

# **EVIDENCE OF SELF SELECTION IN BANKING AND THE IMPACT ON BANK PERFORMANCE**

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This study examines the racial characteristics of employees and customers in “similar” minority owned and nonminority owned banks to determine the existence and extent of self selection in banking and its impact on the performance of banks. The examination of self-selection is in two distinct area, racial characteristics of employees and customers, and racial characteristics of loan applicants. The same group of banks are then analyzed to determine the impact on financial performance.

An important aspect of this study is the comparison of results from minority owned and nonminority owned institutions operating in similar demographic locations. Institutions were paired on the basis of census tract data, age, asset size, and charter type ensuring that compared institutions operated in similar environments.

The overall findings of this study include the following. First, minority owned banks hire minorities more frequently than nonminority owned banks while nonminority owned banks hire nonminorities more frequently than minority owned banks. Overall, minority owned banks hire minorities of the same race as the owners in the same proportion as nonminority owned banks hire nonminority employees. This result holds for executive positions, Tier Two employees, and total employees. In addition, the racial makeup of the customer base closely corresponds to that of the employee base for both minority and nonminority owned banks.

Second, characteristics of loan applicants and their loan request are very similar, with the exception of the race or national origin of the applicant. Even with the pairing technique, minority owned banks have a significantly higher percent of minority applicants and nonminority owned banks have a significantly higher percent of nonminority applicants. The degree of self selection, as defined by the proportion of applicants of the same race as the ownership, was remarkably similar.

Finally, performance measures, including liability and capital management, asset quality, and management efficiency of minority owned and nonminority owned banks are not significantly different. Although self selection exists, it does not significantly alter bank performance.