Bank capital effect on loan terms strictness

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Using a matched bank-firm dataset from Japan, I examine how bank capital position influence the contract terms that an SME receives. Specifically, I explore how bank regulatory capital levels and changes impact the number of contract terms (price and non-price terms). The findings of the empirical analysis suggest that well-capitalized banks and those experiencing a recent increase in capital levels write looser contracts compared to their counterparts that are either capital-constrained or suffering depletions in their regulatory capital levels.

Further examination reveals that the bank capital position effects appear to be pronounced only in non-price terms of the loan contract. However, deeper investigation is required to make such a conclusion, as the Japanese credit guarantee system could be the reason SMEs received terms requiring them to acquire guarantee from a credit guarantee corporation.