

Discussion of  
“Creditor Rights and Allocative Distortions - Evidence  
from India”  
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# Background and Summary

- Contrasting arguments in existing literature on how increasing creditor rights affect access to credit:
  - Positive: Reduce borrowing costs, relax financial constraints (**income effect**).
  - Negative: Excessive and inefficient liquidations (**substitution effect**).
  - Heterogenous: Lilienfeld-Toal et al. (2012).
- Closely related papers find evidence of distortionary effects on credit access:
  - Vig (2007):  $\uparrow$  creditor rights  $\rightarrow$   $\downarrow$  borrowings.
  - Lilienfeld-Toal et al. (2012): increased creditor rights  $\uparrow$  credit access for big firms and  $\downarrow$  access for small firms.
- This paper:
  - explores SARFAESI, a 2002 reform in India that improved creditors' access to collateral (same experiment as Vig (2007)).
  - Asks: Do improved creditor rights lead to **more efficient** resource allocation **across** firms?

# Background and Summary

- Main findings:
  - Support for increased creditor rights improving resource allocation across firms:
    - Reduced secured borrowings at low quality firms, partly due to a reduction in evergreening of loans to zombie firms.
    - This decongestion of zombies increases resources utilized at non zombies (Spillover effect).
    - Resources flow more to more productive firms.

# Discussion

- I like this paper a lot.
  - Very important, interesting and challenging question.
  - Nice use of a variety of data sources (at the firm-, bank- and plant - levels).
  - Well written.
- Discussion focuses on:
  - Interpreting DDD estimates.
  - Channel of resource allocation.
  - Testing spillover effects
  - Some minor comments and suggestions.

# Interpreting DDD estimates- Resource Reallocation

- Question: Does the reform cause secured debt to be allocated **away from** low quality **to** high quality borrowers?
- DDD approach:
  - Specification:

$$y_{it} = \alpha_i + \gamma_t + \eta * 1_{Post} * 1_{LowQ} + \nu * 1_{Post} * 1_{HighT} \\ + \phi 1_{Post} * 1_{LowQ} * 1_{HighT} + \beta * X_{it} + \epsilon_{ijt}$$

- Coefficient of interest,  $\phi$ , captures impact of reform on **difference in outcomes between low- and high- quality borrowers.**

# Interpreting DDD estimates - Resource Reallocation

- **Comment:**

- $\phi < 0$  for secured borrowing: reform is associated with  $\downarrow$  in **difference in secured borrowings between low quality firms and high quality firms**.
  - This may come from low quality firms  $\downarrow$  secured borrowings, or high quality firms  $\uparrow$  secured borrowings, or both.
  - This may also come from low quality and high quality firms both  $\uparrow$  ( $\downarrow$ ) secured borrowings, but low quality firms  $\uparrow$  ( $\downarrow$ ) these borrowings by less (more).
- Key to your argument is establishing that the reform causes  $\downarrow$  **in resources at low quality firms and  $\uparrow$  in those at high quality firms**.

# Interpreting DDD estimates - Spillovers

	(1)	(2)	(3)	(4)
	Secured Debt		CapEx	
$\mathbb{1}_{HighSectorTangibility} * Post$	-29.65*** (9.326)	-33.44*** (10.12)	-17.81 (10.97)	-28.25** (11.53)
Post*Non-Zombie	23.73*** (5.826)	19.25*** (5.822)	30.76*** (8.754)	17.93** (8.567)
Non-Zombie* $\mathbb{1}_{HighSectorTangibility} * Post$	38.61*** (10.25)	38.99*** (10.27)	27.92** (12.05)	33.76*** (11.89)
Baseline Mean	52.62		71.81	
No. of Obs.	52152	52152	52152	52152
R-sq.	0.359	0.366	0.617	0.625
Firm FE	Y	Y	N	N
Year FE	Y	Y	Y	Y
Industry-Year FE	N	Y	N	Y
Controls	N	Y	N	Y

## • Comment (Cont.):

- Triple interaction coefficient  $> 0$  could be entirely attributable to  $\downarrow$  in secured borrowings at zombies and **no change at non zombies**.

# Interpreting DDD estimates

- **Suggestion:**

- Test the effects of the reform separately for high quality and low quality firms (or firms in more vs. less congested industries).
  - Assumption: within each quality group of firms, low tangibility firms provide an unbiased estimate for high tangibility firms in absence of reform.
- Include Low Quality \* Year Fixed effects and High Tangibility \* Year Fixed effects to account for group trends.
- Interact firm level control variables with  $1_{\text{Post}}$ .



