Bank market power and firm finance: evidence from bank and loan-level data

ECONOMIC CHANGE AND RESTRUCTURING
Publicado:
Lunes, 18 Septiembre 2023
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We investigate the impact of bank market power on the interest rates charged for loans to nonfinancial firms within the context of a developing country. Employing a distinctive amalgamation of data encompassing banks, firms, and loan specifics, alongside panel data fixed-effect models, we elucidate that banks wielding greater market power tend to impose higher interest rates on their loan products. This effect becomes more pronounced for banks positioned at the upper echelons of the market power spectrum (*relative* market power) and in instances of lengthier credit relationships. However, its severity can be mitigated for firms managing multiple credit connections (*subjective* market power). Our findings shed light on the presence of practices aimed at extracting economic rents and accentuate the substantial costs associated with changing lending partners in the corporate

credit landscape. Various papers have delved into the empirical examination of how competition impacts the accessibility and expenses tied to bank credit for nonfinancial firms, yielding a mosaic of outcomes. Our contribution to this body of the literature manifests as a more incisive empirical analysis, enabling us to disentangle the opposing dynamics at play. This analytical depth is achievable solely due to the exceptional dataset we have curated. Significantly, our study stands out as one of the initial endeavors to interlink dynamic, bank-level gauges of market power with directly observed interest rates at the firm level, all while controlling for bank and loan-specific characteristics.