Misallocation due to inefficient exits: Evidence from India
--Nirupama Kulkarni

Discussion by
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The Paper

- Considers SARFAESI act 2002 as an exogenous shock to increase creditor rights in the secured debt categories.

- It then shows that post SARFAESI,

    - the bank lending moved away from low quality lenders and towards high quality lenders

    - Low quality borrowers responded by decreasing capital expenditure and employment

    - For Zombie firms, there was an increase in profitability and productivity post SARFAESI

First Impression

- 78 pages to read! And one and a half days to go!!
- Very Interesting and engaging question
- Lucid writing
- Rigorous work..all potential issues addressed

Defining Quality of Firms

- The earlier definition of “zombie” firm in the literature which is based on the basis of subsidized credit(Caballero et al 2008).

- The argument being quality based on operational characterized firms invite high correlation of the quality measure with the operational characteristics

- The definition is modified in this paper by taking account of profitability, leverage making it endogenous

- What is then the best way to define zombie firm?

- Should one ICR should fit across all industries? Some industries the ICG is low, say utility firms, then less than median, without industry adjustments may be misleading

SARFAESI ACT 2002

- Under the SARFAESI Act (section 13 (2)), the creditor is entitled to

  1. Take possession of the secured assets of the borrower.
  2. Takeover of the management of the business of the borrower.
  3. Appoint any person to manage the secured assets, possession of which is taken by the secured creditor.
  4. Require any person who has acquired any of the secured assets from the borrower and from whom money is due to the borrower to directly pay the secured creditor to cover the secured debt owed to the creditor.

Impact of SARFAESI- I

- Argument in the paper is threat of “seizure of secured asset” made it highly effective immediately after promulgation

  - Implication: the law is understood and interpreted very fast, Does it hold?
  - The author argues that “interpretation and reinterpretations” makes the law makes less effective in later years

  - Variation that can add to the story

    - Did implementation of SARFAESI had had any differential impact as compared to perception?
    - What was the impact of DRT? (Bue et al 2017)

Impact of SARFAESI - II

- SARFAESI made secured borrowing more expensive for low quality borrowers

  - Expected outcome unsecured borrowings would rise, it does increase but volume is not very high…what could be a possible rationale?

  - Percentage of low quality versus high quality listed firms versus unlisted firms in the data? Move towards equity financing

  - Access to credit from foreign investors

Impact of SARFAESI -III

- Growth Rate of GDP
- Credit Climate
- High growth rate, easy credit leading to lower credit to firms when creditor has greater rights
- Taken care of by DDD?
- But Competition Act 2002 came same year as SARFAESI!
- Implication for the effect on capital expenditure, employment, profitability and entry and exit

Contribution

- Vig (2007) looks at the adverse impact of SARFAESI Act 2002 led excessive creditor rights on credit availability

- Bue et al (2017) considers the change in bank firm interrelationship post SARFAESI alteration of rights

- This papers adds to the literature by considering the effect of increase in creditor rights on the quality of borrowers existing in the market and overall increase in efficiency, going beyond the effects captured by Caballero et al (2008)

- Further scope: Exploring the theoretical implications of these results

Thank you