The response of firms’ investment and financing to adverse cash flow shocks: the role of bank relationships

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Question?

Are firms with bilateral bank relationships less credit constrained than firms with multilateral relationships?
NO! Firms w/ bilateral relationships have...

- **Lower** bank debt / assets, controlling for size OLS
- Investment **not less sensitive** to cash flow, even during adverse cash flow periods Error correction model
  Fazzari Hubbard Petersen (BPEA 1988), Bond Elston Mairesse Mulkay (REStat 2003)
- During adverse cash flow periods, **no difference** in financing Univariate analysis
- Probability of receiving extra bank debt **lower**, even during adverse cash flow
This Evidence

Is at odds with findings showing that …

(Bilateral) bank relationship firms are:

- Less sensitive to cash flows
  Hoshi Kashyap Scharfstein (QJE 1991), Elston (1998), …

- More sensitive to cash flows
  Houston and James (JB 2001), …

- Bank debt increases during bad times if firms have a main / close bank relationship
  Elsas Krahnen (JBF 1998), Vickerey (2005), …
Paper

- Contains a logical sequence of interesting and insightful exercises
- Yields findings that challenge the established literature
Concerns

- Sample selection
- Definition of a relationship
- Definition of adverse shocks in cash flows
Sample: No Small Firms!

>100 employees or (>50 employees, turnover > 6.25 mln EUR and/or balance > 3.125 mln EUR)

Why?
- Missing sales figures, imprecise info, ...
- Credit reporting limit of 25,000 EUR: bias?

Possibly problematic? (authors admit)
- Theory: opaqueness
- Other empirical work
  - What is then precisely the contribution?
Sample: No Distressed Firms!

= Firms with one (?) negative cash flow

Why? Distressed firms were found to be insensitive to cash flow fluctuations Allyannis Mozundar (JBF 2004)

Possibly problematic?

- Relationships not featured in those exercises
- This paper tests not only cash flow sensitivity
- Definition seems stringent
- Relationships may matter, particularly for distressed firms
Definition of a Relationship

A relationship exists as soon as a bank reports a loan, credit line or collateral for a firm to the Central Credit Office.

- Large firms may just have a credit line with one bank ("bilateral relationship"), but it may not be that important to them
  - You acknowledge this fundamental problem
  - Measure strength of the relationship: time, volume, …?

- Other empirical work: more encompassing definitions: “main bank”, “Hausbank”, “primary bank”, …
  - Difficult to compare results!
Definition of a Relationship

A relationship exists as soon as a bank reports a loan, credit line or collateral for a firm to the Central Credit Office.

- Are there firms that move from bilateral to multilateral during sample period?
- What is the timing of your relationship measurement (year preceding?)
- No cross-border relationships
  - May matter for large firms
Definition of Adverse CF Shock

= First quartile changes in cash flow / capital

= Minimal reduction of cash flow / capital by 5%

- Drop from from really high cash flow in the previous period to say the mean assumed to have the same (financing) effect as drop from say the mean to really low value

- Negative cash flows: disqualifies firms

- Liquidity shocks on the bank side?

Detragiache Garella Guiso (JF 2000)
Minor Comments

- Literature review: few suggestions
- Trivia on marked-up copy
To Conclude

Interesting data and line-up of exercises but contribution of findings possibly (still) unclear