Journal of Monetary Economics
Volume 39, Issue 3, August 1997, Pages 475-516

Organization structure and credibility: Evidence from commercial bank securities activities before the Glass-Steagall Act

Randall S. Kroszner [1], Raghuram G. Rajan [1]

https://doi.org/10.1016/S0304-3932(97)00022-6

Abstract

We examine the two ways in which US commercial banks organized their investment banking operations before the 1933 Glass-Steagall Act forced the banks to leave the securities business: as an internal securities department within the bank and as a separately incorporated affiliate with its own board of directors. While departments underwrote seemingly higher quality firms and securities than did comparable affiliates, the departments obtained lower prices for the issues they underwrote. The higher risk premium associated with the internal department is consistent with investors discounting for the greater likelihood of conflicts of interest when lending and underwriting are within the same structure. As a result, commercial banks evolved toward choosing the separate affiliate structure. Our results suggest that internal structure is an effective commitment mechanism, and absent other distortions, market pressures would propel banks to adopt an internal structure that would address regulators' concerns about conflicts of interest.

Previous Next

Keywords

Glass-Steagall Act; Firewalls; Universal Banking; Credibility; Firm organization

JEL classification

G21; G24; L22; N22

Cited by (0)

1 Thanks to George Benston, Eugene Fama, Robert Gertner, Charlie Himmelberg, George Kaufman, Geoffrey Miller, Mitchell Petersen, Manju Puri, Andrei Shleifer, Clifford Smith (the referee), and Philip Strahan for helpful comments and to Andy Curtis, Dragan Filipovich, Steve Sandberg, and Jim Stoker for research assistance. Research support from the National Science Foundation and the Graduate School of Business of the University of Chicago is gratefully acknowledged.