
Discussant Comments for
Ayyagari , Demirgüç-Kunt, and
Maksimovic (2008)

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Research Questions

- Are Allen, Qian, and Qian (2005) really correct in saying that Chinese firms are primarily aided by alternative governance mechanisms and informal financing?
 - Do the firms that rely on informal financing really have better performance outcomes (highest sales growth and higher productivity growth) together with higher reinvestment rates?
- Are Allen, Qian, and Qian (2005) really correct in concluding that, based on the China example, the law and finance literature's focus on formal financial development is wrong?

Summary of Ayyagari , Demirgüç-Kunt, and Maksimovic (2008): No, Chinese firms are aided by access to bank finance. No, the law and finance is correct in its emphasis on how formal financial development leads to firm-level development.

Comments on Data

- 2400 Chinese firms surveyed across all five of China's regions in 2003
 - Survey data on financing sources coupled with survey data on balance sheet items
 - Sample based on stratified random sampling methodology meant to represent China's five main regions

Comments on Data

Questions:

1. Are all the balance sheet and income statement items self-reported? Is it possible to match them with an external source (particularly audited financials)?
2. Do firms with bank finance have an incentive to overestimate their performance? Do firms without formal finance have any incentive to underreport their performance?
3. What does the gigantic “Other” category of finance sourcing really represent? (42.7 percent of financial sourcing is weakly defined; table implicitly suggests that it’s really mostly about internal reinvestment?) (But great that they have unbundled internal reinvestment and loans from family and friends)
4. Is a low reinvestment rate always “bad”? Shouldn’t well-governed firms in mature industries with cash-cow businesses be returning the money back to investors? Is there a way to control for such firms (separate from firm age)?

Identification Strategy

- IV strategy (use whether the firm's loan required collateral as an instrument for bank finance; then use bank finance to predict firm-level sales growth/productivity growth/reinvestment rate)
- Match on observables using propensity score matching; then see if matched firms do better if they have bank finance

Comments on Identification Strategy

- The IV strategy depends on the exogeneity of collateral to subsequent firm performance.
 - That argument is plausible (relies on assumption that great firms happen not to have collateral and/or collateral requirements are often suboptimally high) but could benefit from additional evidence.
 - What makes a loan require collateral?
 - Best to bring the full definition of the collateral variable into the main text (first definition in the text is about the loan attributes; later definition is about the firm's possession of collateral; definition in Table 5 is more complete/should be brought into the main text)
 - How should we think about the firms that never sought loans? Would they have had collateral?
 - If collateral is more of a must in weak institutional environments (see footnote in paper), then why isn't collateral affecting performance through multiple governance and strategic choice variables?

Further Comments on Identification Strategy

- Propensity score matching is quite attractive and convincing; hence what would make this analysis more of a slam dunk?
 - Is it possible to leverage additional variables from the surveys to get as close as match as possible?
 - Can you demonstrate robustness with the two or three other ways of running the propensity score matching model?

Results

- They find higher reinvestment rates and higher sales growth at the same productivity growth for formally financed firms, suggesting that bank-financed growth is not inefficient growth

Other Suggestions

- Best to Include More and Better IO variables (or otherwise to suggest better IO variables for future survey administration)
 - Past models of sales growth/value added/productivity come from the IO literature
 - The IO literature has at least four decades of results linking specific industry structure variables to these outcomes
 - Productivity growth in particular could be determined heavily by pricing power
 - Not clear what the competition variable means if many firms compete on a local/regional or global basis
 - Simple solution: industry*location interaction dummies

Other Suggestions

- Best to differentiate among cities/regions based on the prevalence of political rents/corruption on the one hand and capitalist heritage and location/agglomeration advantages on the other hand
- Other Measurement Suggestions
 - Best to try other measures of productivity (esp. quasi-rents per worker, given that value added per worker is a blunt measure; hence don't be so surprised that you don't see significant value added per worker results)
 - Best to try other measures of performance (esp. ROIC)
 - Really need to confirm nature of "Other" financing category (go back to a small random sample of firms?)

Other Suggestions

■ Other Measurement Suggestions

- Need to further rule out the possibility that banks seek out successful/reliable firms and loan them money to make the bank's balance sheets appear better; is there a way to examine the volatility of these firms' performance during 1999-2002
- Much of the analysis is based on threshold effects; would be nice to compare the results using solely continuous variables
- Could collateral variable be included as the residual of collateral regressed on past performance?
- (30-31): Should we expect firms to answer honestly whether the bank required a gift or bribe? Would the firms in the sample not expect that is the wrong answer to give (that it reflects badly on their banker, on themselves)?
- (31): Would be ideal to differentiate among distinct types of political connections through a continuous scale; and to ask about family connections to the party and to senior bureaucrats

Last Suggestions

- Interpretation of Findings
 - Is this a story of formal finance working well? (yes), but is this also a story of Chinese state-owned banks learning over time to get the incentives approximately right? (Otherwise, why are the politically connected not more likely to get loans? And why is the proportion getting government help relatively small?)
- Other questions to pursue
 - What impedes these successful SMEs from getting minimum collateral?
 - Are there policy interventions needed to get these firms the needed collateral or to make the banks behave more optimally in their collateral requirements?