Research Working Papers

Sectoral Loan Concentration and Bank Performance (2001-2014)

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Sectoral loan concentration can influence the size-profitability relationship for banks and the likelihood of bank survival. Switching specializations increases the hazard of failure but decreases the odds of being acquired.

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Sectoral loan concentration is an important factor in bank performance. We develop a measure of sectoral loan concentration and study how community bank performance and the size-performance relationship vary with loan concentration and changes in loan concentration. The size-profitability relationship varies with concentration in the residential real-estate (RRE) sector. Higher RRE concentration is associated with lower returns especially for larger community banks—banks with assets totaling a billion or more. Concentration in other sectors, such as agriculture and commercial real estate (CRE), is significantly associated with risk of bank failure or acquisition. Results for changes in concentration appear to be driven by the boom in CRE. Large positive (negative) changes in CRE concentration are both preceded and followed by large increases (decreases) in overall returns. Banks that switch specializations increase the hazard of failure but decrease the odds of being acquired.

JEL Classification: G21, G33, G34

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