

Discussion of Claessens, Ueda, and Yafeh's

Financial Frictions, Investment and Institutions

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Paper Summary

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- **Their Question:** What types of policies reduce financial frictions?
- **Their Approach:** Examine q-dynamics in large cross-country firm-level panel dataset
- **Their Findings:** Shareholders' rights policies reduce financial frictions affecting investment, especially for smaller firms

Agenda

Question and motivations are clear. I'll discuss methodology:

1. Data
2. Model
3. Empirics

Data

- Good data set:
 - 48 countries including some poor countries (S. Africa, India, Sri Lanka, Malaysia, etc.)
 - Detailed financial and real variables
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 - 48 countries including some poor countries (S. Africa, India, Sri Lanka, Malaysia, etc.)
 - Detailed financial and real variables
 - 1,000,000 firm-year observations
- Limitations:
 - Only publicly-traded
 - Less likely to be constrained
 - Results on shareholder rights vs. creditor rights driven by sample?
 - Is selection (e.g., extensive margin on IPOs) important in explaining cross-country variation?

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2. Motivate regression equation
3. Assist interpretation of regression results

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1. Justify use of average q (avg=marginal)
 - How important is intangible capital?
2. Motivate regression equation
3. Assist interpretation of regression results

Model

- Abel and Eberly (1994) in discrete time with financial frictions:

$$rV(K, \varepsilon) = \max \pi(K, \varepsilon) \text{ (current return on capital)}$$
$$- \phi(I, K) - \lambda(B, K, \varepsilon) \text{ (adjustment costs)}$$
$$+ E\{V(K', \varepsilon')\} - V(K, \varepsilon) \text{ (capital gain)}$$

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- Relating marginal q to frictions:

$$\begin{aligned} (r + \delta)V_1(K, \varepsilon) = & \pi_1(K, \varepsilon) - \phi_2(I^*, K) - \lambda_2(I^*, K) \\ & + E\{V_1(K^*, \varepsilon') - V_1(K, \varepsilon)\} \end{aligned}$$

Model

- In order to link to avg. q , assume everything is homogeneous degree 1, i.e.,:
 - $\pi(K, \varepsilon) = \varepsilon K$ (AK technology)
 - $\phi(I, K) = K \phi(I/K, 1)$
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- Then:

