

Spatial Competition among Financial Service Providers and Optimal Contract Design*

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Abstract

We present a contract-based model of industrial organization that allows us to consider in a unified way both different information frictions (moral hazard, adverse selection, both) and a variety of market structures (monopoly, imperfect competition, various strategic interactions). We show how this method can be applied to the spread of the banking industry in emerging market countries, emphasizing observed transitions, namely the geographic locations of branches. Local collusive monopoly organizations and Bertrand-like competitive environments in location and utility space are considered alongside with frictions affecting the outcome, namely provincial spatial costs and the information structure. Mixed environments with fully informed local incumbents and entrants facing adverse selection are analyzed. Our larger goal, beyond calibrated numerical examples, is to develop a framework with an operational toolkit for empirical work.