Taking No Chances: Lender Monitoring and Corporate Acquisitions

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December 2020
Motivation

- Relative lack of empirical evidence on lender monitoring despite an extensive theoretical discussion (Shleifer and Vishny, 1997; Nini et al., 2012)
- Existing empirical studies on creditor governance focus on the loan covenant setting (Nini et al., 2009, 2012; Denis and Wang, 2014; Ferreira et al., 2018)
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- Existing empirical studies on creditor governance focus on the loan covenant setting (Nini et al., 2009, 2012; Denis and Wang, 2014; Ferreira et al., 2018)
- Beyond contractual provisions, lenders monitor regularly to stay informed and make efficient resolution decisions (e.g. Diamond, 1984, 1991; Fama, 1985; Rajan and Winton, 1995)
- Evidence of active non-covenant-based monitoring (Gustafson et al., 2020) - borrower meetings, site visits, demanding information on a monthly, even daily basis
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- Evidence of active **non-covenant-based monitoring** (Gustafson et al., 2020) - borrower meetings, site visits, demanding information on a monthly, even daily basis
- Strong positive association with lead lender’s ”skin in the game”
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Does lender monitoring only serve as information acquisition, or does it also have real effects on firm behavior?
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- Difference-in-difference design based on lender mergers (Chu, 2019) - banks are unlikely to merge based on factors related to a few particular firms.
- Bank mergers are mainly driven by regulatory changes, development in information technology, business strategy reasons such as market penetration (Harford, 2005; Jayaraman et al., 2002).
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- Lender merger ↑ skin in the game → increased incentive to monitor (Sufi, 2007; Ivashina, 2009)
- A more concentrated loan stake ↓ coordination problem with other lenders → ↑ bargaining power when renegotiating with the manager (Chu, 2019)
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- Enhanced lender monitoring disciplines managers from taking risky actions.
Bank-specific borrower selection standards

Market power to command higher loan pricing after merger, economies of scale, etc.
Treatment Effect on Public Takeover Activities

- The effect is solely driven by lender mergers involving a lead lender.
- The effect is stronger for firms that are less subject to bank scrutiny and more prone to risk-taking.
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- Deals that do happen target firms with more cash holdings, and lower cash flow volatility.
- Deals that do happen on average create no additional shareholder value.
Exogenous increases in lead lender “skin in the game” reduce borrowers’ public takeover activities.

Cross-sectional results suggest that this link is associated with intensified lender monitoring over managerial discretion.

Managers are more likely to play it safe amid intensified lender monitoring, leading to over-conservative firm policies that are mainly appealing to creditors, but can forgo good growth opportunities for shareholders.