Abstract

This paper studies how bank ownership of industrial firms affects their markups. We find that bank ownership increases firms’ markups, while bank ownership of industry rivals reduces firms’ markups. Using bank mergers that generate exogenous shocks to bank ownership of industry rivals, we employ a difference-in-differences analysis to establish causality inference. For the affected firms, their costs of loans increase, and the adverse effect on markups is stronger for competitive industries, R&D intensive firms, and when banks have more proprietary information of firms. Our mechanism analysis shows that banks utilize their financing and information advantage to realize their impact.

A fact of bank ownership

Debates: how banks shape competition

❖ Cestone and White (03’, JF); Cetorelli (04’, JMCB); Cetorelli and Strahan (06’, JF)

Recently, two papers reawaken this questions:
❖ Common lender could raise anti-competitive concerns
  Saïdi and Streitz (21’, RFS); De Franco et al. (20’, MS)
❖ Common ownership induces less aggressive competition
  Azar et al. (18’, JF; 21’ FM); Xie and Gerakos (20’, AEAPP); Gutiérrez and Philippon (18’, AEAPP); Anton et al. (21’), etc.

OLS analysis

“Bank-firm connection”

“The merging bank has lending relationship with firm A and B

Identification + DID analysis

“Bank-rival connection”

The merging institutional investor hold block shares of R^4

Mergers between lenders of affected firms and institutional shareholders of industry rivals

Does banks’ incentives matter?

Conjecture 1. As the value of a bank’s stock investment in the industry rivals increases, it has a higher incentive to support the industry rivals

Conjecture 2. If a bank pursues long-term profits in the stock market, it has a higher incentive to support the industry rivals.

Findings
❖ The adverse effect on market power is stronger if a bank’s investment share in the rival (measured by the value of the bank’s holding of rivals divided by the value of its total stock investment) is above the median.
❖ The adverse effect on market power is stronger if the bank is a dedicated investor (Bushee (98’, 01’)).

Two underlying mechanisms

“Financing channel”
Banks may charge higher loan spreads, reduce loan amount, and requires more collateral; thus, reducing firms’ competitive advantage in financing.

“Information channel”
Banks may intentionally or unintentionally leak firms’ proprietary information to those rivals that held by banks, thus reducing firms’ competitive advantage in information.

Takeaways

Literature of institutions and competition
• Bank and competition: Cestone and White (03’); Cetorelli (04’); Cetorelli and Strahan (06’)
• Common lender: Saïdi and Streitz (21’); De Franco et al (20’)
• Common ownership: Azar et al. (18’, 21’); Gutiérrez and Philippon (18’); Anton et al. (21’), etc.

Literature of bank ownership
Firms’ performance and valuation (e.g., Gorton and Schmid (00’, JFE); Morck et al. (00’ JB))
Debt capacity (Santos and Rumble (06’); Santos and Wilson (17’))

Literature of information leakage in financial conglomerates
Acharya and Johnson (07’); Massa and Rehman (08’); Ishidaya and Sun (11’); Chen and Martin (11’) Bhattacharya and Chiesa (95’); Asker and Ljungqvist (10’); De Franco et al. (20’)

Conclusion

This study explores how bank ownership shapes the competitive strength of firms. Bank ownership of firms could enhance firms’ market power. In contrast, bank ownership of the industry rivals could harm firms’ market power.

Our mechanism analysis suggests that the financing channel and information channel are two non-mutually exclusive channels.

Overall, banks ownership of industrial firms induces the reallocation of market power within an industry, thus intensifies concern of unfair competition.