



The real effects of bank-driven termination of relationships: Evidence from loan-level matched data[☆]

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ABSTRACT

In this study we use a matched dataset of Japanese banks and firms to examine how bank-driven terminations of bank-borrower relationships affect the investments of the borrowers. We find that bank-driven terminations significantly decrease investment, exerting an effect that exceeds that due to credit reductions within continuing relationships. Our results also show that the unwanted effect of bank-driven terminations grows as the loan market deteriorates as a whole, which prevents firms from obtaining funding from other sources after their relationships with banks are terminated. Our findings coincide with previous literature emphasizing financial frictions in the matching process and the importance of relation-specific assets in credit markets.

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1. Introduction

Of all the recent financial crises in developed economies, the economic downturn in Japan following the collapse of the bubble economy in the 1990s was longer and deeper than any other. As Fig. 1 shows, bank lending and private investment declined continuously from the early 1990s to the early 2000s. The existing literature on Japan's financial depression has already investigated the existence of a credit crunch during this period and the impact

of the crunch on firm investment.¹ Over the same years, however, the decrease in aggregate bank loans was accompanied by an increase in the number of bank-firm relationships that were being terminated, as shown in Fig. 2 (see Section 2 for the definition of relationship termination).

In this paper we empirically address the aforementioned coexistence of increasing relationship terminations and declining bank loans and firm investment by investigating whether and how firm investment behavior was affected by the relationship terminations elicited by lender-side shocks. Thus, we extend the premise of a bank balance sheet channel in order to focus on relationship terminations as a mechanism that amplifies adverse economic shocks.²

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¹ Woo (2003) and Watanabe (2007), for instance, have used bank-level panel data to identify a credit crunch during the late 1990s. Peek and Rosengren (2005), on the other hand, used loan-level matched data to find that Japanese banks with impaired capital took the opposite course of providing more loans to distressed borrowing firms in the 1990s. Empirical studies in the US have been published by Bernanke and Lown (1991), Peek and Rosengren (1995), Berrospide and Edge (2010), and Carlson et al. (2013).

² The theoretical literature on the balance sheet channel includes Holmström and Tirole (1997) and Gertler and Kiyotaki (2010). To find empirical literature focused closely on the effects of a bank balance sheet on a firm's investment and export

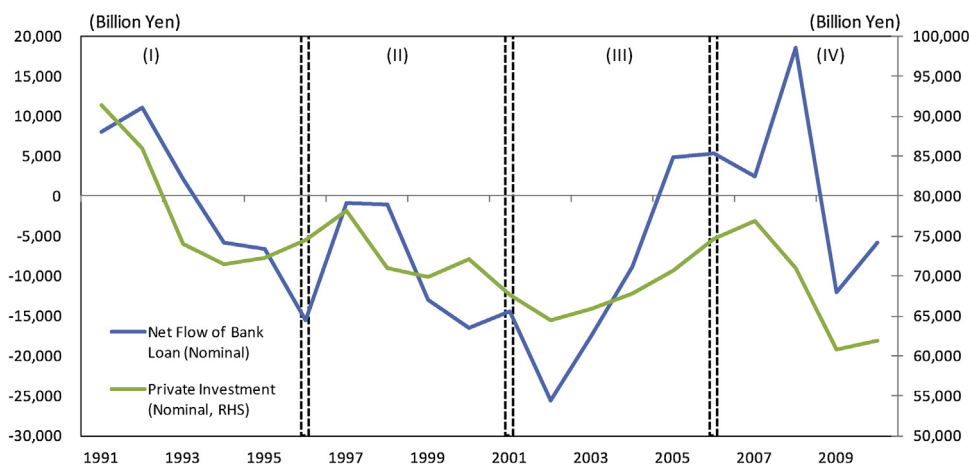


Fig. 1. Bank Loans and Private Investment. *Notes:* The net flow of bank loans is the amount of bank loans that flow from private banks to non-financial private firms from the Flow of Funds. Private Investment is the gross nominal value of private domestic investment in GDP. A dotted vertical line indicates the starting year of each subsample period.