$$V(K, \varepsilon) = H(\varepsilon)K$$

and

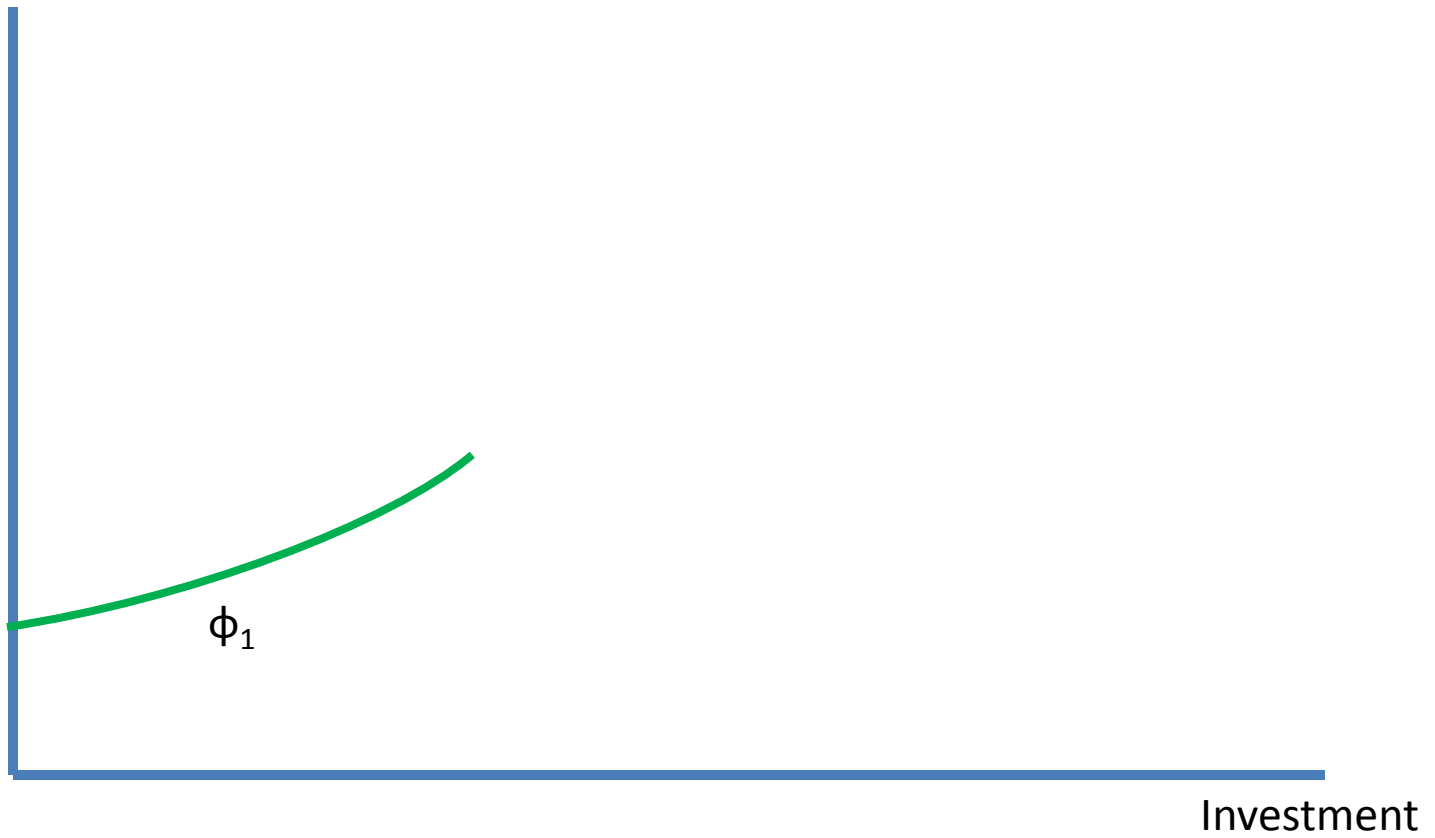
$$q = V(K, \varepsilon)/K = V_1(K, \varepsilon) = H(\varepsilon)$$

(Average Q = Marginal Q)

