The Cost of Intermediary Market Power for Distressed Borrowers

Winston Wei Dou Wei Wang Wenyu Wang *

January 26, 2025

Abstract

In the loan markets for distressed corporate borrowers, a few specialized lenders finance a large fraction of loans. Ultra-high yield spreads prevail even after removing the credit- and liquidity-risk component. Borrowers are in desperate need of financing but face limited funding options, while specialized lenders have repeated syndication relations with restrained participation. We develop and estimate a dynamic game-theoretic model, accounting for strategic competition, endogenous collusion capacity, endogenous participation, and latent heterogeneity. Lender market power accounts for 74 - 92% of the risk-adjusted yield spreads, with a significant fraction attributable to collusion. Smaller borrowers are more susceptible to lender market power. Importantly, both specialized lenders and distressed borrowers would be worse off if collusion is completely prohibited, suggesting that vigorous antitrust policies can be efficiency retarding.

Keywords: Collusion in Syndication, Bankruptcy and Distress, Intermediary Asset Pricing with Imperfect Competition, Bayesian MCMC, Antitrust Policy. (**JEL:** G12, G23, G30, L13)

*Winston Dou is with the Wharton School of University of Pennsylvania and NBER, Wei Wang is with the Smith School of Business at Queen's University, and Wenyu Wang is with the Kelley School of Business at Indiana University. Emails: wdou@wharton.upenn.edu, wwang@queensu.ca, wenywang@indiana.edu. We thank our discussants Fernando Anjos, Samuel Antill, William Mann, Marcus Opp, Zhongzhi Song, Arthur Taburet, Alessandro Villa, and Yufeng Wu, for their suggestions and comments. We are grateful for comments from Darrell Duffie, Brent Glover, Itay Goldstein, John Griffin, Lars-Alexander Kuehn, David Musto, Mitchell Petersen, Tom Sargent, Amit Seru, Adi Sunderam, Chad Syverson, Luke Taylor, Toni Whited, Liyan Yang, conference participants at AFA, BI Norwegian Business School, BPI and Nova SBE Conference in Corporate Bankruptcy and Restructuring, Econometric Society Summer School in Dynamic Structural Econometrics, MFA, NFA, Stanford SITE, Summer Institute of Finance (SIF), WFA, and seminar participants at Boston University, Carnegie Mellon University, Dauphine-PSL Paris, Indiana University, HKUST, Temple University, University of Georgia, and Wharton. We thank Edward I. Altman for kindly sharing the NYU-Salomon Center Default database. We acknowledge the funding support of the Social Sciences and Humanities Research Council of Canada (SSHRC). Wenyu Wang gratefully acknowledges financial support from the Daniel C. Smith Fellowship.