Innovating Banks and Local Lending

Gregor Weiß†
Universitat Leipzig

ABSTRACT

We study the effects of financial and technological innovation by banks on local competition for deposits and credit supply. Banks that innovate increase their local market power by gaining deposits in a zero sum game at the expense of local non-innovating competitors. Innovative banks make use of both the additional liquidity as well as process innovations itselves and expand aggregate local mortgage lending. Banks allocate their additional funding efficiently with loan performance improving for banks that innovate. We employ two instrumental variable approaches that relate the number of patents awarded to a bank holding company to the human capital available to the bank as well as to the leniency of patent examiners to identify the causal effect of bank innovation on deposits and lending.