Discussant comments on *Bank involvement with SMEs: Beyond relationship lending* by Augusto de la Torre, Maria S. Martinez, Sergio Schmukler

Ajay Shah

March 10, 2010
The old US financial system

- Big Firms
- Small Firms
- Individuals

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March 10, 2010
The revolution in finance

Black/Scholes 1973
Computer technology late 1970s
Removal of capital controls late 1970s
Cash settlement 1982
Securitisation early 1980s

Put together: the rise of organised financial trading
The new US financial system

- Big Firms
- Small Firms
- Individuals
- Banks

Equity & bond financing

Securitisation

The securities markets

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What about the little firms?

- Individuals doing credit card financing was one channel
- Venture capital in some form was another
  (difficult to enforce call option payoff of equity with small firms).
- Overall, seen as a weakness of the new finance
The question

- Can the tools of the new finance do better at lending to small firms?
- Can the technology of credit models and securitisation be applied to small firms?
The conventional wisdom is not correct: big banks are doing significant work with SMEs.

Competition has driven banks to take interest in SMEs.

Relationship lending is not the essence of it.

New technology and process design matters - which is wielded best by big and foreign banks.

The bank sells a comprehensive array of services to the firm, and hooks up to the upstream securities markets.
Part I

An Indian take
Basic problems of Indian banking

- Presence and domination of public sector banks
- Barriers to entry by private and foreign banks
- Detailed rules-based regulation which limits judgment by banks
- Other than the equity market, lack of the organised financial trading that banks can plug into
- SME financing is but collateral damage
Let’s start with the big firms: All non-financial firms in the CMIE Database

<table>
<thead>
<tr>
<th></th>
<th>1991</th>
<th>1999</th>
<th>2009</th>
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<tbody>
<tr>
<td>Equity</td>
<td>28.7</td>
<td>33.9</td>
<td>40.5</td>
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<tr>
<td>Total borrowing</td>
<td>43.0</td>
<td>39.4</td>
<td>30.1</td>
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<td>Borrowing from banks</td>
<td>11.7</td>
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<td>16.2</td>
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<tr>
<td>Total</td>
<td>100</td>
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And these are the biggest firms.
RBI data for bank lending

About September 2007, released Nov 2009:

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Remainder

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'Standard micro and small enterprises' 1.86 9.78 4.65

Overall Non-food credit 19.01 100 47.5
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Citibank’s work
Credit bureaus can lead to better loans to individuals
Frontiers of SME financing in India

- Citibank’s work
- Credit bureaus can lead to better loans to individuals
- Competition
- Improvements in banking regulation
- Achieve the sophisticated upstream markets.
Comments on the paper

- Is there something going wrong with SME financing? Maybe all-equity financing from friends and family is not bad.
- Underwhelmed by survey evidence
- Before and after would be very interesting
- Would be very interesting to have a model so we can obtain better insights into what is going on
- Heterogeneity in the setting, of banking in the country.
Thank you.