Discussion of “Identifying Financial Constraints from Production Data”

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• Financial constraints are extensively theorized but hard to measure in practice

• This paper proposes and tests a novel approach to studying financial constraints
  – Based on ‘foregone profitability’ relative to comparison set which suggests firm faces binding (financial) constraint
  – Tested on dataset of ~ 725,000 firm-year observations across five countries from 2005-2015, compiled by the ECB And Bureau van Dijk

• Estimates substantial foregone profitability on average
  – Interesting heterogeneity by firm size, time period and country
  – Relatively low correlation with traditional measures of financial constraints (which have been shown in other work to be perhaps poor measures of FC)
• Interesting paper with a different take on an important question in the literature

• Focus of my comments
  – Conceptual differences in measure used and traditional view of financial constraints
  – A few thoughts on the empirics
Conceptual Difference

• Traditional view:
  – Financing constraints conceptualized as NPV positive project that does not get financed due to inability to raise capital from outsiders
  – Wedge between internal and external cost of finance due to (typically information-related) frictions

• In theory:
  – Could be at profit maximizing point given current inputs and still be financially constrained (current projects financed through internal cash flow but new growth opportunity needs external finance)
  – Could be off the profit maximization point given inputs and not be financially constrained (e.g. large adjustment costs)

• Discuss conceptual distinctions and implications in more detail
Empirics

• What are (small and micro) firms optimizing?
  – Leisure and non-pecuniary benefits?
  – Tax shield and business expenses through firm?

• Can financial constraints be treated as exogenous to production behavior of (small and micro) firms?
  – Credit rationing due to over-optimism, managerial quality (discipline of external finance)

• Lack of customer demand
  – Seems particularly salient given time period; on average firms self-report as being twice as much an issue as financial constraints
  – Current tests reassuring but more can be done