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EUROPEAN CENTRAL BANK

EUROSYSTEM

Business models and bank performance: A long-term perspective

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*Any views expressed are those of the discussant and do not necessarily reflect those of the ECB.

Contribution

From an economic / policy perspective

- Provides a new look at bank business models by applying rigorous econometrics and factor analysis techniques to an interesting data set (500 banks, 30 European countries, 1998-2013).

From a technical / modelling perspective

- Unified evaluation of existing business model classification methods.
- Factor analysis on business model variables: identifies 2 latent lower-dimensional strategies, generating continuous common factors.
- Random effects estimator on panel data (performance as function of bank characteristics). “Between” parameters capture long-run, business model/strategy. “Within” parameters capture short-term, bank-specific parameters.

Main Findings

Economic findings

- Highlights limitations of defining business models as discrete clusters. business models better described as a continuum of strategies.
- Diversification increases profitability but also susceptibility to distress.
- Business models matter a lot for banks' risk-return profiles
  - "Retail"-oriented banks have higher profitability and stability.
- Effects of business model are markedly different for different bank types.

Policy-related findings

- Regulators and supervisors should also consider business models (in addition to liquidity and minimum capital requirements).
- Lends support to Basel III additional capital buffers for systemically important banks.
  - Capital ratios more performance impact for larger, wholesale funded, high LR

General remarks

- Very relevant and timely topic from policy-making perspective
  - Good example of technique at the service of providing practical understanding
- Good application of well-known econometrics technique to gain new depth and angles on this particular topic
- Choice of business model variables:
  - Why use only observed financial ratios and ignore quantities and ratios related to distribution channels, types of clients and products, branches and employees, etc?
  - Sensitivity to choice of variables?
- Naming/interpretation of top 2 factors identified could be better justified, especially “RETAIL” one (“negatively related to size” – but there exist very large retail banks).
  - Why just use top 2 vs top 3 eigenvalues? Does this choice change much?
- Should revisit how the conclusions found compare to existing literature, e.g. role of diversification, different effects for different types of banks

Technical Remarks

- The paper has a clear focus and is well written.
- Use of multidimensional scaling method to compare existing business model classification methods: beware of over-simplifying when interpreting projection from 7 to 2 dimensions.
- Z-score definition different from standard one and maybe problematic
- Assumption: strategy as a long-term notion. Is it changing after the crisis? If yes, what does long-term mean? Could do robustness checks using the time dimension (given time window includes crisis).
- Calculation of NSFR from historical data not straightforward – please explain in more detail how achieved.
- Good point about observing banks at the level at which business model decisions are taken - but could do sensitivity checks of treatment of foreign vs. home subsidiaries.
- Good that robustness analysis sheds light on areas where questions had naturally arisen. Country-year fixed effects could be better justified. Robustness check?

Policy Issues

- Motivations of paper…
  - Seemingly successful business models proved fragile in the crisis (EG ??)
  - Regulation is causing business models to change, and the implications of those changes for profitability should be analysed.

  … could be re-visited after the analysis - how have they been addressed? What are the implications?

- Policy recommendation (regulators and supervisors to pay more attention to bank business model analysis) could be discussed, e.g. :
  - What is already being done in this respect? SREP mentioned but very briefly.
  - Comment further on conclusion that "large size is more stable in the long run but maybe at high societal cost" (section 4.2.1).
  - How should business models be taken into account? Difficulties? Consequences?