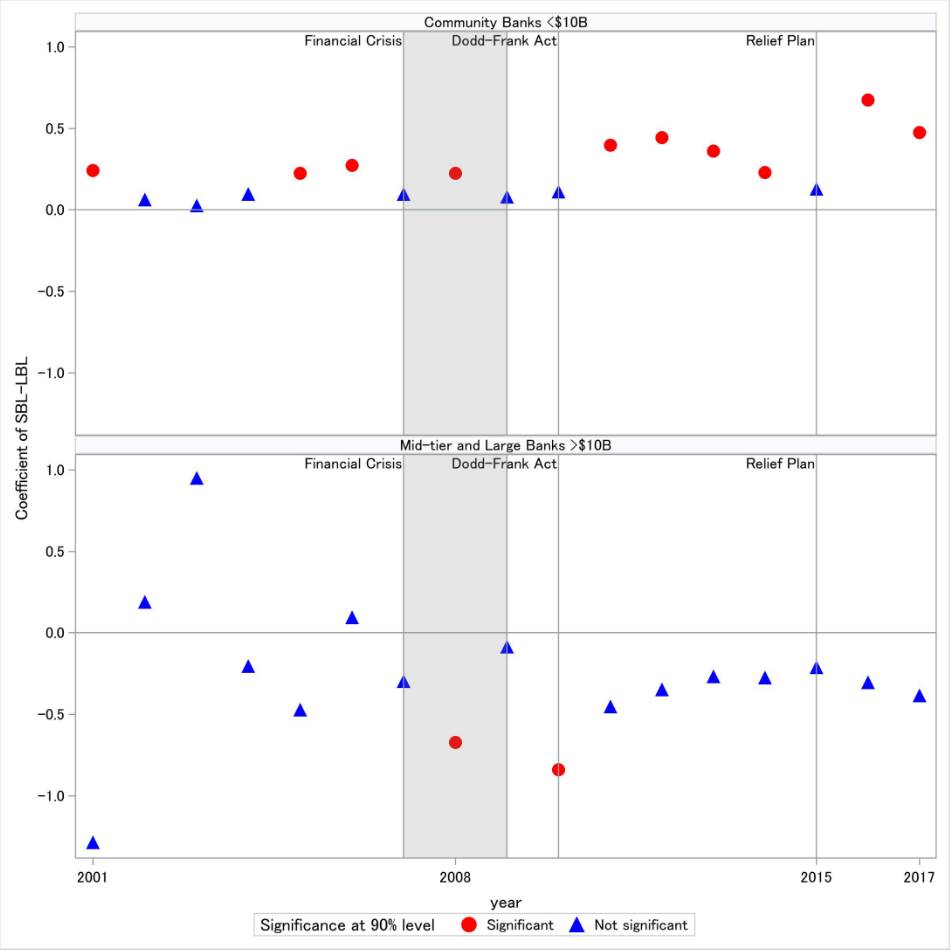
Does the Capital Market Reward Small Business Lending?

- Xuan (Sarah) Zou (2019)
- Top-tier bank holding companies
- 2001 – 2017
- Cross sectional and panel data

