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Banking competition and firm-level financial constraints in Latin America☆

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ABSTRACT

Prior literature argues that, given the existence of information asymmetries and agency costs, higher competition may increase financial constraints by reducing banks' incentives to build lending relationships. Using a sample of listed firms for six Latin American countries, we analyze the relation between banking competition and financial constraints. We find evidence in line with prior research that banking competition increases financial constraints. This result is robust and heterogeneous. We include other country-specific variables and check the robustness of our findings; the main results hold. Our results show that the effect of competition differs across firms and industries. Specifically, consistent with the information hypothesis, the negative impact of competition is higher for small quoted firms and for low-assets tangibility industries. Also, as expected, we find evidence that firms are more affected by financial constraints during the last crisis. This negative effect is larger for firms in more competitive banking industries.

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1. Introduction

Prior literature has widely debated the relation between banking competition and credit access. Theoretically, higher competition has an ambiguous impact on firm financing. On the one hand, the market power hypothesis suggests that, by reducing interest rates, higher competition facilitates credit access or relaxes financial constraints. On the other hand, the information hypothesis argues that, given the existence of

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information asymmetries and agency costs, higher competition increases financial constraints by reducing banks' incentives to build lending relationships (Petersen and Rajan, 1995). Also, fierce competition may relax the quality of screening (Broecker, 1990; Marquez, 2002) and reduce investments in information acquisition technologies (Hauswald and Marquez, 2003, 2006).

The empirical literature has not yet settled this debate, and the evidence is, in general, mixed. Recent evidence by Ratti et al. (2008) for European countries find that higher banking concentration, which serves as a proxy for competition, is associated with reduced financial constraints. In contrast, Ryan et al. (2014), using the same method for a large sample of SME European firms shows strong support consistent with the market power hypothesis that lower competition increases financial constraints.[1]

Two other recent studies also favor the market power hypothesis. Leon (2015) examines a large sample of firms from 69 developing and emerging countries and three indicators of banking competition and finds evidence that competition alleviates credit constraints. Also, Love and Martinez-Peria (2015) find evidence that competition increases access to finance in a sample of firms from 53 countries. Both Leon and Love and Martinez-Peria show that banking concentration is not a good measure of banking competition. Instead, direct measures of banking competition provide less ambiguous findings about the relation between competitive markets and financial constraints.

We contribute to this literature in two ways. First, we provide new evidence for a sample of Latin American countries. Second, we look at potential heterogeneous effects by firm size, industry financing needs, and the onset of financial crises. The question of banking competition's effect on credit access is very relevant not only due to the ambiguous theoretical predictions but also because it has important policy implications. Prior literature shows that credit access is important along several dimensions including productivity (Ibarrarán et al., 2009; Crespi et al., 2014), firm creation and growth (Aghion et al., 2007), innovation (Savignac, 2008), and entry and survival in export markets (Berman and Héricourt, 2010; Jaud and Kukenova, 2011; Manova, 2013), among others.

Our results are in line with the information hypothesis. We find that banking competition increases financial constraints. This result is robust and heterogeneous. We include other country-specific financing variables and check the robustness of our findings; the main results hold. We also find that, as expected, the negative relation differs across firms and industries. Consistent with the information hypothesis, the negative impact of competition is higher for small listed firms and for low-assets tangibility industries. Compared to previous studies (Love and Martinez-Peria, 2015 and Leon, 2015) focusing on small firms, our sample is constituted by listed firms. These listed firms have access to external funds, but may be partially constrained. Then, we interpret our findings as negative effects of competition along the intensive margin rather than the extensive margin as the other previous studies do.

The remainder of this paper is organized as follows. Section 2 describes the data set. Section 3 discusses the method. Section 4 presents the results and several robustness checks. Finally, Section 5 concludes.

2. Data sources

Our data set comprises firm-level information from Thomson Reuters One and S&P Compustat Global Advantage and country-level data from the World Bank. Our raw data sample consists of 593 firms and 7239 observations of annual financial information from 1999 to 2013. Because we focus only on nonfinancial firms, following Ratti et al. (2008), we exclude all firms with a SIC over 6000. We also eliminate firms with less than three years coverage and firms with missing values for capital expenditures, sales, assets, debt, cash flow, and stock prices. Following Ratti et al. and Love (2003), we also exclude observations with ratios of investment to assets above 2.0 and sales to assets above 4.5. Finally, we merge the financial data from Compustat Global with ownership data obtained from Thomson One and drop outliers in the top and bottom 1% of each variable. The final sample is an unbalanced panel of 3181 observations from 445 quoted nonfinancial firms from Argentina, Brazil, Chile, Colombia, Mexico, and Peru. Table 1 provides the definition of each variable considered in the empirical analysis. Table 2 provides a further description of the sample by country.

[1] Some prior studies use the introduction of regulations in the United States to look at the impact of a more competitive banking industry on several dimensions of credit access. These results are also mixed. See, for example, Zarutskie (2006) and Rice and Strahan (2010) for contrasting empirical evidence.

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