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Abstract

This paper provides the first econometric analysis of problem banks in Germany. Drawing on an original dataset of distressed co-operative and savings banks, we develop early warning indicators for banking difficulties using a parametric approach. Taking the idiosyncratic characteristics of the German banking sector into account and controlling for microeconomic variables, we evaluate as to whether bank type and location matter. Findings indicate that banks in West Germany are less risky than credit institutions in the Neue Länder and that co-operatives are more prone to experience financial difficulties than savings banks. We conclude that a model that combines both savings and co-operative banks is sufficient to identify problem institutions up to three years prior to the surfacing of distress.