

Common Lender Monitoring and Supply Contract Design

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Abstract

Monitoring supply contracts can be costly for customers and suppliers, particularly when they lack specialized expertise. However, when both parties borrow from a common lender, the lender can leverage its monitoring capabilities and information advantages to provide cost-effective oversight for the entire supply chain. Using public data on supply contracts, I find that supply chain partners with a common lender are less likely to use explicit covenants, especially in settings characterized by greater hold-up opportunities or severe information frictions. Suppliers also tend to offer longer trade credit terms when a common lender is present. Exploiting exogenous shocks to common lender formation, I find robust evidence that common lender monitoring mitigates contracting frictions and enhances supply chain stability. These findings reveal a new governance role played by common lenders, extending beyond their traditional financing function.

Keywords: Common Lender Monitoring, Supply Contract Design, Covenant Substitution
JEL Classification Codes: G21, L14, D86

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