Bank Specialization and the Design of Loan Contracts
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Objectives

- Study bank specialization in the US corporate loan market.
- Focus on industry dimension.
- Understand implications for financial contracting.
- Investigate possible benefits for firms.
- Shed light on economic rationale: information advantage or risk taking?

Introduction

Motivation

- Diversification plays a key role in theories of financial intermediation.
- Yet, there is evidence of specialization in bank lending.
- Thus, firms might not substitute credit easily across banks [3].

Contribution

- Document presence of specialization in lending to specific industrial sector in a large, competitive credit market.
- Leverage detailed information on loan contracts to obtain insights on why credit from specialized lenders is not easy to substitute for firms.
- Present novel evidence that specialized lenders offer credit with looser restrictions (covenants) and at lower cost (interest rates).

Data Sources & Sample Selection

- Data Sources: Dealscan, Compustat.
- Industry definition: TNC (Hoberg & Phillips).

Empirical Framework

Strategies. Compare loan terms between loans:
- made by the same bank in the same year,
- to different industries,
- controlling for firm observed & unobserved heterogeneity.

\[
\text{Loan Term}_{f,b,t} = \alpha_{b,t} + \beta_{f} + \gamma \cdot X_{f,b,t-1} + \epsilon_{f,b,t}
\]

We also control for:
- Relationship strength between firms and banks;
- Geographical proximity;
- Banks’ industry market (not portfolio) shares.

Main Result

- Specialized banks offer credit with looser covenants.
- This reflects lower information asymmetry between lenders and industry of specialization [1].

Further Evidence

- Employ defaults on lenders’ portfolios as shocks to lenders’ screening ability assessment [2].

Underlying Idea

- Shocks in industry of specialization should drive greater revision in lenders’ assessment,
- independently of sector-exposure.

Covenant Strictness

<table>
<thead>
<tr>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Default (spec) × Special.</td>
<td>4.25***</td>
<td>4.63**</td>
</tr>
<tr>
<td>Default (other) × Special.</td>
<td>-0.274</td>
<td>-0.681</td>
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<tr>
<td>Specialization</td>
<td>-4.1</td>
<td>-5.83</td>
</tr>
<tr>
<td>FEs &amp; Controls</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Adj. $R^2$</td>
<td>0.24</td>
<td>0.24</td>
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<tr>
<td>Obs.</td>
<td>4,472</td>
<td>4,472</td>
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</tbody>
</table>

Conclusions

- Banks specialize in lending to specific industries.
- Our evidence supports a monitoring-advantage explanation of specialization [3].
- Firms obtain looser covenants when borrowing from banks specialized in their industry, which could explain non-substitutability of credit.

References


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