Discussion of “Precautionary Debt Capacity” by Deniz Aydin and Olivia Kim

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A large-scale high stakes experiment on an important topic

- Research Question: How do SMEs respond to a random increase in debt capacity?

- Main Findings:
  1. Seemingly unconstrained SMEs also borrow and invest *as if they are constrained.*
  2. Response changes over time – use debt first for operating expenses then investment.
  3. Firms with volatile expenses preserve more debt capacity.

- Conclusion: SMEs are *dynamically financially constrained*. Desire to preserve *financial flexibility* is the key friction.
  - Also discuss some other potential drivers: lumpy investments, encouragement, learning.

- Ambitious experiment on an important topic with great potential to be influential.

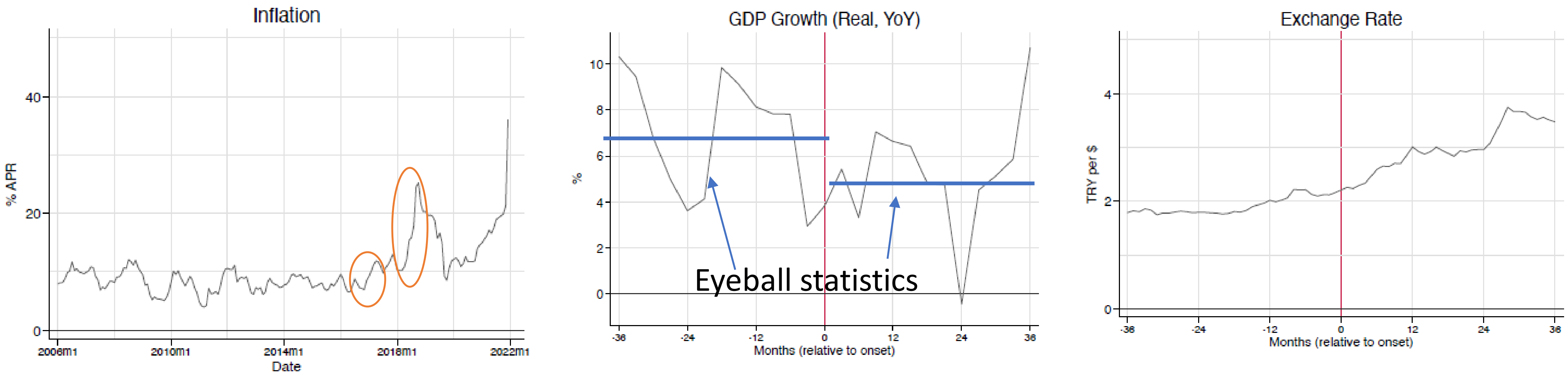
Outline of the discussion

- Turkey during 2014-2017 (and 2018):
  - growth, inflation, USD/TRY exchange rate, gas prices

- Alternative explanations:
  - Strategic considerations
  - Liability structure, personal guarantees, personal use etc.
  - Information about the macroeconomic environment
  - Behavioral explanations

An unusually good time to run an experiment in Turkey, but still…

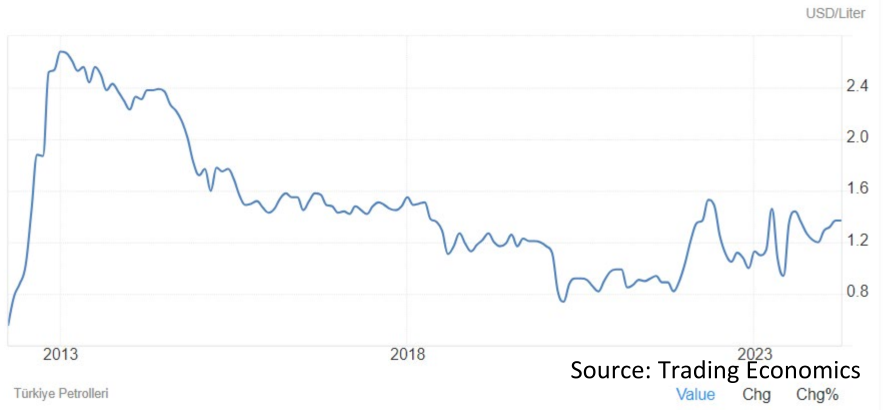
- Late 2010s: Turkey increasingly an outlier. The experiment ends before 2018.



- Experiment ends before the large inflation spike of 2018, but decisions taken during the experiment period might include expectations of the spike.
- Higher growth before and low growth after the onset and rising USD (from 2 to 4).

Several potential issues due to the macro environment

- Potentially rising input costs (for importers), low inflation and low growth:
  - Can we rule out that some firms actually needed more financing during the exp.?
  - Treatment heterogeneity w.r.t import intensity?
- Gas prices: A significant share of revolving debt into gas. Substitution/income effects?



Source: Trading Economics

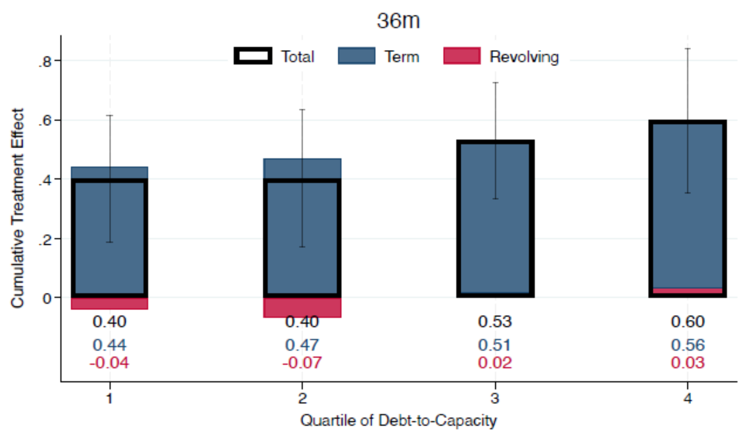
- Previous high growth and the large inflation of 2018 potentially problematic:
  - Strategic considerations
  - Information content of debt capacity increase about the macroeconomic environment

