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"A Search Model of Bank Default"

Abstract
This paper develops a model in which bank default is endogenously determined, and depends notably on bank size and bankers' behavior. By accounting for heterogeneity in entrepreneurs' productivity and information asymmetry at the expense of financial investors, moral hazard arises following a sectoral productivity shock: bankers tend to choose investments that are more profitable in the short-run but whose risk is borne by the financiers. This 'risk-shifting' mechanism magnifies credit rationing in the economy, particularly for safe borrowers, and contributes to bank default since financial investors may prefer not to (re-)capitalize intermediaries as long as they cannot control for bankers' choices. The search theory helps to depict a financial market freeze, i.e a slow down in fund-raising for even sound borrowers.

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