Benefits of Bank Diversification: The Evidence from Shareholder Returns: Discussion
Author(s): Stephen J. Brown
Source: *The Journal of Finance*, Vol. 39, No. 3, Papers and Proceedings, Forty-Second Annual Meeting, American Finance Association, San Francisco, CA, December 28-30, 1983 (Jul., 1984), pp. 893-894
Published by: Blackwell Publishing for the American Finance Association
Stable URL: http://www.jstor.org/stable/2327953
Accessed: 27/11/2009 07:47

DISCUSSION

STEPHEN J. BROWN*: Eisenbeis, Harris and Lakonishok (EHL) have used the event study methodology to examine the nature and extent of economies of scope[1] in the banking industry. The exploitation of such economies was limited by the Bank Holding Company Act of 1956; the study examines the impact on shareholder wealth of the adoption of a particular organizational form: the one bank holding company (OBHC) designed to circumvent the restrictions imposed by the Act.

This is important and interesting work, and has significant contributions to make at a number of levels. I am not aware of any study which has addressed the contestability of the banking markets. EHL appear to believe that adoption of the OBHC form is evidence of market imperfections in the banking industry. In point of fact, Baumol, Panzar and Willig (1), p. 248 show that economies of scope are necessary for the existence of multiproduct *competitive* firms. If the banking markets are contestable and the authors are correct in identifying the magnitude of scope economies, then the retrictions of the Bank Holding Company Act of 1956 may impose severe social costs.

At another level, the paper is a model of what an event study should be. They have observed the important caveats of Brown and Warner (2). By being very precise about the timing of events, they are able to observe effects missed by others. I am particularly pleased with the care EHL took in selecting an appropriate index. The perils of blind application of control portfolio procedures are well known (see Brown and Warner (2), p. 238). In contrast, EHL conduct a very careful data analysis to show the extent to which the particular control portfolios they use control for everything but the event in question. By use of such careful analysis EHL are able to make a substantial contribution to the literature in this area. Not only are they able to show a positive impact of Citicorp's adoption of the OBHC form on the wealth of its stockholders, but also this announcement had a positive impact on other OBHC candidates. EHL are able to show the incremental values of branching.

There is a potential problem here. The event study methodology assumes that the "events" are exogenously given. In this case, Citicorp's decision would clearly have been strategic: the timing of the announcement was a choice variable of Citicorp. The announcement effect is thus an upper bound on a measure of scope economies. Furthermore, the decision to change to a OBHC form was not independent of Citicorp's successful decision. EHL rightly point out that the positive spillover effects of Citicorp's announcement on other OBHC candidates and the weak effect of subsequent announcements is consistent with the view that the capital markets correctly anticipated the decisions of those who followed Citicorp. While I agree with EHL's analysis on this point, it does suggest some

* Bell Communications Research Inc., currently visiting Yale University.

[1] Economies of scope measure the decrease in cost resulting from the combination of separate activities into one firm (see Panzar and Willig (3) and Baumol, Panzar and Willig (1), pp. 71 ff.). The term "diversification" used by EHL is an unhappy locution: it implies the misleading impression that the OBHC form of organization solely reduces uncertainty.

limitations of the event study methodology in this strategic context.

Nevertheless, the "spillover" finding is interesting in and of itself. Presumably the capital markets did not perceive Citicorp's decision as precluding other companies from doing the same thing. This is at least (very) weak evidence of the contestability of banking markets.

In conclusion, I found this a valuable and stimulating paper. It is an important starting point for further analysis of the organization of the banking markets.

REFERENCES

1. W. Baumol, J. Panzar and R. Willig, *Contestable Markets and the Theory of Industry Structure*, New York: Harcourt Brace Jovanovich, 1982.
2. S. Brown and J. Warner, "Measuring Security Price Performance," *Journal of Financial Economics*, 8 (1980), pp. 205–258.
3. J. Panzar and R. Willig, "Economies of Scope," *American Economic Review*, 71 (May 1981), pp. 268–272.