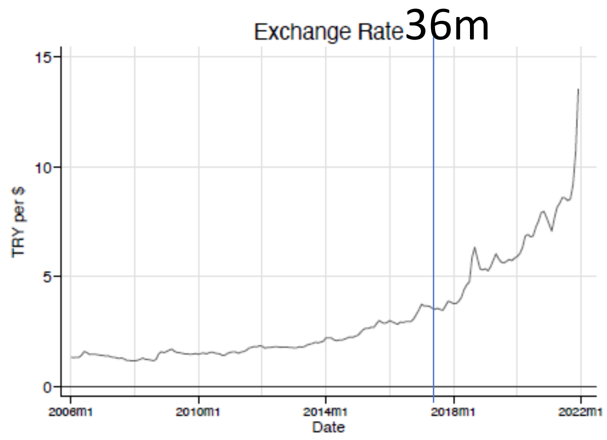
Strategic considerations

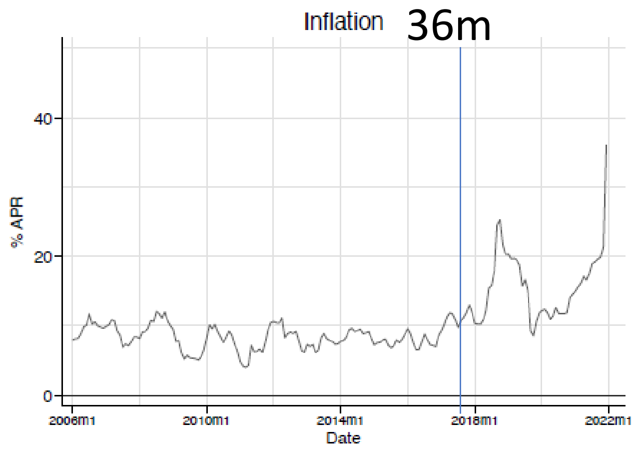
- 2018: a sharp deterioration of FX and inflation. Given the political climate, not entirely unpredictable (“The coming of Thursday is evident from Wednesday”).

- Firms could be taking (interest-free) term loans to:
    - frontload these purchases before to shield themselves from a possible TRY depreciation (durables are more likely to be imported)
    - strategically borrow more to benefit from inflation eroding the real value of the term debt

(b) Long-run: 36-month







Are future credit lines a function of current usage?

- For example, in the US, no credit use results in a reduction of the credit score and eventually debt capacity. Can something similar be going on here?

- Just increase the use of the credit lines to signal the bank that they are using them in order to receive future credit line increases?

- Could be consistent with the firms with more volatile earnings tapping more into CL.
  - Those are the ones that need future credit lines more.

- Describe the credit line allocation and limit expansion process in more detail.

Personal liability/personal use?

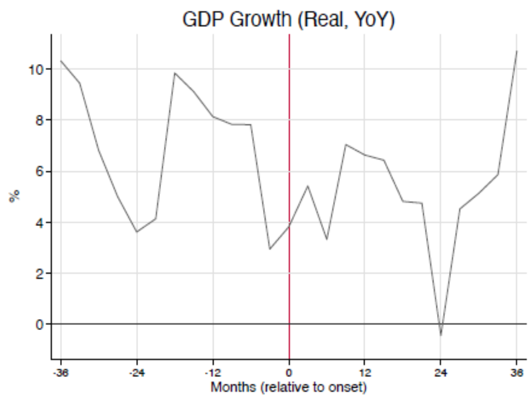
- What is the liability structure? Do business owners have any personal liability in case of bankruptcy? Are there personal guarantees to the loans? This could explain the precautionary debt capacity.

- Authors argue only 11% of businesses have multiple banking relationships and take that as evidence that no substitution is going on.

- Can we exclude that there is no personal use of company credit limit?
  - These are especially worrisome for very small firms etc.
  - Likely makes the small ticket items/revolving debt unreliable for firm outcomes.

Information about the macroeconomic environment

- Can firms take the debt capacity increases as a signal from the bank about a positive macro environment?



- Authors test an encouragement effect of a lender-initiated capacity increases and find no evidence of treatment heterogeneity between firms that experienced the increase for the first time vs multiple times.

- This test does not exclude that debt capacity increases might signal a more positive macro environment (for everyone whose limit increased).

Behavioral explanations

- Learning: exclude by showing young and old firms use “more expensive” revolving debt similarly.
  - Revolving debt is more expensive only if the purchase qualifies for a term loan and the firm does not fully pay at the end of the billing cycle.
  - Just comparing revolving vs term debt is insufficient. More statistics about the payment of revolving debt. What fraction of firms carry the revolving debt over?

- Salience:
  - Just the fact that you receive a phone call or text from the bank about your debt capacity could increase the salience of debt capacity and make you use more debt?
    - Are results different for firms that received phone calls vs texts?

  - Can we be sure that the bank does not communicate the credit line limit increases to businesses that sell electronics etc which would also target their marketing towards these firms?

Conclusion

- Causal effects of financing on firms. Overcomes two key challenges:
  - Correlated confounds: factors that affects financing affect investment opportunities.
  - Selection: firms seek financing if they expect needing it.

- The paper deserves credit for a large scale experiment on an important topic.

- Address potential issues due to macro environment and alternative explanations:
  - Perhaps a survey of firms could help.
  - Follow the firms during the Covid-19 crisis. Did they use precautionary debt buffers?

- Potential to be a significant contribution, hope to see it at a top journal!