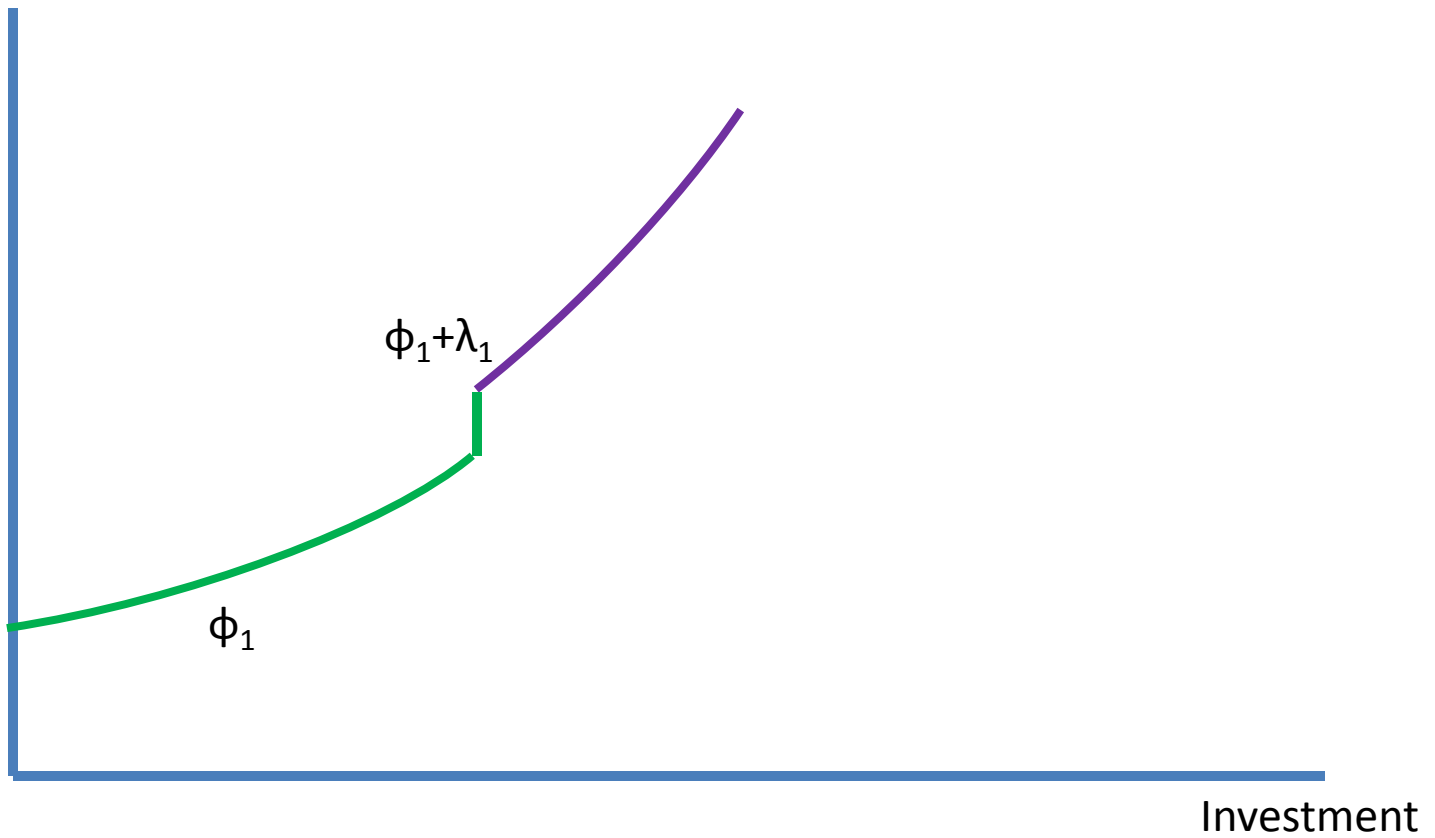
Issues

1. Firm size indeterminate (no curvature in K)
 - strange for firm-level analysis
2. Optimality is now independent of K
$$E\{q'\} = E\{H(\varepsilon' \mid \varepsilon)\} = \phi_1 + \lambda_1$$
3. q is exogenous, determined purely by technology shock process, not frictions
 - convergence intuition doesn't make sense
4. Investment identifies frictions

