The Direct Shock of Bank Failure and Investment Self-Selection Bias[*]

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Abstract

This paper studies the effects of bank failure on client firms' investments. Using a natural experiment of special mega bank failures in the late 1990's in Japan, this study identifies the direct lending market shock caused by bank failures. Linking failed banks and their client firms from past loan quantities, this study regresses Tobin's Q and a bank failure dummy on client firms' investments. Also, setting the firms whose main banks are unhealthy as a control group and the firms whose main banks are failed as a treatment group, self selection biases are removed using difference in difference and propensity score matching method. The main findings are the following three facts. First, bank failures decrease the client firms' investments. Second, the high investment growth firms choose unhealthy banks. Also, these firms' choices of banks generate a self selection bias and the true shock is larger than using ordinary OLS. Third, the negative failure shocks cannot be mitigated by other financial sources. (JEL E22, G21, G33, L16 Keywords: Bank Failure, Investment, Self Selection Bias, Average Treatment Effect).

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