Relationship lending, accounting disclosure and credit availability during crisis

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Discussion by Reint Gropp

The paper

- Uses Asian crisis as case study in the effect of bank/firm relationships on credit constraints
- Theory: relationships are valuable during crisis (and costly in good times as banks extract rents)
- Excellent data: World bank survey of SMEs in four Asian countries
- “How has the availability of credit to your plant changed since the onset of the crisis?”
  - Possible answers: “much more restrictive”, “somewhat more restrictive”, “same”, “somewhat less restrictive”, and “much less restrictive”

The paper

- Excellent measure the **change** in credit constraints
  - much better measure than "have you been turned down or discouraged from applying" question in standard surveys (SCF, SSB in US).
- Measure of relationship: Number of banks the firm does business with
- Careful about endogeneity
- Mixed results: in some countries relationships seem useful in others not (or even detrimental)

The paper

- Extension: use whether or not the firm had an external audit as a further explanatory variable
  - Are relationships and external audits substitutes or complements?
- Result: Audits don’t seem to matter or are “bad news”

General comments

- Very nice paper with excellent data
- Implications much beyond emerging markets, as this is -potentially- a very clean case study
- Results are somewhat disappointing
  - Why?

Main comments

- The dependent variable and some ideas
- Measurement of bank/firm relationships
- What to do with the audit variable?

The dependent variable and some ideas

- The dependent variable is great!
  - It reflects the **change** in credit availability
  - Suggestion 1: use pre- to post-crisis change in balance sheet information rather than levels

The dependent variable and some ideas (cont.)

- The authors throw away a lot of information!
  - The question is answered separately for domestic banks and foreign banks, as well as other sources (friends, “local money lenders”, suppliers (trade credit!), bond market, equity market etc.
  - The authors use only the domestic banks part
  - Suggestion 2: Some descriptive statistics
    - tabulate change in credit constraints by different sources
    - Question: does the number of banks include or exclude foreign banks?
  - Suggestion 3: Did foreign banks pick up the slack for good firms? This could explain the strange results for audited firms.

The dependent variable and some ideas

- The strength of the bank should matter for its **ability** to provide insurance in bad times
  - Suggestion 4: Do we know from which banks the authors borrowed and can we use bank specific information? If not, we can use information on the banking sector as a whole (Indonesia).

Measurement of bank/firm relationships

- Literature:
  - length of relationship
  - (log) number of counterparts (this paper)
  - intensity of relationship (number of products)
  - soft versus hard information (Fischer, 2001)

Measurement of bank/firm relationships

- First stage regression dependent variable is a count variable
  - OLS inappropriate
  - Use Poisson or negative binomial model to account for non-normality and discrete nature of dependent variable
- Authors use log of the number of relationships as the independent variable
  - some non-linearity but probably not enough
  - Suggestion 6: try dummy variable equal to one if the bank only has one bank and/or try flexible functional form

What to do with the audit variable?

- Public audit: hard information
  - should this matter for the effect of a relationship in a crisis
  - more discussion
  - Question: can we use information on the opaqueness of firms' assets?
- Suggestion 5: interact audit dummy with length of relationship
  - Idea: in crisis times audited firms should have less of an advantage from the relationship
  - Alternative: if only soft information matters, audit should have no effect
  - Some evidence on substitutability and complementarity between audits and relationships

Final comment

- The Philippines did not have a crisis!
  - This may explain the counterintuitive results for the Philippines!
  - Final suggestion: Drop the Philippines!