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How does banking industry consolidation affect bank–firm relationships? Evidence from a large Japanese bank merger

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Abstract

We employ standard event study methodology to examine how bank consolidation affected bank–firm relationships in Japan. We also investigate the source of relationship benefits to client firms. Our analyses focus on the case of Mizuho Holdings, which became the largest bank in the world upon the merger of three large Japanese banks on August 19, 1999. Our findings indicate that firms using one of the three banks as their main bank or for large credit exposures did not experience the significant negative stock price reactions of nonmain bank or lower credit exposure firms. Multiple regression analyses reveal that, holding constant a number of firm-level characteristics, main bank status was the most important determinant of bank–firm relationships in Japan. Further tests suggest a lesser though significant role for the size of loans from the main bank.
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On August 19, 1999, the Industrial Bank of Japan announced that it was forging an alliance with large rival banks Dai-ichi Kangyo Bank and Fuji Bank to form a $1.2 trillion dollar banking organization named Mizuho Holdings Inc. Exceeding Deutsche Bank's $735 billion in assets at that time, the merger of these healthy banks, each of which was known to have sizeable nonperforming loans, would create the largest bank holding company in the world and the first universal bank in Japan. Due to the merger, city banks Fuji and DKB would gain investment banking expertise, while long-term credit bank IBJ

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would benefit from retail franchises. Other motivations included potential cost cuts associated with overlapping facilities and staff, access to public funds in March 1999 (i.e., $66 billion for 15 banks including these merged banks) made available by regulators in lieu of the implementation of restructuring measures to improve bank safety and soundness,[1] and global banking competition. Historically subject to heavy regulation, analysts interpreted the announcement as a signal that further banking consolidation was likely to be allowed among Japan's leading 19 banks in the years ahead. Investors viewed the mergers positively as the banks' share prices and the overall stock market rose on news of the event. However, little or no discussion in the financial press addressed how client firms of these large banks would be affected by the merger.

It is well known that in bank-centered financial systems, such as in Japan, firms depend on banking institutions for deposit, credit, and other financial services (Aoki et al., 1994; Aoki, 1990; Hoshi et al., 1991; Kang and Shivdasani, 1995). Not surprisingly, the Japanese banking crisis beginning in early 1990 had negative implications for client firms. Studies by Gibson (1995, 1997) and by Kang and Stulz (2000) documented significant stock value declines among bank-dependent Japanese firms, especially when bank financial health was weakened. Bae et al. (2002), using data from the Korean credit market, also found that bad news to the main bank caused negative valuation effects to the client firms.

These studies examined bank health and bank–firm relationships for the Japanese banking sector as a whole. The present study complements this research by focusing on the case of the Mizuho merger and its implications to client firms of its constituent banks. By forming a stronger and larger main bank, client firms might be expected to benefit from more reliable access to credit, improved bank efficiency, broader monitoring services, and increased financial expertise and resources. On the other hand, it is possible that major consolidation in the banking industry would tend to reduce competition and thereby lower the quality and quantity of financial services to client firms. Especially information problematic firms, such as small, growth firms that require effective bank monitoring and certification to secure financial services, could experience diminished bank relationships and services. Moreover, to the extent that access to capital markets is dependent on bank certification and monitoring (see Diamond, 1991; Hoshi et al., 1993), these and perhaps other client firms could be adversely affected. In a case study of bank–firm relationships, Slovin et al. (1993) showed that client firms' stock prices reacted negatively to the failure of Continental Illinois Bank but later responded positively to news of its rescue by the Federal Deposit Insurance Corporation (FDIC).

In regard to client-firm stock price responses to changing bank–firm relationships, Boot (2000) has commented that previous empirical studies have not examined the precise sources of value in relationship banking. Holding idiosyncratic risks associated with client firms constant, the impact of the Mizuho merger on client firms could be conditioned by what makes their bank relationship special. That is, depending on the sources of value in bank–firm relationships, the stock price reaction of client firms could differ. We seek to

[1] In March 1999, regulators allocated about 7.5 trillion yen among 15 Japanese banks. The capital injection required that banks carry out restructuring plans in the near future.

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