

Acquiring Failed Banks*

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JOB MARKET PAPER

November 14, 2017

Abstract

Banks create value by issuing deposits and making loans, yet little is known about the relative importance of these two functions. I study this question in the setting of failed bank auctions. This allows me to obtain causal estimates by comparing outcomes for the winning bank to those of the second highest bidder. Consistent with a positive value effect from the acquisition, the winning bank experiences a large positive abnormal return upon announcement of the auction result. I show that this increased value is mainly due to deposits, not loans. After the acquisition, the winning bank sharply cuts lending to the failed bank's borrowers, including those who were not responsible for the bank's failure. However, the winning bank retains almost all of the failed bank's deposits, despite shutting down some of its branches. It does not channel these deposits into lending in other areas, indicating that the value of deposits is separate from their role in financing loans. Rather, the winning bank lowers deposit rates, including in markets where the failed bank was not present. This suggests that the value to the winning bank is partly due to increased market power over deposits. Overall, my results show that the deposit franchise is the main source of value in these acquisitions, and hence likely a principal source of bank value more broadly.

Keywords: Bank failure; acquisitions; bank regulation; competition

JEL Codes: G18, G21, G34

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*I am grateful to my advisors Philipp Schnabl, Viral Acharya, Alexi Savov, and David Yermack for their guidance and support. I would also like to thank Manasa Gopal, Kose John, Andres Liberman, Anthony Lynch, Holger Mueller, Fahad Saleh, Tony Saunders, Kate Waldock, Larry White, Robert Whitelaw and seminar participants at NYU Stern for helpful comments. All errors are my own.

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