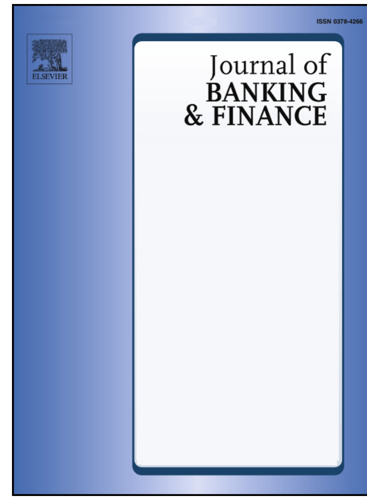

Institutional failure or market failure?

Ike Mathur, Isaac Marcelin

PII: S0378-4266(14)00399-9
DOI: http://dx.doi.org/10.1016/j.jbankfin.2014.12.018
Reference: JBF 4629

To appear in: *Journal of Banking & Finance*

Received Date: 25 October 2013
Accepted Date: 23 December 2014

Institutional Failure or Market Failure?

Ike Mathur[†]

&

Isaac Marcelin[††]

November 6, 2014

Abstract

We investigate the effect of the power of creditors, property rights protection, and institutional quality, on bank profits using a panel of 498 banks from 46 countries. Results show that better institutions and stronger property rights protection reduce bank profits, while stronger power of creditors drives up bank profits significantly. Results imply that better institutions and enhanced property rights protection lead to greater flow of credit allowing firms and investors to undertake more profitable ventures. By extension, stronger creditor rights erect steeper barriers to external finance for firms and investors. National indicators of economic freedoms may be more important to lowering the spread than strict creditor rights. Seemingly, credit markets fail when economic institutions fail or when governments intervene into these markets in ways that impede the safety and soundness of financial transactions and private contracting.

JEL classification: D23, G20, G21, G28, G32, K42
Keywords: Institutions; property rights; law and finance; power of creditors; bank spreads; bank profits

[†]Ike Mathur, Department of Finance, Southern Illinois University Carbondale, Carbondale, IL, 62901, USA; Tel: +1 618-581-1613; Fax: +1 618-453-5626; E-mail: imathur@business.siuc.edu

[††]Isaac Marcelin, School of Business, Management and Technology, University of Maryland Eastern Shore, Princess Anne, MD 21853, USA; Tel: +1 410 651 7884; Fax: +1 410 651 6529; E-mail: imarcelin@umes.edu

Acknowledgements:
The first version of this paper was presented at the Southern Finance Association Meeting, held in Key West Florida, November 2011. We thank the participants of the conference for their helpful comments. We thank Co-Executive Editor Carol Alexander for the efficient handling of this submission. We are particularly indebted to two anonymous referees for their insightful comments. We are also thankful to Michael Masoner, emeritus professor at SIU School of Business, Kevin Sylwester of the SIU Department of Economics, Nanivazo Malokele of the UNU-WIDER (United Nations University-World Institute for Development and Economic Research), Wesley, LaVern & Safiya McNeese, and Rexford Abaidoo for their useful comments. We take ownership of all remaining errors and omissions.