BANCO DE PORTUGAL
EUROSISTEMA

Collateral channel and small business lending

Ari Hyytinen and Ilkka Ylhainen

Discussion by

Diana Bonfim

Research question:

A look at the collateral channel: how do house prices influence SMEs access to bank debt?

Housing and real estate owned by firm owners may be an important source of pledgeable collateral.

Empirical strategy:

- The research question is highly relevant, but also highly endogenous.

- The authors are very careful about identification.

- Key element for identification: detailed regional and zoning data.

- IV approach (planned areas and municipal mergers).

- Arellano-Bond estimation.

Main conclusions:

- Higher house prices are associated with more access to bank loans.

- This results across many specifications and robustness tests.

1. IV approach: planned area

- Great instrument.

- Only possible caveat not mentioned by the authors: lobbying pressures?

- Suggestion: exclude municipalities with high concentration of firms (what if Nokia wants to build a new factory?); exclude election years?

- Playing devil's advocate: can this instrument directly affect bank debt?

  If there is no sufficient construction space, firms may prefer to invest elsewhere, as their growth opportunities in this municipality may be more constrained. Is this reflected solely on house prices?

1. IV approach: planned area

- Timing assumptions:

    - "In areas where land supply is relatively inelastic, shocks to the housing demand translate into higher house prices."
    But even when this is not the case, demand shocks may take some time accommodate; construction is not immediate – try to use some lags (is the sample long enough for this?)

- Non-linear effects are indeed important. Do also some sample splits (low vs high planned areas; high vs small changes in planned areas,…).

2. What happened in housing markets in Finland during this period?

- How much house prices variation? Nationally? Locally? How much heterogeneity?

- Are there differences between rural and urban areas?

- Any information on commercial property prices?

- The external validity of the results relies to some extent on these dynamics.

- Given that most evidence is based on the US, highlighting this may actually make the contribution of the paper clearer.

- Some statistics on credit dynamics could also be interesting.

3. Firm controls

- Firm controls: age, size and credit score. Is this enough?

- There are advantages in keeping it simple, but…

  omitted variables problem?

- Credit score has a counterintuitive negative coefficient in many specifications.

4. The effect of the financial crisis

“The financial crisis originated from the US housing markets and highlighted the risks in using real estate and housing as collateral.”

“… the effect may have become weaker due to the financial crisis.”

- Some doubts about this conclusion. Evidence that banks are actually asking for more collateral.

- The problems had more to do with the valuation of collateral than with collateral itself. No collateral should still be riskier than weak collateral, all else equal.

Test also the direct effect of the crisis dummy (without it, the interaction may be capturing a slowdown in credit growth during this period).

5. The wealth effect

- Important channel; measured through dividends distribution.

- Is this the best measure?

- If the wealth effect works through entrepreneurship, then maybe it makes more sense to look at real variables:
    - change in employees
    - change in investment (done in 4.4; note: a lag may be needed)
    - 1st time borrowers.

6. Policy implications

- “A 100€ increase in regional house prices increases the use of bank debt of such firms by about 1.88 percentage points.”
- What are the policy implications? Though it’s good to be agnostic, is this good or bad?
- Briefly discussed in the last paragraph.
- Suggestion (for a different paper?): track ex-post performance of these firms.
- Look at financially constrained firms and at highly levered firms.

7. Minor issues

- “Collateral channel and small business lending” – is this the best title? House prices play a key role in the paper.

- The results for micro firms (<5 employees) are often emphasized. But what are these firms? In which sectors do they operate (restaurants, hairdressers, lawyers?)

- Several sectors are excluded from the analysis (and included for robustness purposes). Construction and real estate may be interesting to look at separately.

7. Minor issues

- Look at house price growth vs house price level?

- Try separately firm fixed effects and region fixed effects.

- Placebo tests: house prices in other regions? Large firms?

- Many zero leverage firms – run regressions only for the sample of firms with bank debt.

In sum

- Great paper.
- Very careful identification strategy.
- Extensive robustness analysis.
- Very clear and transparent analysis.
- Important contribution: fast growing literature, mostly US based. The contribution of the paper is correctly emphasized.