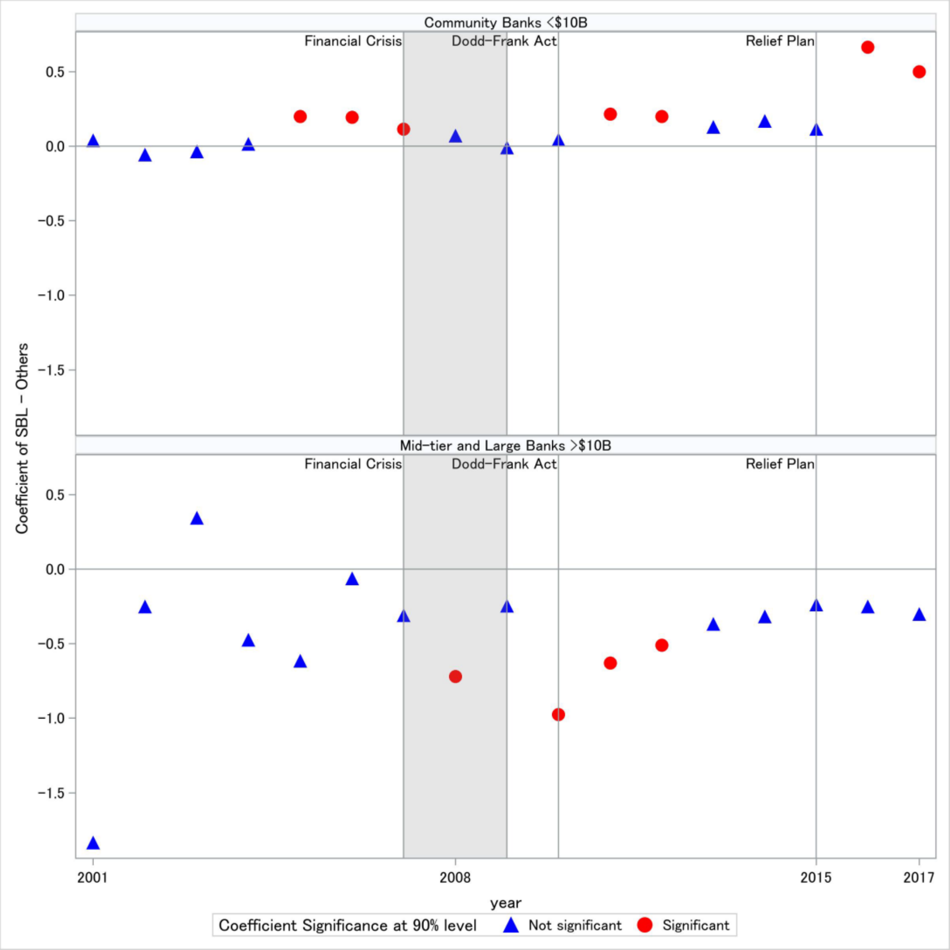
Tobin's *q* and SBL/Assets



Tobin's *q* and Substitution of SBL for LBL



Tobin's *q* and Substitution of SBL for Nonbusiness Loans



Is Fintech Lending Competitive?

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- Compare unsecured consumer lending by **commercial banks** and **LendingClub**
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- 2016 Median Nonperforming Loan Ratios by Volume of Unsecured Consumer Lending

	< 10 M	> 10 M < 100 M	> 100 M < 1 B	> 1 B < 10 B	> 10 B
All	0.0181	0.0215	0.0218	0.0420	0.0496
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Is Fintech Lending Competitive?

- How much of nonperformance is due to **lending to riskier borrowers** who default more often?
- How much is due to **inefficiency at assessing and managing credit risk**?

Is Fintech Lending Competitive?

- Use **stochastic frontier estimation** to decompose the nonperforming unsecured consumer loan ratio into
  - The **best-practice minimum ratio** that a lender could achieve if it were fully efficient at credit-risk evaluation and loan management
  - **inherent credit risk**
  - The portion due to less skill at assessing credit risk and managing loans
  - **lending performance inefficiency**

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  - **lending performance inefficiency** (difference between observed and minimum nonperformance)

Is Fintech Lending Competitive?

- Top-tier US bank holding companies
- LendingClub
- Year-end 2013 and 2016
- Stochastic frontier analysis to estimate minimum best-practice conditional on
  - scale of lending (lending technology)
  - economic conditions in a lender’s local markets
  - average contractual interest rate on consumer loans

Is Fintech Lending Competitive?

- LendingClub's NPL ratio resembles that of the large consumer lenders.

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Noise-Adjusted NPL Ratio	**0.0181**	**0.0215**	**0.0217**	**0.0420**	**0.0416**	**0.0496**
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- **What is the incentive to lend to small businesses at community banks?**
- **At large banks?**
- **Is fintech lending competitive with large banks? Community banks?**