Three Essays on Corporate Finance and Intermediation

by

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ABSTRACT

This dissertation consists of three distinct but related essays in corporate finance and financial intermediation. In the first two essays, I examine how the deregulation and consolidation of banking industry in the US affect two types of business customers, namely newly formed businesses and publicly traded corporations. The third essay, taking a law and finance perspective, examines how state regulations on covenants not to compete affect the going public process of entrepreneurial companies.

As the trend of banking deregulation and consolidation activities continues to grow in the US and globally, tremendous research efforts have been spent to understand the causes and consequences of such policy and environmental changes in the banking sector. This line of inquiry provides many insights on the lending behavior of consolidated banks. Banks are an important source of external financing to non-banking firms, be they large or small. However, little evidence has been documented on how banking deregulation and consolidation affect bank customers. Therefore, it is my intention to fill this gap in the literature by providing further empirical evidence.

The first essay investigates the effects of the actual intensity of bank consolidation on the formation of new businesses in the US local markets. Evidence portrays that in the short-run, the overall intensity of bank consolidation is negatively related to the rate of new business formation, and this negative relationship is primarily driven by consolidations initiated by large acquirers. On the contrary, consolidations between small-to-medium sized banks show a positive impact on new business development and these results are consistent even when the M&As are distinguished with respect to in-market or out-of-market acquirers initiating the deals. However, two years after the consolidations, the evidence reveals a positive and significant impact on the rate of new business formation in the local markets for consolidations initiated by large in-market acquirers.

The second essay examines how banking deregulation affect the financial policy of non-banking firms in the US, using corporate cash holding policy as an example. Firstly, employing a generalized difference-in-difference approach, I document a positive and significant relationship between interstate banking deregulation and corporate average cash holdings. Secondly, I construct a set of indexes measuring the

actual intensity of bank consolidation following deregulation, and find consistent results that corporate cash holdings tend to be positively related to out-of-market M&As, especially when the acquirers are large banks. In addition, corporate cash holdings are negatively related to bank M&As when the acquirers are in-market small banks. Lastly, I categorize sample firms as rural, small city and urban firms, and it appears that small city firms and urban firms are more inclined to respond to bank M&As initiated by large out-of-market acquirers by increasing their cash holdings.

In the third essay, I intend to draw a link between managerial stability and firm's going public process and empirically test the effects of the legal enforcement of covenants not to compete (CNCs), making use of the variation of enforceability of such contractual agreements across different states in US. Management quality and reputation have been shown to be a certificate to firm value and thus impact various aspects of IPO process. However, in order for management to credibly convey the intrinsic firm value to the market, managerial stability needs to be taken into consideration. In line with the assumption that increased managerial stability will reduce the uncertainty and alleviate the asymmetry information problem, I find that state enforceability of CNCs is negatively related to the degree of underpricing and positively related to secondary sales. I also documented that the legal enforcement of CNCs is negatively related to underwriter reputation and the price revision during the bookbuilding process. In addition, I find that the high enforceability of CNCs mitigate the already documented "price drop around lockup expiration" significantly. Lastly, I document that issuing firms located in states with the highest enforceability index do not underperform up to 3 years after going public.