

# Entrepreneurship and Credit Constraints

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# Outline

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- Place it in theory
- Discuss features specific to loan guarantee programs
- Discuss the main empirical findings
  - Many robustness tests.
  - Some quibbles
- Ask for more work while commending the paper.

# What this Paper Does:

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- **How effective is the French Loan Guarantee Program (LGP) in**
  - Alleviating credit constraints? (*firm level*)
  - Affecting growth rates of small, credit constrained firms? (*firm level*)
  - Facilitating entrepreneurship? (*industry level*)
  
- **Findings**
  - Firms targeted by LGP raise more debt, at least in the short term.
  - Firms targeted by LGP grow faster.
  - No evidence of LGP fostering entry into entrepreneurship.
  - Causes firms to become bankrupt – high default rates (37%).

# What I Liked About the Paper:

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- **Great Data:** Merger of 4 databases
  - Firm and Loan Level Information
  - Employment data
  - Tax files (for financials)
  - Bankruptcy Filings
  
- **Empirical Analysis** accounting for selection effects
  
- **Potential to make an important contribution**
  - To both academic literature and policy
    - One of the few papers looking at evaluation of guarantee programs using firm-level data

# What the paper needs more of:

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## □ Better placing of the paper in literature

### ■ *Papers on LGP:*

- **Chile (FOGAPE):** Benavente, Galetovic, and Sanhueza (2006) – improves access to credit, low default rates (1.05%).
- **Japan:** Uesugi, Sakai, and Yamashiro (2006) – increase in long term loans, increased efficiency for program users, less than 7% defaulted.

### ■ *Other studies on Directed Credit:*

- Zia (2008), Arping, Loranth, Morrizon (2008), Li (1998), Vogel and Adams

### ■ *Constraints and Firm Entry:*

## □ Policy Implications

- What should be the role of government in SME - Access to finance?
- Debate on direct vs. indirect subsidies.

# Questions:

## Loan guarantee programs

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- ❑ What is the specific **credit market imperfections** the French LGP sought to address?
  
- ❑ Back of the envelope calculation suggests that subsidy amounts to 4200 euros per long term job!
  - Are **true costs** of LGPs – costs of setting up, subsidizing, and participating in loan guarantees - factored in?
    - ❑ Increased transaction costs due to inclusion of a third party (guarantor)
    - ❑ Program subsidies

# Questions:

## Loan guarantee programs

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### □ How are the benefits (additionality) being measured?

#### ■ Substitution Effects:

- Lenders may transfer their existing loan portfolio to the guarantee programs
- Lenders under political pressure try to comply by shifting existing borrowers (perhaps riskiest)
- Borrowers covered by a LGP could be clients of other lenders

#### ■ Paper explicitly mentions “*In contrast to US SBA’s Loan program, firms do not need to prove that they were not able to obtain credit on the regular market*”

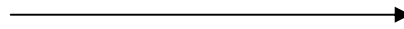
- So potential substitution effects could be huge or not since they are new firms

# Empirical Set-Up

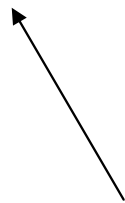
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- Use exogenous shock (policy change in 1995) that affected availability of credit to an identifiable subset of firms (construction and services industries)

Did the firm receive a loan through loan guarantee program in year 1 after creation



Firm performance in years 2,4, and 6 after creation



**Instrument:**

1: Newly eligible industry after 1995

0: Already eligible industry

# Empirical Analysis

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- ❑ So is this really comparing small firms in services and construction to manufacturing firms?
  - Service liberalization dates in France?
  
- ❑ Missing variables from selection model?
  - Connections between Lenders and Guarantor – political pressures
  - Past Loans from same lender
  - Loan guarantee varies between 40-70%. How is this accounted for in the analysis? Could be a big factor in determining default rates.

# A closer look at the results

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## □ Impact on Debt Growth and Financial Burden:

- To what extent can we rely on the selection model?
  - Short term (2/4 years) versus Long Term (6 years)
  - Includes defaulting firms who are likely to have high default rates.
- Financial Burden: Tough to interpret results

## □ Impact on Bankruptcy Probability

- Budget Constraint of guarantor
  - Banks monitor less (a function of % guarantee)
  - Moral Hazard

## □ Why the focus on only the Creation Fund?

# Conclusion

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- This is an important and interesting paper.
- Raises a number of interesting questions.
- Significant scope for additional research