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Abstract

We study the effects of establishment of a captive finance subsidiary on parent firm's competitiveness. Firms with captives have higher profitability, larger market share, lower volatility of sales, and maintain lower cash balances. Following the establishment of a captive, a firm's profitability and its industry market share gradually increase, but it takes about four years to become economically relevant. Stock returns of companies with captive finance subsidiaries correlate more with finance industry returns than stock returns of companies without captives. We estimate that captives generate about 17% of parents' net income. Thus, significant part of profits of the largest US industrial corporations comes from what in essence are financial services.

JEL Classification: G23; G32

Keywords: captive finance, competitiveness, organizational structure, shadow banking, conglomerates

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