Do Programs Mandating Small Business Lending Disincentivize Growth? Evidence from a Policy Experiment

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Summary & Findings

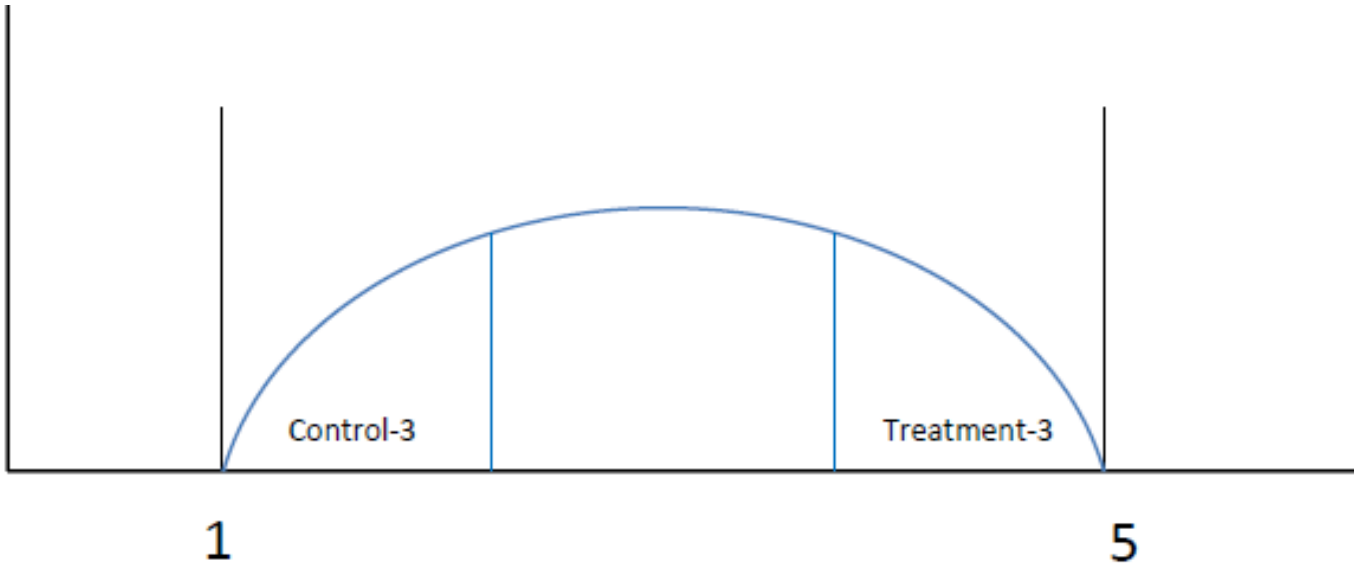
- Indian government policy pressured banks to lend to firms with plant & machinery of less than ₹10 million (priority sector)
- A 2006 policy change redefined priority sector as firms with plant & machinery of less than ₹50 million
- Authors study the growth of the newly eligible firms (plant & machinery in ₹10-50 million range)
    - Firms no longer eligible for directed lending program if plant & machinery grows larger than ₹50 million

Summary & Findings

- Estimate differences-in-differences. Compare effect of policy change for *large* newly eligible firms (treatment group) versus *small* newly eligible firms (control group)
- Main finding → After policy change, growth is lower for large newly eligible firms *relative* to small newly eligible firms
- Main tests use growth of *plant & machinery*. Robustness tests show similar results using growth of *electrical power consumption*.
- Argue that firms (and their lenders) have an incentive to keep firm size below the ₹50 million cutoff, and that "policies that direct credit to small firms can actually *inhibit* small firm growth."

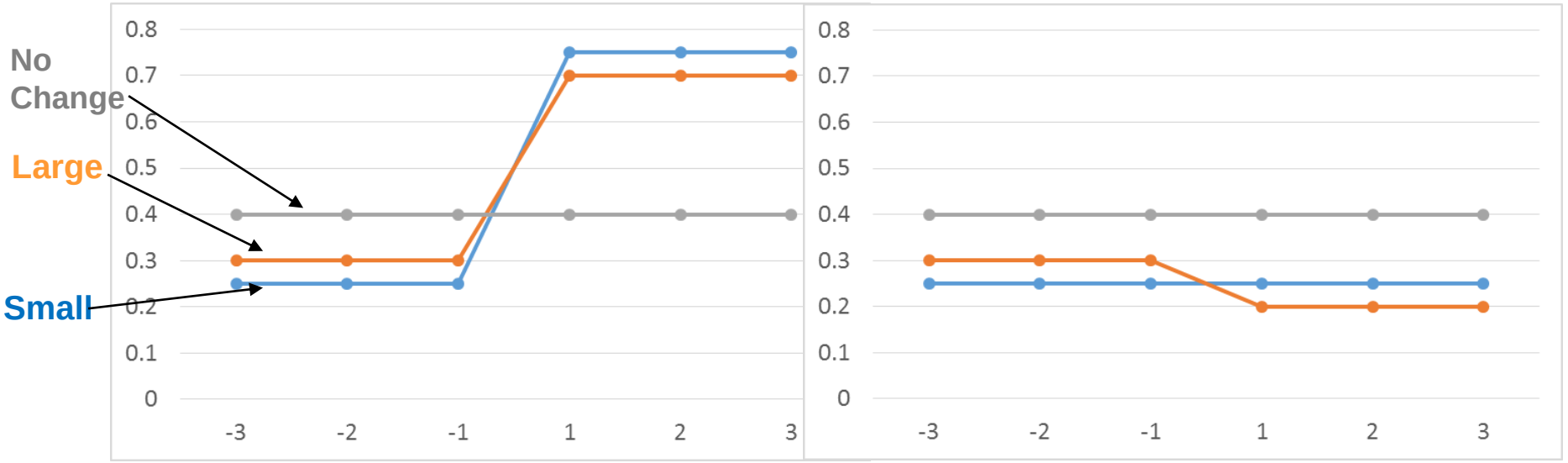
Control Group

- Policy change affects both control and treatment samples
  - Control sample has improved access to credit
  - Treatment sample has improved access to credit, provided firm remains below ₹50 million



