Banks' Specialization and Private Information

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Discussion by

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What is the link between bank specialization (local and sectoral) and private information?

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 - Compare similar firms served by banks with ≠ spec. levels (+ "bank-municipality, bank-sector, bank-firm, and loan level controls")
- ⇒ Lower defaults and better predictions for **Micro & Small** firms for higher **Local Spec.**
- ⇒ Lower defaults and better predictions for **Medium & Large** firms for higher **Sector Spec.**

My Take on the Paper

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Benefits of specialization depends on firm size (e.g. firms' type dependent)

Emphasizes the link between bank specialization and enhanced private information

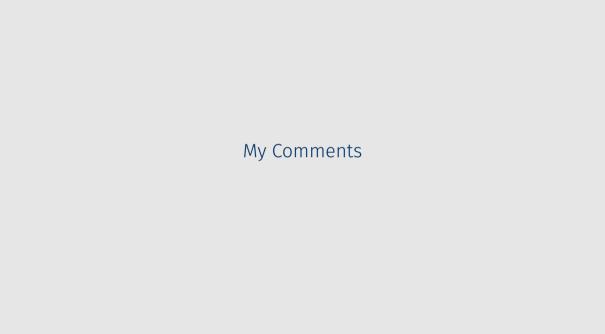
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Very nice paper that sheds light on novel facts about banks' specialization



My comments

- 1. Self-Selection in low default markets Cheap but relevant
- 2. The mechanism(s) behind the results
- 3. Complementarities or Substitutability
- 4. Minor Comments

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- Issue: banks specialize in "good" areas (low-default ex-ante)
- Suggestion: compare municipality/sector default probabilities with high and low average degree of specialization
- ⇒ No "strong relation" if selection is not too strong
 - Idea: avoid local factors, explain a large chunk of default probability
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Alternative:

• Natural experiments like mergers or branch closures could serve as IVs for specialization

The Mechanism(s) Behind the Results

"By focusing its lending activities [...], the bank can gather local-specific information particularly valuable for evaluating loans to the small manufacturing firm. This includes insights into changes in demand related to house construction, supply and prices, natural disasters affecting local production, [...], and local economic downturns that can reduce consumer spending on non-essential items like furniture."

"Conversely, by specializing in the manufacturing sector, the bank can acquire sector-specific information more relevant for assessing loans to the multinational company, including technological advancements and innovations, fluctuations in raw material prices, supply chain interruptions, and changes in global economic conditions such as trade policies, tariffs, and international market dynamics."

"This differentiation in the utility of local versus sector-specific information aligns with our empirical results, explaining how specialization benefits banks in managing loans for firms of different sizes."

The Mechanism(s) Behind the Results (1/5)

Local lending specialization valuable for assessing local risk for **micro & small** firms

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- **1.** Local Specialization relates to funding risk
 - Banks have better info in their top municipality ⇒ lower defaults (smaller firms)
 - However, lack of diversification raises ex-ante risk and funding costs
 - Implication: ↑ local bad shock ⇒ ↓ lower profits → risk absorption → lower defaults smaller firm

Spec. banks extract higher yield when hit with local-shocks, especially for firms where info is most relevant (Iyer et al. 2022)

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 - Spec. banks extract higher yield when hit with local-shocks, especially for firms where info is most relevant (Iyer et al. 2022)
- 2. Local Specialization relates to risk taking
 - Financial booms inherently linked to risk taking, but ...
 - Soft information → specialized banks target "safer firms" (reduced risk-taking)
 - Implication: ↑ local boom ⇒ ↓ lower risk taking → lower defaults smaller firm
 Specialization mitigates risk taking, especially for smaller firms (Granja et al. 2022)

The Mechanism(s) Behind the Results (2/5)

- Both mechanism require information advantage
- Can you exploit differences in local or sectoral economic conditions?
- Shock types to disentangle the two channels:
 - Local climate shock or other local shock: funding risk channel dominates
 - ΔHouse Price Index: risk taking channel dominates
- Would like to see more direct evidence on the mechanism to rationalize the type dependency of information benefits

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 - Examine updating frequency of PDs: Are specialized banks updating PDS more often?
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- Interpretation:
 - Few updates + high AUC → superior ex-ante screening
 - Frequent updates + improving AUC → better monitoring/learning

While collateralization is low in your sample, personal guarantees are widely used

Guarantee Shares			
	All	Micro & Small	Medium & Large
Loan Level			
Has a form of Guarantee	0.47 (0.50)	0.57 (0.49)	0.29 (0.45)
Personal or Financial Guarantee	0.31 (0.46)	0.37 (0.48)	0.20 (0.40)
Personal Guarantee	0.22 (0.42)	0.30 (0.46)	0.07 (0.25)
Observations	4,945,061	3,242,692	1,702,369

• For small firms more 90% of personal guarantee have full loan coverage

Do guarantees lower borrower moral hazard, or do spec. banks still discipline borrowers via pricing/monitoring (Mayordomo et al. 2017)?

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 - If low, sign that specialized lenders have **lighter contractual terms** (superior info) **or** that they **specialize in types of contract** (concentrated in smaller firms)

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Would like to see more direct evidence on the connection of non-pricing strategies and information acquisition

Complementarities or Substitutability

- Are local and sectoral specialization complementaries or substitutes?
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- Are local and sectoral specialization complementaries or substitutes?
- Does specialization work jointly with long-term relationship?
- Suggestion: 2 × 2 interaction on specialization and relationship length:
 - Interactions: Local Spec \times Sector Spec and Spec^j \times Rel.Length, with $j \in \{Local, Sector\}$
 - Substitute: strong performance for low spec. in sector and for short relationship
 - Complementaries: stronger performance when all of them are high

Minor Comments

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- Do firms benefit from connecting to these banks?
 - Explore firms' profitability and size with specialization measures who benefits from this?

