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Do Small Banks have an Advantage in Lending? An Examination of Risk-Adjusted Yields on Business Loans at Large and Small Banks

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Abstract

Consolidation in the banking industry has sparked concern about the survival of small banks, particularly as it relates to the availability of credit to small businesses. However, if small banks have an advantage in processing credit information, compared to large banks, they should continue to survive in a competitive environment. We evaluate risk-adjusted commercial loan yields (gross yields less net charge-offs and the risk-free rate of return) at small and large banks for the period of 1996 through 2001. Our primary finding is that, after controlling for market concentration, cost of funds, and a variety of other factors that might influence yields, smaller banks earn greater risk-adjusted yields than

larger banks. This result suggests that small banks make better choices from the available small business loans and is consistent with the notion that these banks have an information advantage in evaluating credit.

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