Securitization and the Firm

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Abstract:

This paper integrates production into the framework of collateral equilibrium to explain how securitization leads to overproduction and overindebtedness. The analysis consists of two parts. The first part is normative and proposes a constrained value maximization criterion for the choice of production scale and security structure. An equivalence result establishes a link to the theory of the firm in incomplete markets: Collateral equilibria under the proposed criterion are equivalent to partnership equilibria under the Drèze criterion. Therefore, they are the only candidates for constrained efficient equilibria. Moreover, when no securities are issued, producers willingly behave as price takers and do not exert market power. The second part points out that securitization destroys this property: Producers get an incentive to deviate from constrained efficient choices. An intermediary who securitizes in the pure interest of producers would dismiss marginal cost pricing and design securities such that investors are exploited.