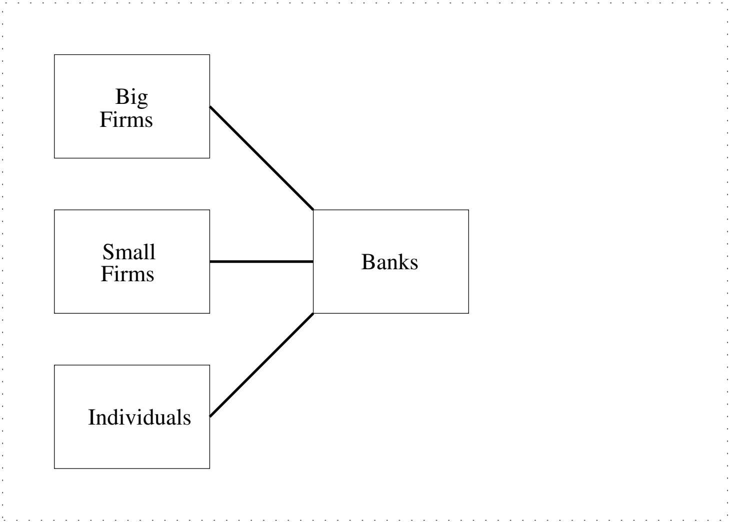
Discussant comments on *Bank involvement with SMEs: Beyond relationship lending* by Augusto de la Torre, Maria S. Martinez, Sergio Schmukler

Ajay Shah

March 10, 2010

The old US financial system

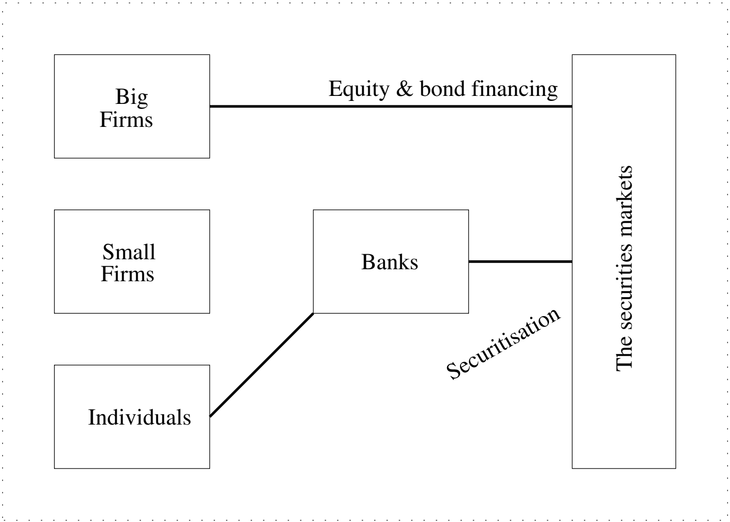


The revolution in finance

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



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
- A critique of foreign banks in emerging markets – e.g. *Foreign bank acquisitions and outreach: Evidence from Mexico* by Thorsten Beck and Maria S. Martinez Peria, *Journal of Financial Intermediation*, 2009.

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?
- *Does distance still matter? The information revolution in small business lending*, Mitchell A. Petersen and Raghuram G. Rajan, *Journal of Finance*, December 2002

Key arguments of the paper

- 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

	1991	1999	2009
Equity	28.7	33.9	40.5
Total borrrowing	43.0	39.4	30.1
Borrowing from banks	11.7	11.5	16.2
Total	100	100	100

And these are the biggest firms.

RBI data for bank lending

About September 2007, released Nov 2009:

Component	Value (Trn. Rs.)	in bank credit (Per cent)	to GDP (Per cent)
Individuals	4.93	25.9	12.3
CMIE database firms	6.00	31.5	15.0

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Sum of these	10.93	57.4	27.3

RBI data for bank lending

About September 2007, released Nov 2009:

Component	Value (Trn. Rs.)	in bank credit (Per cent)	to GDP (Per cent)
Individuals	4.93	25.9	12.3
CMIE database firms	6.00	31.5	15.0
Sum of these	10.93	57.4	27.3
Remainder	8.08	42.6	20.2
'Micro and small enterprises'	1.86	9.78	4.65
Overall Non-food credit	19.01	100	47.5

Frontiers of SME financing in India

- 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.