

# Distributional Implications of Bank Branch Expansions: Evidence from India

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  - ▶ Financial frictions stemming from information asymmetry can create barriers in access to finance
  - ▶ Firms cannot invest in positive NPV projects due to lack of financing
  - ▶ Bank branches in the local area would facilitate better screening and monitoring of firms
  - ▶ Increase in supply of credit would ease credit constraints, increasing investment and employment

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- ▶ Main findings
  1. Increase in capital expenditure in underbanked districts
  2. Driven by credit constrained firms

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- ▶ Main findings
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- ▶ Comments
  - ▶ Empirical analysis well-executed
  - ▶ Scope for improvement
    - ▶ Contribution
    - ▶ Mechanisms

# Comment 1: Contribution

The paper belongs to two large strands of literature in finance

1. Real effects of credit supply shocks
2. Role of physical distance in alleviating financial frictions

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## Real effects of credit supply shocks

- ▶ Franklin Allen in his 2001 AFA address: financial intermediaries are a veil; have no real effects on resource allocation
- ▶ Numerous studies after the global financial crisis showing how bank credit can affect firm investment (Chodorow-Reich, 2014)

# Comment 1: Contribution

## Real effects of credit supply shocks

- ▶ Franklin Allen in his 2001 AFA address: financial intermediaries are a veil; have no real effects on resource allocation
- ▶ Numerous studies after the global financial crisis showing how bank credit can affect firm investment, especially for financially constrained firms
- ▶ **Suggestions:**
  1. Asymmetric effects of positive vs negative effects of credit supply shocks on firm investment
    - ▶ While a negative credit supply shocks would certainly reduce investment, an increase in credit supply would increase investment only if firms had profitable investment opportunities but did not have access to financing
    - ▶ Possible to look at loan applications?
  2. Use institutional details on credit markets in India to say something about the magnitude of the effect
    - ▶ Role of internal capital markets?

# Comment 1: Contribution

## Role of physical distance in reducing information asymmetry

- ▶ Information about small businesses is “soft” and has to be collected overtime through relationship lending (Berger and Udell, 1995; Petersen and Rajan, 1994)
- ▶ Local lenders can facilitate better collection of soft information (Agarwal and Hauswald, 2007)

# Comment 1: Contribution

## Role of physical distance in reducing information asymmetry

- ▶ Information about small businesses is “soft” and has to be collected overtime through relationship lending (Berger and Udell, 1995; Petersen and Rajan, 1994)
- ▶ Local lenders can facilitate better collection of soft information (Agarwal and Hauswald, 2007)
- ▶ **Suggestions:**
  1. Link results to this literature. It would be useful to provide summary statistics on the average distance between lenders and borrowers for small vs large firms before the policy
  2. Explore the IO of credit markets in India. Evidence on informational rents? Dynamics of loan pricing
  3. Would be useful to think about the interaction between competition and strategic information acquisition to assess effects in the medium-long term.

## Comment 2: Mechanisms

- ▶ It would be useful to spend more time discussing the economic mechanisms
- ▶ It is not clear ex ante whether entry of private banks would improve credit access for small firms
- ▶ Gormley (2007) shows that foreign bank entry in India leads to ‘cream-skimming’ where banks lend to most profitable firms
- ▶ What incentivizes loan officers in private banks to lend to small firms which often do not have enough collateral?

## Comment 2: Mechanisms

- ▶ Can you provide evidence on how physical proximity affects financial frictions?
- ▶ Does local monitoring allow banks to reduce NPLs, suggesting reductions in frictions in ex post monitoring?
- ▶ Do we see a change in the borrower pool? This could provide suggestive evidence on whether lender-borrower proximity can reduce adverse selection
- ▶ Looking at loan pricing for the same firm borrowing from a local vs external bank can also shed light on the importance of proximity in reducing financial frictions

## Other Comments

- ▶ Why not take the size of each branch into account to identify underbanked regions?
- ▶ Implications for productive allocation of credit? See Chakraborty, Javadekar, and Ramcharan (2021)
- ▶ What explains the muted effect on productivity?

# Conclusion

- ▶ Great experiment and excellent data
- ▶ Need to strengthen the discussion on mechanisms and contribution to the literature
- ▶ Lots of avenues for future research!