

Letter

Letter: Local lenders could help US banks' discrimination problem

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The first article in the FT's series on "race and finance" in the US provides anecdotal evidence that banks may be missing profit opportunities in lending to small businesses in minority neighbourhoods ([The Big Read](#), December 14). I wish to put forth one possible explanation for this.

Over the past several decades the US banking sector has experienced a massive increase in concentration. Since 1984 the number of banks has decreased by 70 per cent. The consolidation has been accompanied by an attrition of local, neighbourhood-based lenders. It is understandable that a large institution will use analytics, which can be centrally created and managed, to evaluate credit risk. Lenders in those banks earn bonuses for issuing loans that meet the data-driven standards. They are usually insulated from any losses, so it doesn't make sense to empower them to use non-quantifiable factors — what we recognise as judgment — in making loans.

However, as Friedrich Hayek, the Austrian-British economist, pointed out “special knowledge of circumstances” cannot easily be quantified. A good example of this is the grit of Adenah Bayoh, the entrepreneur featured in the article. A smaller, local lender is more likely to take that quality into account. The reason is that top management and key shareholders are closer to lending decisions — because there are fewer loans and they are familiar with the local area.

Moreover, if the management of one bank discriminates against certain groups — either from misjudgement or prejudice — it will create a profitable lending opportunity for a competing local bank.

A takeaway is to examine the reasons for the demise of local banks and propose changes — in regulation and maybe other areas — that will enable them to operate profitably. A system that can make small loans to small entrepreneurs not only helps the borrowers, but also promotes a more efficient allocation of resources in the economy.

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