Abstracts of Papers to be presented at USC-UCLA-UCI Finance Day, April 22nd 2011

1. The Ties that Bind: Bank Relationships and Small Business Lending (Lori Santikian (USC))

Abstract: Banks are a primary source of capital for small, private firms, yet the inner workings of small firms' bank relationships remain obscure. This paper uses hand-collected, proprietary data from a mid-sized regional bank in the United States to empirically identify the channels that strengthen the relationship between a small business and its bank. In contrast to earlier work that focuses on the role of relationships in alleviating information and incentive problems in lending, I find that the source of value in relationship banking is not limited to enhanced monitoring. I introduce two novel channels of relationship strength that embody an entrepreneur's non-lending profit appeal for a bank: (1) the depth of cross-selling of non-loan products to the entrepreneur, and (2) the breadth of additional bank business referred through the entrepreneur's social and professional connections. I show that a borrower's intensive margin of profit (the depth and profitability of cross-selling) and extensive margin of profit (the quantity and profitability of referrals) lower the cost of borrowing and generate access to more credit. These effects are additive. A one-standard deviation increase in both cross-selling and referral profits is associated with a 35 basis point reduction in the loan interest rate and a 26 percent increase in the amount of credit available to a firm.

2. Financing Shortfalls and the Value of Aggregate Liquidity (Andrea Eisfeldt (UCLA) and Adriano Rampini)

Abstract: This paper studies the level and dynamics of the value of aggregate liquidity induced by firms' financing shortfalls. We model liquidity and cash flows as internal funds available for investment in an economy where external funds are costly. We study whether the use of liquidity to hedge investment opportunities can generate substantial liquidity premia with empirically observed countercyclical properties, and show how firms' financial positions affect the value of aggregate liquidity. Cash flows affect the "natural supply" of liquidity and are procyclical. Thus, we argue that shortfalls between firms' financing needs and available liquid funds are more likely to occur in bad times when current cash flows are low, rendering liquidity premia countercyclical. We investigate the relationship between such shortfalls and the value of aggregate liquidity empirically using US Flow of Funds data (1952-2008) and Compustat data (1971-2007).

3. The Impact of Mandatory Hedge Fund Portfolio Disclosure (Christopher Schwarz (UCI) and Stephen Brown)

Abstract: In this paper, we examine the use of hedge funds' 13(f) filings by market participants. While many argue disclosure of equity holdings in these filings could harm investment funds, we find hedge funds largely benefit from disclosure while providing little private information to the marketplace. We detect abnormal trading volume around disclosure dates and also find significant, positive abnormal returns immediately after disclosure, suggesting the presence of copy-cat traders. Fund companies have a period of time, usually up to 45 days after the end of the quarter, to announce their quarter end holdings. We find evidence of significant trading in the days leading up to the public announcement, which raises the possibility that some traders are taking positions in anticipation of the possible market impact of the 13(f) disclosure. Indeed, a long-short portfolio of these companies' expanded-contracted positions purchased prior to the disclosure date earns positive, significant abnormal returns through the disclosure period. Finally, we find no evidence disclosed holdings offer long-term investors access to profitable information.

4. Size Anomalies in U.S. Bank Stock Returns: A Fiscal Explanation (Priyank Gandhi (UCLA) and Hanno Lustig (UCLA))

Abstract: We use bank stock returns to develop an ex-ante measure of the distortion created by the implicit collective guarantee extended to large U.S. financial institutions. The average return on a stock portfolio that goes long in the largest U.S. commercial banks and short in the smallest banks is nearly minus 8% compared to a portfolio of non-bank stocks and bonds with the same exposure to standard risk factors. We provide evidence that 6.35 % of this spread is a subsidy that reflects the government's implicit guarantee of large banks, but not of small banks, when a financial disaster occurs. As predicted by theory, this long-short portfolio of bank stocks rallies during recessions, when the probability of a financial disaster increases, while the benchmark portfolio of non-banks stocks and bonds does not. This 6.35 % spread can be decomposed into a 3.1% implicit subsidy to the largest commercial banks and a 3.25% tax on the smallest banks. The annual subsidy to the largest commercial banks is $4.71 bn per bank in 2005 dollars.

5. Evidence on the existence and impact of corruption in state asset sales in China (Yongxiang Wang (USC) and Raymond Fisman)

Abstract: We document evidence of corruption in Chinese state asset sales. These sales involved stakes in partially privatized firms, providing a benchmark of the price - publicly traded shares - to measure under-pricing. We document under-pricing of more than 70 percent, which is correlated with deal attributes associated with misgovernance and corruption. Sales by ‘disguised’ owners that misrepresenting their state ownership to elude regulatory scrutiny are discounted 5-10 percentage points more than sales by other owners; related party transactions are similarly discounted. Post-transfer profitability is higher, though uncorrelated with under-pricing, suggesting that ownership transfer improved efficiency, even when the transfers themselves were corrupted.

6. Portfolio Choice with Illiquid Assets (Mark M. Westerfield (USC), Andrew Ang, and Dimitris Papanikolaou) Abstract: We solve for optimal asset allocation and consumption policies for long-lived constant relative risk averse (CRRA) investors holding both liquid and illiquid assets. Liquid assets can be rebalanced continuously, whereas illiquid assets can only be traded at infrequent, stochastic intervals. By creating an unhedgeable source of risk, illiquidity induces additional time-varying risk aversion above the constant utility coefficient of risk aversion. Illiquidity risk affects the asset allocation of both liquid and illiquid securities and causes optimal consumption and portfolio policies to depend on the mix of illiquid and liquid assets in the investor’s portfolio. Illiquidity effects are observed even for log utility investors and when liquid and illiquid asset returns are uncorrelated.

7. Female Leadership and Gender Equity: Evidence from Plant Closure (Geoffrey Tate (UCLA) and Liu Yang (UCLA))

Abstract: We use unique worker-plant matched data to track the employment outcomes of workers following plant closures. We find that plant closures result in significant and lasting declines in worker wages, particularly among women. We correct for endogenous selection of both the original and new employer using a unit-pair fixed effects model to compare the wages of men and women who move from the same closing plant to the same new firm. We observe lower post-closure wages among women immediately upon re-entering the workforce and continuing for the following three years. These differences persist throughout the wage and age distributions. However, we find a significantly smaller gap between men and women who move to a new firm with a higher fraction of female managers: The magnitude of the extra losses to women is cut in half. Our results suggest that adverse labor market shocks exacerbate gender differences in worker wages in ways which cannot be explained by differences in job selection. But, women in leadership positions foster cultures which are beneficial to female workers throughout their organizations.