Discussion of:

Liquidity Insurance vs. Credit Provision: Evidence from the COVID-19 Crisis

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Summary

- Broad Question: do banks face a trade-off between providing liquidity insurance to large firms and providing credit to small businesses?
- Using syndicated loan, regulatory, and survey data for the U.S. around the COVID shock, paper finds:
    1. Before the shock: Large banks provide more liquidity insurance to large firms than small banks
    2. After the shock: Large banks provide less credit to small firms than small banks
- Interpretation: credit line drawdowns by large firms caused the decline in lending to small firms

A different trade-off story: technology

- Stein (2002)
  - Small business lending: requires information that is difficult to communicate, decisions cannot be centralized, agency cost of decentralizing decisions increases sharply for large organizations
  - Large business lending: benefits from economies of scale, diversification
  - Trade-off: bank technology, organizational design, incentive scheme, and size for small and large business lending are incompatible

Empirical implications: Quiet times

- Segmented market
- Banks that are good at providing liquidity to large firms are worst at small business lending (and viceversa)
- Revealed preference: banks with a high Credit Line Exposure (CLE) are better at providing liquidity to large firms and bad at small business lending

Note 1: this theory provides an explanation for why banks are heterogeneous in CLE

Empirical implications: Negative demand/uncertainty shock

- Liquidity demand increases
  - Large firms draw down credit lines from high CLE banks
- Relative informativeness of hard signals decreases (e.g., current account turnover versus management quality)
  - High CLE banks shy away from small business lending

Note 2: this theory provides an explanation for why banks are heterogeneous in CLE and why CLE is negatively correlated to small business lending during crisis

Consistent with every finding in the paper

- High CLE before COVID crisis is correlated with
  - Higher credit line drawdowns
  - Less lending to small firms
  - Fewer PPP small loans
  - Tightening of lending standards (to small firms)

  during the crisis

- Distinguishable from the liquidity story?
  - Unlikely because ex ante credit line volume is the best proxy for technology and liquidity risk exposure
  - Controlling for observables doesn't work (e.g. size)
  - Within-firm approach doesn't work

But very different policy implications

- If story is liquidity
  - Providing liquidity to large, high CLE, banks during COVID shock would expand credit to small firms
- If story is technology/segmentation
  - Providing liquidity to large, high CLE, banks during COVID shock would have no impact on credit supply

Conclusion

- A very nice empirical documentation of the negative association between bank liquidity provision and small business lending during COVID
- Cannot reach normative conclusions without pinning down the economic mechanism