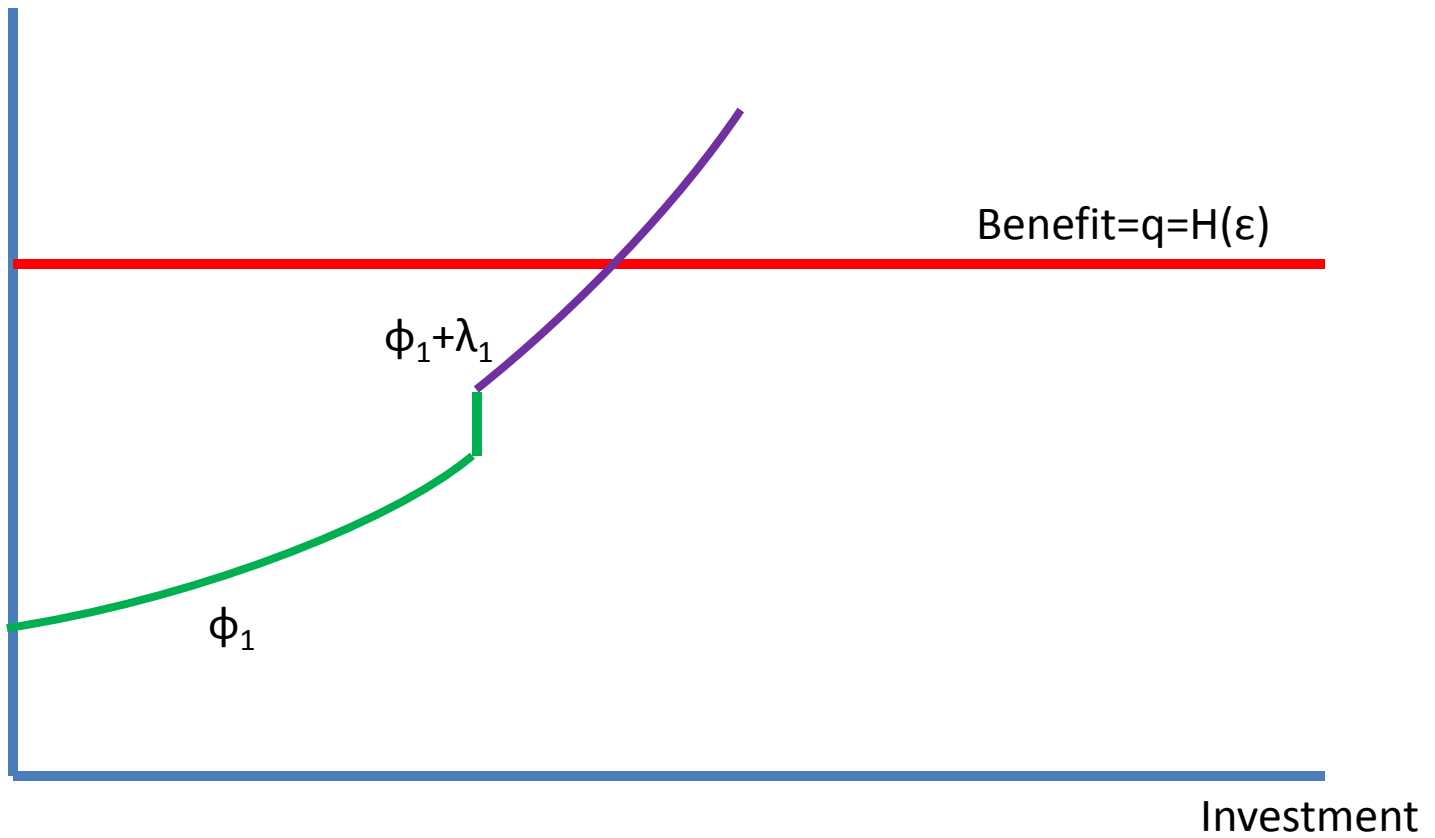
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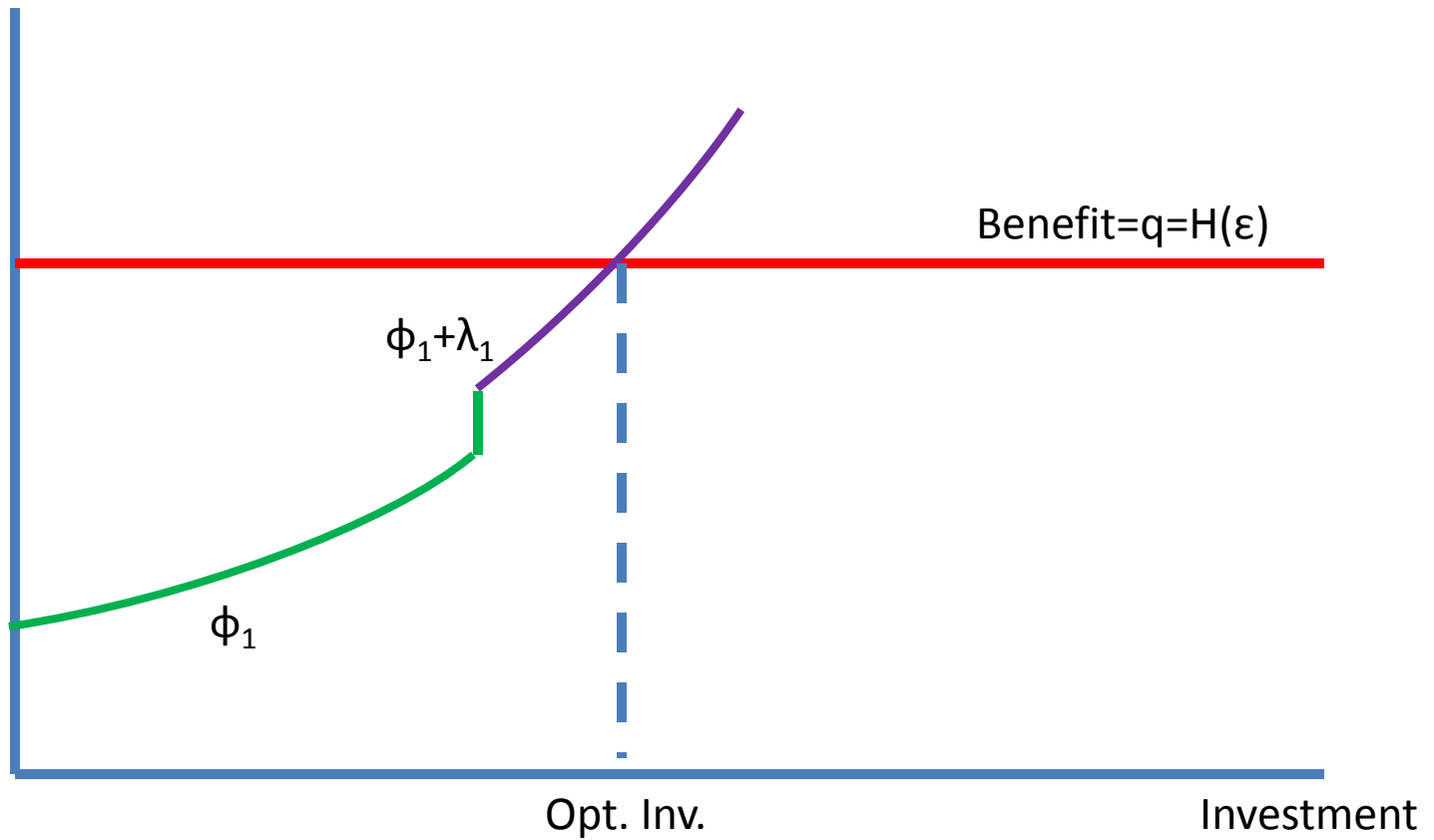
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- Leaving out many more moment conditions – any current variable is an instrument
- Their timing decisions help identify more

Empirics/Results

- Result on shareholders' rights appear fairly robust
- But possible measurement issues/important outliers
 - intangible capital important?
 - mean q is 3.3, 75th percentile just 1.9, std. dev=157.2
 - Why doesn't capital flow to "poor" firms?

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 - marginal profit
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- Other measurement concerns: treatment of disinvestment, cash
- Opaque:
 - Identification depends greatly on timing assumptions
 - lots of triple interactions
 - Alternative? Get ϕ and λ coefficients, country by country. Then plot against institution variables

Summary

- Great question
- Interesting data
- Convergence language is problematic
- Neat estimator
- Striking, robust result on shareholder's rights
 - Hard to interpret, despite model and OLS