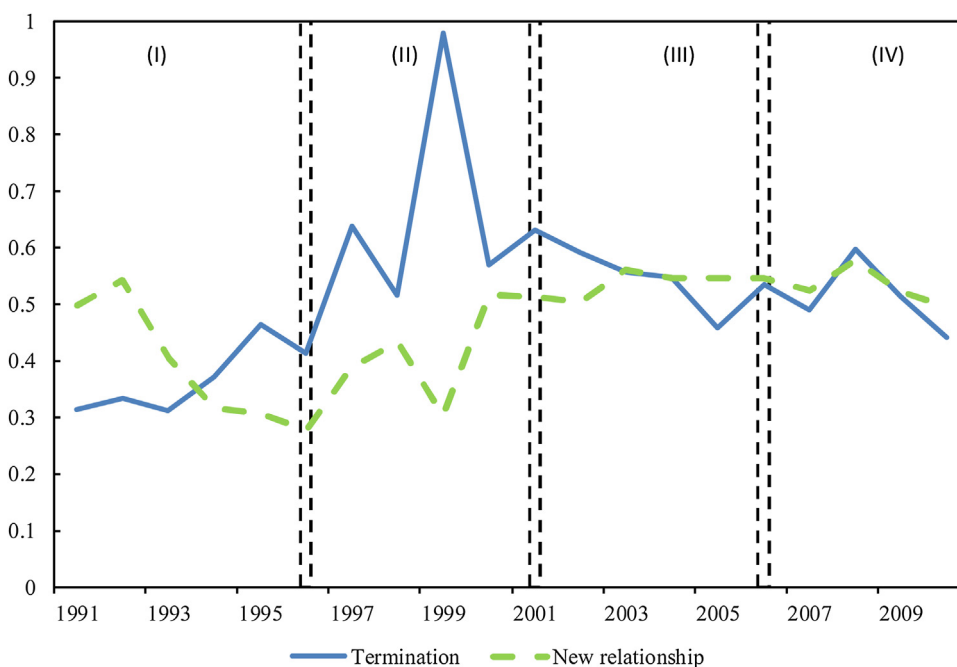


Fig. 2. The Number of New Relationships and Termination. *Notes:* New Relation and Termination indicate sample averages that are calculated period-by-period using the numbers of new relationships and terminations, and are normalized by the number of listed firms. A dotted vertical line indicates the starting year of each subsample period.

According to stylized banking models focused on inside information generated by the history of bank-firm interactions (e.g. [Sharpe \(1990\)](#), [Rajan \(1992\)](#), and [von Thadden \(1995\)](#)), the maintenance of relationships mitigates asymmetric information problems between banks and borrowing firms and then cultivates relationship-specific assets, that is, implicit property rights not available from outside lenders. This relationship-specific asset can help lower the agency cost for the inside banks and facilitate the funding of borrowers.³

behavior in Japan, see [Gibson \(1997\)](#), [Kang and Stulz \(2000\)](#), [Gan \(2007a\)](#), and [Amiti and Weinstein \(2011, 2018\)](#)). Of these studies, [Gan \(2007a\)](#) and [Amiti and Weinstein \(2011, 2018\)](#) used bank-borrower matched data, whereas the other two used firm-level panel data.

³ The relation-specific asset allows a bank to control the borrower's projects and extract rents over time, which could lead to hold-up problems. Theoretical studies have shown, however, that various institutions can help lenders and borrowers

We can infer from this theoretical prediction that relationship terminations are the most important events for lending based on bank-firm relationships, given that an inside bank and borrower terminating a relationship both lose their relationship-specific

evade such problems, and thereby increase the efficiency of credit allocation. [Sharpe \(1990\)](#), for example, emphasized the role of implicit contracts based on a bank's reputation, while [Rajan \(1992\)](#) focused on the role of a firm's portfolio choice of borrowing sources. [von Thadden \(1995\)](#) emphasized the monitoring performed by a bank within a long-term relationship as a mechanism to avoid inefficiency arising from hold-up. Indeed, evidence from [Miyakawa \(2010\)](#), [Sakai et al. \(2010\)](#), and [Nakashima and Takahashi \(2018\)](#) support the existence of a relationship-specific asset in Japanese bank-firm relationships, and findings from [Berger and Udell \(1995\)](#) support the same in bank-(small) firm relationships in the U.S. In contrast, evidence from [Ongena and Smith \(2001\)](#), [Degryse and Ongena \(2005\)](#), and [Ioannidou and Ongena \(2010\)](#) singles out the hold-up problem as a main driving force.

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