When Japanese banks become pure creditors: the effects of declining shareholding by banks on bank lending and firms' risk-taking

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Abstract

Utilizing the regulatory change relating to banks' shareholding in Japan as an instrument, this study examines the causal effects of declining shareholding by banks on bank lending and firms' risk-taking. Banks may hold equity claims over client firms for either of the following two reasons: (i) gaining a competitive advantage by exploiting complementarity between shareholding and lending activities, and (ii) mitigating shareholder–creditor conflict. Exogenous reduction in a bank's shareholding would then impair the competitiveness of the bank's lending activities and aggravate the risk-shifting behavior of client firms. Using a firm–bank matched dataset of Japan's listed firms during the period 2001–2006, we empirically test the two hypotheses and obtain the following findings. First, a bank's removal from the list of major shareholders of a client firm (extensive margin) and the reduction in the ratio of the bank's shareholding to the firm's total shares on issue (intensive margin) decreases the bank's share of the firm's loans. Second, a reduction in the extensive margin of a bank's shareholding increases the volatility of the client firm's return on assets and reduces their Sharpe ratio. However, we do not find the same effect when a bank reduces the intensive margin of its shareholding.

JEL classifications: G21, G32, G34

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