Control Group

- Diff-in-diff results in the paper are consistent with both figures



  - Diff-in-diff: (0.70 - 0.30) - (0.75 - 0.25) = -0.10
  - Diff-in-diff: (0.30 - 0.20) - (0.25 - 0.25) = -0.10

Control Group

- Interpretation would be clearer if compared both small and large newly eligible firms with a control group that was not affected by the policy change
  - Comparing treated to non-treated control sample is interesting
  - Comparing differential effect of treatment for large vs. small firms is interesting
- Authors discuss problems using firms in ₹0-10 million range as non-treated control. What about using firms in ₹55-65 million range?

Control Group: Sensitivity to Credit Access

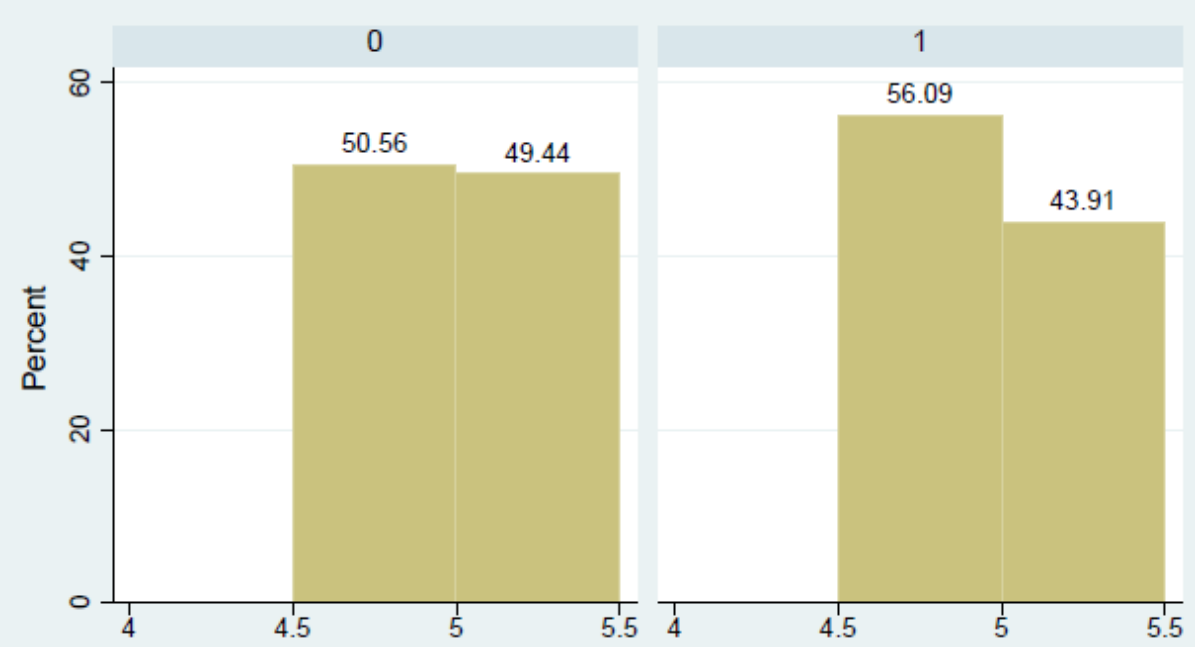
- Identifying assumption for diff-in-diff is parallel trends: the average change for the control group is the (counterfactual) average change for the treatment group if treatment had not occurred
    - Without the ₹50 million threshold, both small and large newly eligible firms would have experienced the same average growth rates in response to the policy change
- Even without the ₹50 million cap for eligibility, would smaller firms have been more constrained before the policy change and thus more sensitive to relaxation of financial constraints?

Survival of Small vs. Large Firms

- In Table 2:
  - Move from column (1) to (3) → Add 2 years and 1,853 observations
  - Move from column (3) to (5) → Add 2 years and 682 observations
- Suggests considerable non-survival over full sample period. Non-survival usually worse for smaller firms. Does this bias upward estimates of the growth of smaller firms?
- Suggestions:
  1. Report whether non-survival rates for small vs. large newly eligible firms are different
  2. As a robustness check, redo analysis but retain non-survivors and plug in plausible/estimated dependent variable

Clustering Around the Threshold

- Paper tests whether *newly created* firms are more likely to be below the ₹50 million threshold after the policy change



Clustering Around the Threshold

- Use pre-existing firms, and test whether firms less likely to cross ₹50 million threshold following the policy change
- E.g., Compare probability a firm in ₹45-50 million range crosses into >₹50 million range before and after policy change. Use probability a firm in ₹25-30 million range crosses into >₹30 million range as control.
- Are firms in ₹45-50 million range less likely to cross threshold after policy change?

Conclusion

- Very interesting paper on important policy topic
- Show that after a policy change that improved access to funding, growth of larger firms close to threshold was lower than growth of smaller newly eligible firms
- More clarity about claim. Is the claim that:
  - The policy change caused large firms to grow more slowly than small newly eligible firms (but not necessarily more slowly than in the absence of the policy change)?
  - The policy change caused the large firms to grow more slowly than they would have in the absence of any policy change?