Sorry, we're closed: loan conditions when bank branches close and firms transfer to another bank

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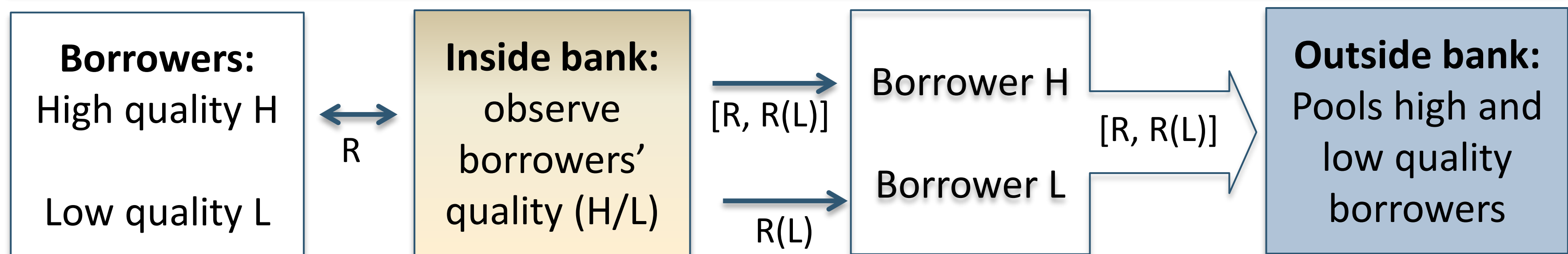
* The views expressed are those of the discussant and do not necessarily represent the official position of the EBA

Summary of the paper (1/3): theory

Switching costs are an established source of banks rents:

A. fixed technical costs (Klemperer, 1995) give firms a degree of market power over their repeat-purchasers;

B. informational switching costs (Sharpe, 1990; Rajan, 1992; von Thadden, 2004)



von Thadden (2004): outside banks limit the inside bank's rent extraction by using "optimal randomization" to attract high quality borrowers:

- Full competition on low quality borrowers,
- Limited degree of competition on high quality borrowers.

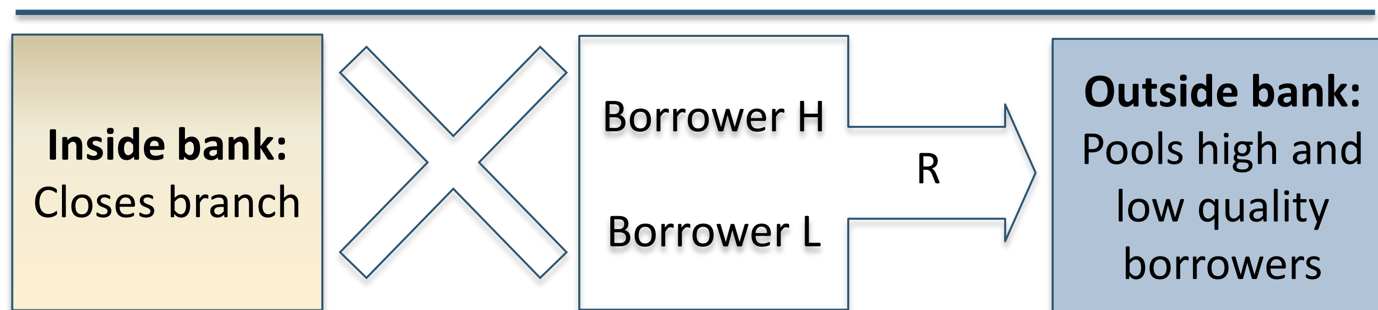
Summary of the paper (2/3): testable HPs

H1: borrowers switch banks from one period to another,

H2: switching loans have lower interest rates than non-switching loan,

- Ioannidou and Ongena (2010): empirical evidence on contract conditions just before and after a firm switches to a new bank.

H3: if the inside bank has no private info outside bank will pool price the arriving firms lending at market prices and transfer loans do not have lower interest rate.



This paper focuses on loan conditions prevailing on transfer loans when inside lender has no information advantage

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Summary of the paper (3/3): contribution

- Great empirical test of the exact switching costs' source
- Very detailed database which allows to:
  - ✓ Distinguishing between switching and transfer loans,
  - ✓ Matching loans on month of loan origination and on bank, firm and contract characteristics.
  - ✓ Approximate unobserved rates offered by the inside bank to switchers/transferred with rates offered to comparable non-switching borrowers
- Comparing loans conditions on switching and transfer loans allows to disentangle fixed switching costs a-la Klemperer with informational switching costs.
- Main findings are:
  - A. switching loan rates are on average lower than non-switching loan rates
  - B. no significance difference between interest rates offered on transfer and non-switching loans.
- Only informational switching costs could explain both findings.

Comments (1/2): Hypothesis and assumptions

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- Improve theoretical explanation of why there should be no significant difference between rates on transfer and non-switching loans:
  - What is the relation between first period interest rates with full competition and interest rate on transfer loans?
  - Transfer loans are loans which reflect average quality of the pool of applicants what about non-switching loans?
  - Is there competition in transfer loans?
- Branches proximity is a results' key driver but not sufficiently explained:
  - ✓ Is there a branches location effect in switching vs non-switching loan rates?
  - ✓ which is the % of firms which keep relationship with inside bank after branch closes and and at what rates?
- Quasi-natural experiment? assumption that branch closures is independent on local branch quality of firms need supporting evidence:
  - If closed branches are expected to have lower than average quality of firms,
  - no discount on transfer loans consistent also with fixed switching costs.

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Comments (2/2): open questions

- The existence of switching costs may fan competition to draw customers, so that some of the expected rents will be competed away ex-ante (first period)
  - ✓ Can this affect the pool price of transfer loans if there is more than 1 outside bank in the proximity?
  - ✓ Interest rates may be slightly lower than the ones reflecting pooled risk?
- Ioannidou and Ongena (2010) find lower loan rates on switching loans which increase over time:
  - ✓ What happen over time on transfer loans?
  - ✓ Should they be constant according to theoretical predictions?
- Do you observe any effect of bank/contract characteristics on the overall discount size on switching/transfer loans?
- Section on policy implications would complete the paper: what is the effect of IMF recapitalisation/restructuring plans on banking competition?

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Minor points

- Comparison between switching/transfer loan rates with non-switching loans rates within the outside bank is the benchmark:
  - ✓ Do you have results for transfer loan compared with non-switching loans by the inside bank?

- The effect of the number of firms switching vs transferring is not well clear:
  - ✓ In principle many firms could switch contemporaneously
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  - ✓ What is the difference if 1 firm rather than many firms transferring to the outside bank?

- The discount on switching loan in areas affected by branch closures is similar to discount on overall sample. Can we conclude that inside bank power in extracting rent is not reduced by the close branch closure?