# Channel of Resource Allocation

Alternative explanation for low quality borrowers reducing secured debt:

- Vig (2007): Coasian response due to fear of premature liquidation.

Solutions:

## ① Effect of reform on interest rates:

- Vig (2007): lower interest rates on **new secured** loans.
- This paper: interest rates (total interest expense/Total debt) for low quality borrowers  $\uparrow$  post reform.
- **Comment:**  $\downarrow$  in secured debt or  $\uparrow$  in interest rates on new loans?
- **Suggestion:** Examine interest rates on new loans (data availability?)

## ② Substitution into unsecured debt:

- Argument: Coasian response - substitute into unsecured debt.
- This paper finds no effect of reform on unsecured borrowings.
- **Comment:**
  - Alternative explanation: Inability to seamlessly substitute into unsecured debt (Vig, 2007).

# Channel of Resource Allocation -Zombie lending

Is reduction in secured borrowing partly attributable to reduction in evergreening?

	(1)	(2)	(3)
	Secured Borr.		$\mathbb{1}_{zombie\ current}$
High Tangibility * Post	3.699 (4.288)	2.559 (4.238)	0.0336*** (0.0120)
Zombie * Post	-22.40*** (7.281)	-17.28** (7.433)	-0.204*** (0.0575)
Zombie * Post * High Tangibility	-36.65*** (10.63)	-37.75*** (10.83)	-0.139* (0.0718)
Baseline Mean	62.34		0.08
No. of Obs.	51939	51939	11975
R-sq.	0.358	0.387	0.677
Firm FE	Y	Y	Y
Year FE	Y	Y	Y
Industry-Year FE	N	Y	N
Controls	N	Y	N

# Channel of Resource Allocation-Zombie lending

- **Comment:**

- Zombie definition: (A) borrowing cost below minimum prime lending rate, (B) **ICR below 1**, (C) leverage  $> 0.2$ , (D) **a change in debt**  $> 0$ .
- Zombies are a subset of low quality firms (Condition (B)).
  - Contribution of this analysis above analysis on Low quality firms?

- **Suggestion:**

- Examine how much of result in column (3) is driven by decline in **cheap** credit (reduction in evergreening) or improvement in firms' performance.
- Treat this result as a robustness test.

# Channel of Resource Allocation - Banks' characteristics

- **Comment:**

- Increased borrowings and resources at high quality firms can be consistent with:
  - Income effect (higher borrowing capacity and cheaper credit) dominating substitution effect (reduced borrowing due to fear of premature liquidation)
- Your main hypothesis: **Banks** reallocating resources.

- **Suggestion:**

- Move analysis involving banks from Appendix to main text.
- Examine if reallocative effects are more pronounced for banks with better industry experience.

# Real Outcome - Spillover Effects

	(1)	(2)	(3)	(4)
	Secured Debt		CapEx	
$\mathbb{1}_{HighSectorTangibility} * Post$	-29.65*** (9.326)	-33.44*** (10.12)	-17.81 (10.97)	-28.25** (11.53)
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R-sq.	0.359	0.366	0.617	0.625
Firm FE	Y	Y	N	N
Year FE	Y	Y	Y	Y
Industry-Year FE	N	Y	N	Y
Controls	N	Y	N	Y

- **Comment:**

- Is  $\mathbb{1}_{HighInd. Tangibility}$  correlated with  $\mathbb{1}_{HighTangibility}$ ?

- **Suggestion:**

- Examine spillover effects separately for high tangibility firms and low tangibility firms.

## Minor suggestions

- Specification:

$$y_{it} = \alpha_i + \gamma_t + \eta * 1_{Post} * 1_{LowQ} + \nu * 1_{Post} * 1_{HighT} \\ + \phi 1_{Post} * 1_{LowQ} * 1_{HighT} + \beta * X_{it} + \epsilon_{ijt}$$

- Replace change in secured debt with secured debt as the dependent variable (as control variables are in levels).
- Test with balanced sample for robustness.
- Use pre-reform level of secured debt instead of tangibility for robustness.

# Summary

- Super interesting work documenting the effect of increased creditor rights on resource allocation and real outcomes.
- Main suggestions: Sharpen analyses on
  - whether the reform causes resources to **decrease** at bad firms and **increase** at better firms.
  - ruling out alternative hypotheses on the channel of resource reallocation, especially with more analyses focusing on **bank characteristics** and **interest rates**.

Thank you!