# Regulatory Protectionism and Learning in the U.S. Commercial Banking Industry:
# An Exploration of Survival-Enhancing Learning in New Banks

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## Abstract

This research focuses on environmental impediments to organizational learning. Specifically, I examine how one particular type of mechanism, government mandated regulations, can disable and impede organizational learning. I use data from approximately 2000 newly chartered U.S. commercial banks over a 15-year period to assess the impact of temporary protective bank regulations on organizational learning using the survival-enhancing learning construct. I argue that protective regulations may enhance a bank's life chances early on, but hinder its life chances in the long run by impairing its ability to learn effectively during the period of protection. Thus, I posit that when regulations are eased, banks that were initially subject to the most stringent regulations (most protected) will fail at a higher rate than those initially subjected to lower levels of regulation (least protected).

I conduct this research in the setting of newly chartered U.S. commercial banks. This context provides two important features that make this an ideal setting to study impact of regulatory protectionism on survival-enhancing learning. First, there is variation in the regulatory environment depending on the charter class of the bank. Second, there are clear time periods of both protection and non-protection. Thus, one can observe a bank's fate in both the protected regulation period and the unprotected post-regulation period.

I rely on multiple types and sources of data for this research. Archival data sources are used to measure bank performance variables (loans, capital, income etc.). In addition, I draw on archival sources such federal policy letters, policy statements and the Code of Federal

Regulations (CFR) to establish the context of the bank regulatory environment during the time period of this study. Moreover, I also conduct qualitative interviews with all of the major stakeholders in bank regulation. This includes all three U.S. federal bank supervisory agencies (The Federal Reserve Board, Office of the Comptroller of the Currency (OCC) and The Federal Deposit Insurance Corporation (FDIC)), state-level bank supervisory agencies, bank trade and lobbying associations, bank consultants, established bank CEOs and newly chartered bank CEOs. All of these different perspectives, as well as my own prior work experience as a bank executive, help to ground both the theory and the measures in this research.

Consistent with prior work in this area, I use the survival-enhancing learning construct (Baum & Ingram, 1998). Survival-enhancing learning is a form of organizational learning that serves to lower the risk of failure (Baum & Ingram, 1998). Thus, the research mode here is one of observing a learning outcome, failure, rather than directly examining a learning process. Hence, the primary dependent variable in this study is organizational failure. I employ event history analysis to determine the unobserved hazard rate of bank failure—the probability of bank failure at any given point in time, given that a bank has survived up until that time.

This research has important implications for both theory and practice. First, it highlights a general tension in learning processes. On one hand, if competition is too intense, fledgling firms may meet their demise long before survival-enhancing learning lessons take hold. Thus, some level of protection is both warranted and desirable. On the other hand, if too much protection is granted, then firms may unknowingly forfeit the acquisition of valuable experience (e.g., cause and effect relationships between actions and outcomes), which in turn, may hinder the development of their capabilities.

Second, this research underscores the potential for unintended outcomes in higher-level learning scenarios. When a government agency, or some other entity, attempts to encode "lessons learned" from previous episodes (e.g., the U. S. Savings and Loan debacle of the 1980s) into norms, rules and regulations, this can sometimes backfire and lead to unanticipated and sometimes undesirable outcomes (e.g., organizational decline). Finally, this work emphasizes the difficult conundrum that managers and policy makers face. While there is a strong desire to cultivate a supportive environment where young firms can flourish, at the same time, this must be balanced against the prospect of disrupting valuable learning processes that can occur under

less benign environmental conditions.  While some degree of protective assistance is clearly necessary, the crucial question becomes, “How much is too much?”