Essays on Corporate Finance and Financial Intermediation
Schmeits, A.

Citation for published version (APA):

General rights
It is not permitted to download or to forward/distribute the text or part of it without the consent of the author(s) and/or copyright holder(s), other than for strictly personal, individual use, unless the work is under an open content license (like Creative Commons).

Disclaimer/Complaints regulations
If you believe that digital publication of certain material infringes any of your rights or (privacy) interests, please let the Library know, stating your reasons. In case of a legitimate complaint, the Library will make the material inaccessible and/or remove it from the website. Please Ask the Library: http://uba.uva.nl/en/contact, or a letter to: Library of the University of Amsterdam, Secretariat, Singel 425, 1012 WP Amsterdam, The Netherlands. You will be contacted as soon as possible.
# Table of Contents

## Chapter 1: Introduction and Outline of Dissertation

1.1 Introduction and Motivation ........................................ 2  
1.2 Approach and Background ......................................... 6  
1.3 Outline of the Dissertation ..................................... 9  
1.4 Concluding Remarks ............................................ 14  

## Chapter 2: Information Asymmetry in Financial Markets: Implications for Financial Contracting and the Firm’s Funding Source Choice

2.1 Introduction ......................................................... 16  
2.2 Asymmetric Information, Investment Incentives and Market Failure in Debt and Equity Markets .................................. 18  
2.3 Solutions to Informational Problems: Financial Contracting ......................................................... 25  
2.3.1 Solutions to Adverse Selection ................................ 25  
2.3.2 Solutions to Moral Hazard ................................... 30  
2.4 Solutions to Informational Problems: The Firm’s Funding Source Choice ............................................. 37  
2.4.1 Bank Financing .................................................. 38  
2.4.2 Financial Market Financing .................................... 48  
2.4.3 Venture Capital Financing ..................................... 54  
2.5 Concluding Remarks ............................................ 56  

## Chapter 3: Discretion in Bank Contracts and the Firm’s Funding Source Choice between Bank and Financial Market Financing

3.1 Introduction ......................................................... 60  
3.2 Related Literature .................................................. 64  
3.3 The Basic Model ..................................................... 67  
3.3.1 Production Possibilities for Firms .......................... 67  
3.3.2 Information Structure, Types of Contracts and Funding Sources ............................................. 68  
3.3.3 Sequence of Events in Lender-Borrower Interaction ......................................................... 70  
3.4 Model Analysis ....................................................... 71  
3.4.1 Determination of Interest Rates .............................. 71  
3.4.2 The Borrower’s Choice of Contract Type and Funding Source ............................................. 78
3.4.3 Discussion ......................................................... 88
3.4.4 A Numerical Example .......................................... 89

3.5 Model Extensions and Further Analysis ...................... 91
3.5.1 Ex Ante Investment Incentives, Project Types and the Borrower’s Contract Choice ............................................. 92
3.5.2 Long-Term versus Short-Term Contracts .................. 94
3.5.3 Information Production in Financial Markets and Reputation Formation ................................................................. 96
3.5.4 Implications for Comparative Financial Systems .......... 98
3.5.5 Application to Bank Contracts: Loan Commitments ...... 100

3.6 Conclusions .................................................... 101

Appendix:
A.1 Proofs of Propositions .......................................... 102

Chapter 4: Market Discipline and Incentive Problems in Conglomerate Banks
4.1 Introduction ...................................................... 118
4.2 General Framework and Intuition ................................ 121
4.3 The Model: Setup and Analysis ................................. 123
4.3.1 Specification .................................................. 123
4.3.2 Analysis ....................................................... 126
4.3.3 A Numerical Example ....................................... 135
4.3.4 Discussion ..................................................... 135
4.4 Internal Allocation of Cost of Capital and Incentive Contracting Issues ............................................................... 137
4.4.1 Internal Allocation of Cost of Capital ..................... 137
4.4.2 Incentive Contracting Issues ............................... 140
4.5 Proprietary Trading versus Relationship Banking .......... 143
4.5.1 Introduction .................................................... 143
4.5.2 Specification and Analysis .................................... 144
4.6 Further Implications and Empirical Evidence ............... 147
4.6.1 The Diversification Discount ............................... 147
4.6.2 Conglomeration in Developed and Developing Economies .......................................................... 149
4.6.3 Applications to Corporations: Spinoffs and Equity Carve-Outs ........................................................... 150
4.7 Conclusions .................................................... 151

Appendix:
A.1 Proofs of Propositions .......................................... 152
Chapter 5: Issues in Venture Capital Financing

5.1 Introduction ................................................................................................................. 166

5.2 Main Problems in the Financing of Entrepreneurial (Start-Up) Firms .................. 168
   5.2.1 Informational Problems between Entrepreneurial Firms and Financiers ...... 169
   5.2.2 The Supply Side of the Market for Risk Capital; Policy Issues .................... 171

5.3 Solutions to Informational Problems in the Financing of Start-Up Firms ............. 173
   5.3.1 Information Production .................................................................................. 173
   5.3.2 Contractual Features .................................................................................... 175
   5.3.3 Other Features of Venture Capital Financing ............................................... 189

5.4 Shortcoming in Financing Forms and Institutional Arrangements; Government
   Intervention .................................................................................................................. 190
   5.4.1 Rationales for Government Intervention in the Market for Venture
         Capital .................................................................................................................... 191
   5.4.2 A Simple Model of Government Intervention in the Market for Risk
         Capital .................................................................................................................... 194
   5.4.3 Measures of Government Intervention ......................................................... 198
   5.4.4 Potential Caveats and Possibilities for Extensions ....................................... 205

5.5 Overview and Evaluation of Dutch Measures of Government Intervention in
   the Market for Venture Capital .................................................................................. 207
   5.5.1 Key Arrangements; Government Guarantees ............................................... 208
   5.5.2 Recent Measures ............................................................................................. 211
   5.5.3 Evaluation ....................................................................................................... 212

5.6 Concluding Remarks and Avenues for Future Research ....................................... 213

Appendix:
A.1 Proofs of Propositions ............................................................................................ 217

Summary .......................................................................................................................... 223

References ....................................................................................................................... 227

Summary (in Dutch) ......................................................................................................... 240