Discussion

Christian Calmès

Kevin Stiroh's paper focuses on the impact of non-traditional activities on the performance of U.S. bank holding companies. The author finds two counteracting effects at work. First, an indirect effect stems from diversification. Second, and more importantly, there is a direct effect on bank performance. This effect comes from the negative impact of the volatility of non-interest income, and it is significant throughout all experiments, regardless of the mode of analysis. Hence, a significant exposure effect appears to exist. Exposure works in a straightforward manner: increases in non-interest income are associated with declines in risk-adjusted returns. I believe that the author's treatment of this aspect is the paper's main contribution.

I believe that this type of modelling is appropriate for the question at hand. I have a few concerns, however. First, while I understand the complexity of the paper's focus, I would like to examine the endogeneity of the variables. Equation (5) displays a specification that helps to control for the fixed effects at the firm level. This partly alleviates the problem, along with the use of past non-interest income share, but further investigation would certainly be useful.

Second, how do we talk about diversification benefits here? I will return to equation (5). When one uses the model specified, the diversification variable is not significant, so, in a sense, the title may be somewhat misleading, a priori. The subject is diversification, and yet, through the analysis, the diversification's effect apparently vanishes. Nevertheless, I understand that the paper raises the question of diversification to lead the reader through the study. In fact, one can conclude that the only obvious impact of

diversification is found primarily looking across bank holding companies over time, and not within bank holding companies over time. This suggests a very specific type of diversification, one occurring across financial companies.

A third point relates to the fact that net interest income and non-interest income are different by nature. Some might consider the former as being related to stocks and idiosyncratic shocks, whereas the second would be related more to flows and aggregate shocks. Therefore, again, I think the author considers diversification in a very specific manner.

My final concern touches on the collinearity of diversification and the share of non-interest income. The diversification variable is constructed over two series: the non-interest income and the net interest income series (see equation (2)). As Stiroh mentions, the diversification variable, the share of non-interest income, and net interest income are related, though not linearly. Hence, further investigation and robustness checks might be helpful.

The paper's most intriguing implication concerns why bank holding companies are moving into these activities, despite the fact that this shift would seem to impair their risk-adjusted performance. It appears to be sub-optimal decision making. While this question is not the focus of the paper, the author still ventures to propose explanations for this counterintuitive phenomenon. One plausible candidate is of a static nature, while the other corresponds more to a dynamic vision of this inconsistency. I am drawn to this second type of explanation. Intuitively, the larger bank holding companies might have had time to reach optimal diversification. Hence, time and maturation might help explain the situation. Furthermore, competitive forces may have eliminated profits. Perfect competition may be a myth, since competition is generally imperfect. Competition, however, is probably a significant factor. Therefore, I am inclined to think that the time to build argument (and the related adjustment-cost argument) merit closer scrutiny.

Indeed, the speed of adjustment might be overstated. We usually think that adjustment costs play an important role, but the adjustment itself might be very slow—slower than we think (see Caballero and Engel 2003). Canadian data suggest that the covariance between non-interest income and interest income has decreased over time. This might suggest that there is some sort of integration of the two activities, and a maturation process on the way. Unfortunately, however, this does not appear to be the case in the United States. The difference between Canada and the United States could be that

the regulatory shocks are not perfectly synchronized. Whatever the case, this discrepancy should be examined.

Reference

Caballero, R.J. and E. Engel. 2003. "Adjustment Is Much Slower Than You Think." National Bureau of Economic Research Working Paper No. 9898.