Home Biased Credit Allocations

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Motivation

- How resources are allocated a fundamental question in economics.
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- **Bank credit** particularly important.
  - Family settlement, entrepreneurship, investments, job opportunities, innovation, emotional well-being, society orders etc.
Motivations

“...we are committed to serve every community under our network.”
Anonymous Bank B

“We are proud to make life better for everyone.”
Anonymous Bank A
"We are proud to make life better for everyone."

Anonymous Bank A

"...we are committed to serve every community under our network."

Anonymous Bank B

⇒ Our paper: A systematic CEO “home bias” in credit allocation policies within banks. This has real effects on the local economy.
Main results

- Banks (1) make more lending, (2) open more branches near the bank CEO’s birthplace

This arises out of ‘hometown attachment’ intentions rather than reflecting information advantages or agency motivations.

Bottom-line: Counties with a greater exposure to hometown favoritism enjoy better economic developments. Evidence of credit inequality.

\[ \Rightarrow \]

Hometown bias not only matters for investment decisions (Coval & Moskowitz, 1999). Home bias affects a firm’s internal business strategy & production outputs (bank credits). Real effects on the economy.
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Hand-collected CEO’s birth data (county-level)

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- Mortgage loans: Home Mortgage Disclosure Act (HMDA)
  - Borrower’s location information
  - Borrower (race, age, sex, income) & loan (purpose, type, amount)
  - Collapsed to bank-county-year level
  - Both accepted & rejected applications

- Others: FR Y-9C forms, SOD database, BoardEx, US Census Bureau
Empirical strategy: Summary

\[ \text{Outcomes}_{ikt} = \alpha + \beta_1 \ln(\text{dist hometown})_{ikt} + \beta_2 \ln(\text{dist HQ})_{ikt} + \text{Controls}_{ikt} + \text{Fixed effects} + \varepsilon_{itk} \] (1)

- **Prediction**: Banks (a) lend more; (b) open more branches in counties near its CEO’s hometown compared to counties further away.

- $\beta_1$ compares lending
  - of the same bank (=bank FE)
  - between close vs. far counties from CEO’s birth county
  - holding local economic conditions, credit demand etc. constant (=county-year FE)
Empirical strategy: Illustration

- Mr. James E Rohr, CEO of PNC Financial Services 5/2000-4/2013
Empirical strategy: Illustration
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- William S Demchak replaces James Rohr as PNC CEO in 4/2013
Empirical strategy: Illustration
Lending, branching, & proximity to CEO hometown

Dependent variables:

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Standard Error</th>
<th>p-value</th>
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<tbody>
<tr>
<td>Ln(originated loan)</td>
<td>-0.244***</td>
<td>-0.012***</td>
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<td>Loan growth</td>
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Control variables:

- County-Year FE: Yes
- Bank FE: Yes

1 sd. closer to CEO hometown (1200 km): 8% higher mortgage approval rates.
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# Lending, branching, & proximity to CEO hometown

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How do CEOs influence local mortgage lending?

1. Open more branches.
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3. Hire acquaintances as branch managers.

As a test to demonstrate a CEO’s influence on local lending: Changes in bank lending in response to natural disaster event.

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- **Intuition**: CEOs need to decide whether to reallocate credits to ‘assist’ areas affected by disasters.
- **Hypothesis**: More likely to help if their own hometown is affected.
A greater increase in bank lending in response to natural disasters that occur closer to the CEO's hometown.
Underlying economic explanations

- **Information advantages**

  Proximity to hometown $\uparrow$
  $\implies$ Information access $\uparrow$ (Coval & Moskowitz, 2001)
  $\implies$ Lending $\uparrow$ (Agarwal & Hauswald, 2010)
  $\implies$ If true, **superior** bank outcomes.
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  Hometown lending is the result of CEOs seeking private gains (e.g., local directorships) at the expense of shareholders.
  
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- **Hometown attachment**
  
  Hometown proximity $\uparrow$
  
  $\Rightarrow$ Emotional attachment $\uparrow$ (Hernandez et al, 2007)
  
  $\Rightarrow$ Invest time & resources (e.g., lending) (Manzo & Perkins, 2006)
  
  $\Rightarrow$ If true, **no effect** on bank outcomes.
Performance analysis

- Hometown lending does not explain a bank’s: (a) total lending, (b) bad loans, (c) ROA, (d) Stock returns
- Information advantage/agency unlikely

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<th>(2) %bad loans</th>
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<td>% mortgage lending birth state</td>
<td>0.009</td>
<td>-0.001</td>
<td>-0.015</td>
<td>-0.010</td>
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<tr>
<td>Bank controls</td>
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<td>Yes</td>
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<td>Yes</td>
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(All values are coefficients with standard errors in parentheses.)
The hometown lending effects are **stronger** for:

- CEOs who complete UG degree in birth state ⇒ stronger attachment to hometown communities.
- CEOs whose cultural heritage places a greater emphasis on selflessness, collectivism, & patriotism ⇒ more willing to 'help'.
- Traditionally 'marginalized' mortgage applicants: non-white, female, & poor =⇒ Emotional attachments to hometown (Hernandez et al. 2007) ⇒ Little help to the communities.
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Little help to the communities
Do residents near CEO’s hometown benefit from home favoritism?

Yes!

County-level analysis.

Prediction: Counties with a greater exposure to favoritism would enjoy greater economic developments

Exposure = fraction of branches located within 400 km (25 \text{th}) from the bank’s CEO birthplace

Key advantage: A county’s aggregate exposure to home favoritism is plausibly exogenous

Banks do not appoint a candidate for CEO position because of economic conditions in the candidate’s birthplace.
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Home favoritism & local economic developments

- Counties with greater exposure to favoritism: 5% higher income per capita and 3.1% unemployment rate

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| Home favoritism exposure_{t-1} | 0.016*** | -0.268*** |
|                               | (3.542) | (-4.224) |
| HQ favoritism exposure_{t-1}  | 0.016*** | -0.193*** |
|                               | (3.039) | (-2.539) |
| Location controls             | Yes     | Yes     |
| County FE                     | Yes     | Yes     |
| Year FE                       | Yes     | Yes     |
Thank you.