

Do banks extract informational rents through collateral?

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Summary

This paper investigates if informational monopolies resulting from relationship lending and bank market concentration allow for rent extraction through collateral. Our identification strategy hinges on the notion that informational equalization shocks (such as equity IPOs) erode rent seeking opportunities, while competing theories do not rely on information asymmetries among lenders. Using a unique hand-collected database of 9,288 bank loans obtained by 649 listed Chinese firms, we find that collateral incidence is positively associated with relationship intensity and bank market concentration, while this effect is moderated for post-IPO loans. We also demonstrate important cross-sectional variation among borrowing firms: after an IPO, rent extraction through collateral is moderated for less risky firms, but intensified for risky firms. These findings are not driven by alternative theories including: shifts in firm risk around an IPO; heterogeneous dynamics of risk shifting around an IPO; and concurrent lending and corporate bond underwriting. We further demonstrate that our results are not sensitive to: endogeneity of an IPO or relationship lending; unobserved time-invariant firm risks; alternative samples; and the endogeneity of loan contract terms. Our study complements the findings in other studies that banks extract rents by charging higher lending rates from their informational monopolies (Hale and Santos, 2009; Schenone, 2009). Furthermore, we provide the first loan-level evidence on the determinants of collateral in Chinese bank lending markets.