Discussion of On the Real Effects of Bank Bailouts: Micro-Evidence from Japan by M. Giannetti and A. Siminov

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Key contribution

1. Provides thorough evidence that substantial bank recapitalizations mitigate credit crunches
2. Shows that mitigating loan supply effects has real effects on value of firms and corporate investments

- Insufficient recapitalization might have no (or even an opposing) effect on loan supply
- Insufficiently recapitalized banks tend to zombie lending

Loan supply effects I

- Annual bank-firm loan data for Japan covering 1998-2004
- Estimate growth of loans granted by bank k to firm i using firm x year fixed effects
- Regress loan growth on outstanding loans from k to i
- Interact outstanding loans from k to i with bank k's recapitalization

→ Loan supply effect of a recapitalization

- Interact interaction term with dummy for still undercapitalized bank

→ Differences in loan supply effect of a recapitalization

- Interact interacted interaction term with a dummy for 'zombie firms'

→ Differences in adjustment of lending to zombie firms at well- and undercapitalized banks

Loan supply effects II

Results show

- Strong bank-firm credit relationships declined
- Recapitalization generally induced banks to increase loans the closer credit relationships

→ Generally recapitalization fosters loan supply

- For undercapitalized banks a recapitalization induces banks to reduce loans to the closer relationships

→ Insufficient recapitalization fosters banks' deleveraging which reduces loan supply

- Only undercapitalized banks increase their lending to related zombie borrowers after recapitalization

→ Insufficient recapitalized banks try to avoid default of bankrupt borrowers in order to shirk loan write-offs

Real effects: Firm value

- Estimate daily abnormal returns of firms' stocks after announcement of recapitalization measures

→ Daily abnormal returns of a firm are larger, the higher the recapitalization received by a relationship lender to the firm

→ This effect is weaker (or even not there) if the bank remains undercapitalized

→ For Zombie firms the announcement effect is not necessarily significantly different

Real effects: Investment

- Changes in firms debt ratio, cash holdings, employment and investment estimated using the recapitalization received by relationship lenders

→ Do recapitalizations relax financing constraints?

→ Investment higher at firms whose relationship lenders received a higher capital injection

→ At firms whose relationship lender is still undercapitalized after injection, a higher injection is detrimental to firm's investment

→ At zombie firms' investment does not decline in the capital injection if relationship lender remain undercapitalized

Comment: Different Story

- Decline in loan growth of still undercapitalized banks after capital injection might not be a supply effect
- 'Firm x year' fixed effects take care of changes to the overall loan demand of a firm but not to the structure of a firm's loan demand
- Firms with a strong credit relationship to a still undercapitalized bank might be worried about their future funding
- They want to diversify their funding sources and demand relatively more loans from well capitalized banks

Comment: Maturity

- Loan growth refers to outstanding amounts; not to new business
- If different types of banks offer loans at different maturity a drop in demand will also affect the outstanding amount to different banks differently
- More fragile banks might have reduced the maturity of their outstanding loan at the beginning of the crisis
- If firms credit demand dropped in the years of the recapitalization particularly outstanding amount with weaker banks declined

→ Your data should allow to control for changes in the maturity

→ Generally, it would be interesting to see the effects of the recapitalization on maturity of newly granted loans

Comment: Relationship unknown

- Recapitalization of relationship lenders can only have an impact on stock returns if strength of relationships are known to stock investors
- Given an average lending concentration of 8% with a SD of 12.5 there is rarely one single prominent relationship lender that might be publicly known
- If your data on relationship lending was known to stock market participants state it
- Otherwise you need to explain, how a recapitalization of relationship lenders affect stock market participants' expectation of future financial constrain, if lending relationships are not publicly known

Conclusion

- A very nice paper, very convincingly shows that bank recapitalizations help mitigate credit crunches and its real economic effects
- I am not yet 100% convinced of the detrimental effects of too little capital injections

Minor comments

- Definition 1 of undercapitalized banks refers to tier 1 capital which was not affected by capital injections
- Recapitalization did not bring banks closer to meeting the requirements
- Why should incentives to deleverage (to meet requirements) then increase due to recapitalization for undercapitalized banks?