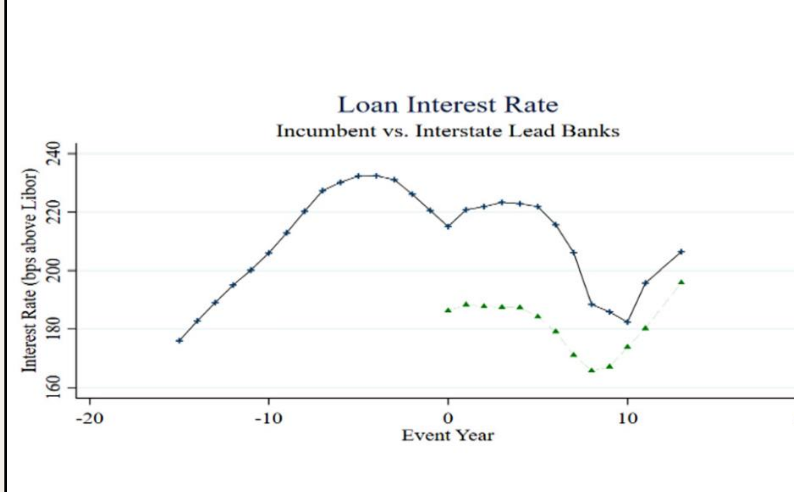
To Bank or Not to Bank… How Bank Entry Barriers Impact Firm Risk Taking

Does bank entry increase or decrease borrower risk-taking?

The study examines how the 1994 Riegle-Neal Act, which allowed banks to open branches in other states, influenced nonfinancial firms' risk-taking.

Large multistate firms borrowing from entrant banks received larger, cheaper loans (green triangles), and boosted capital investment while cutting R&D risk. Small firms that stayed with local banks (blue crosses) faced higher interest rates and increased risk.

FIGURE 1
In-State versus Out-of-State Banks



Entrant out-of-state banks could selectively target less risky borrowers because geographical diversification reduced their risk, increased client data collection (from branches across states), and cut costs (via internal settling by branches and better data analysis).

MAJOR TAKEAWAYS:

- Poor and outdated regulations can be very costly to customers
- Low interest rates can turn negative NPV investments into positive
- Average interest rates decreased because the new banks offered lower interest rates to large diversified borrowers exploiting economies of scale and scope and better information technology and data collection.

WHO NEEDS TO KNOW:

- Bank Regulators (Domestic and International)
- Bank Managers
- High Stakes Investors

CONTACT US:

- Sudipta Basu, professor of Accounting and Stanley Merves Chair
@sudipta.basu@temple.edu

- Bank Entry Barriers and Firms' Risk-Taking
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