SPECIALIZATION IN BANKING

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Discussion by **Diana Bonfim**

ECB Annual Research Conference 2024

CONGRATULATIONS!

SUMMARY OF THE PAPER (OR EULOGY)

What do we know about specialization in banking?

A lot more, after we read this impressive effort to document, characterize and understand bank specialization in the US.

In a nutshell: banks specialize disproportionally in a few industries and this matters.

SUMMARY OF THE PAPER

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- Specialization seems to yield **lower returns** (especially in tranquil periods).
- Banks prefer to support sectors on which they are specialized in **distress periods**.

SOME THOUGHTS

01

SPECIALIZATION AND COMPETITION

02

SPECIALIZATION AND EVERGREENING

03

THE MANY DIMENSIONS OF BANK SPECIALIZATION

04

POLICY IMPLICATIONS

1. SPECIALIZATION AND COMPETITION

Are the firms operating in the same industry **competing with each other**?

The incentives of banks are different depending on this:

- if firms are not competing directly, specializing to explore existing knowledge makes sense.

- but if firms are competing with each other, banks may want to **protect** existing borrowers, thereby not lending to their competitors (Degryse et al., 2023).

Can we disentangle the two?

1. SPECIALIZATION AND COMPETITION

Do banks sometimes specialize in the same industries and **compete directly**?

Or do they stay in their own territory?

Can this allow to better understand the role of **market power** vs. **better screening coming from specialization**?

2. SPECIALIZATION AND EVERGREENING

Specialized banks focus on attracting **high-quality borrowers**. Low risk and, consequently, low profitability (at least in low aggregate risk periods).

But can something be hidden here?

Can in some cases the lower ex-post defaults and charge-offs reflect banks' **incentives to evergreen**, avoiding to record losses in industries on which they are more specialized?
Or are they **less likely to engage in zombie lending** to avoid the negative spillovers on healthy borrowers (De Jonghe et al., 2024)?

3. THE MANY DIMENSIONS OF BANK SPECIALIZATION

Where does specialization come from? Do firms select banks or banks select borrowers?

Is it possible to distinguish strategic specialization from “random” (e.g., based on geography)?

How stable is specialization?

In the appendices there is some evidence on some of these questions.

3. THE MANY DIMENSIONS OF BANK SPECIALIZATION

Can this be the starting point for future research?

.- specialization and innovation (De Jonghe et al., 2024)

- specialization and start-ups (Bonfim et al., 2024)

- specialization and global supply chains (Alfaro et al., 2024)

- specialization and control rights (Giometti et al., 2024)

- more ideas: Schnabl et al., 2024, JF 2023 Brattle Group Prize in Corporate Finance

4. POLICY IMPLICATIONS

What are the policy implications of the paper?

Should bank specialization be encouraged?

- Should the large exposures regime be revised?
- Can sectoral capital buffers be especially detrimental for some banks?

What about contagion and systemic risk?

SUMMING UP

This is a paper which will have a long life, given the many important facts documented.

“Mandatory reading”

Leads to many other questions and will certainly inspire new research.

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