Institutions, Bank Monitoring and the Structure of Credit Contracts: Evidence from Korean Chaebols
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Main question:

- Do institutional and/or regulatory arrangements negatively affect the functioning of credit markets?
- Specifically, did the bailout protection offered by South Korean government to chaebols impact lenders’ incentive to monitor?
Methodology

✓ “Reversed” event study
  ▪ Crisis-induced reform affecting chaebols in 1998
    • Lifting of safety net (implicit bail-out guarantees) and chaebol cross-debt guarantees
    • Increased accounting transparency

✓ Idea: if government policy discouraged lenders from monitoring chaebol firms then one should find:
  ▪ A difference in monitoring of chaebols compared to non-chaebols when policy was in place
  ▪ But disappearing after reform

✓ Monitoring effort captured by retention rate/concentration in syndicates (Holmstrom & Tirole, 1997; Sufi, 2007)
Main findings

- During policy RR/concentration of loans to chaebols lower than loans to non-chaebols, after reform difference narrowed

- Other findings:
  - Foreign banks participation weaker for chaebols, but strengthened after reform
  - Effects stronger for “big five”
  - Larger equity stake of domestic banks further reduced need to monitor → channel of bail-out execution
  - In chaebols with poorer incentives for controlling shareholders lenders’ monitoring stronger

- Conclusion: government bail-out policy diluted lenders’ incentive to monitor
General comments

- Very interesting question with important policy implications
  - Helps understand how/whether policies protecting business groups distort financial contracting and monitoring incentives

- Well executed and easy to read
  - Extensive set of extensions to test the validity of main findings

- Comments focus on strengthening robustness of findings/interpretation of results
Comment I – Expected impact policy

✔ Two policy-induced key characteristics of chaebols
  ▪ Safety net due to implicit bailout guarantee
  ▪ Lack of reliable accounting information as no need to attract outside funds

✔ Does this reduce monitoring incentives?
  ▪ First characteristic: yes
  ▪ Second characteristic: I would say no, expect opposite effect → less information, stronger need for monitoring (Sufi, 2007)

✔ Two characteristics could offset each other; but results indicate that safety net overrules lack of information effect
  ▪ Would not argue in paper that expect monitoring to improve after lifting of policy due to increase quality of accounting information
Comment II – Dependent variable

✓ Three variables to capture monitoring effort in syndicate
  ▪ Retention rate and concentration (standard)
  ▪ Presence foreign lead arrangers

✓ Foreign lead banks different from domestic
  ▪ Can process “hard” information better
  ▪ Less subject to political pressure

✓ But does it proxy for better monitoring? Not necessarily
  ▪ Foreign lead can also limit own stake
  ▪ In general the borrower choses lead and lead choses participants.
    Possible non-Chaebols more need for foreign capital
    • Reflects different position of Chaebols (e.g. easier access to credit) but not necessarily reduced incentives to monitor
Finding:
- RR/Concentration lower for Chaebols before reform
- Difference narrowed (or even reversed) after reform

Authors interpretation:
- Government policy diluted lenders monitoring effort

But lengthy post-reform period (1998-2007) where lot of things happened. So possible alternative mechanisms at work
Reform coincides with severe crisis that might have affected default risk of Chaebols more inducing more intensive need for monitoring
- Control for large number of firm characteristics
- Results sometimes insignificant; possible omitted variable export activity

Post period includes credit boom where risk was not priced
- Could this have driven narrowing of differences?

Better to study shorter post-reform period
- In any case, would expect the impact of the reform to have strongest impact in short run
Comment IV – Tier 1 vs Tier 2 Chaebols

✓ Interesting and important test
  ▪ Tier 1 more (only?) protected by safety net so effects should be stronger

✓ Are the effects really stronger for Tier 1 chaebols?
  ▪ Formal test on difference of the parameters

✓ Some results bit puzzling
  ▪ No significant difference Tier 2 chaebols when policy in place
  ▪ But in post-reform period the difference in RR/concentration seems higher for Tier 2 chaebols
  ▪ Is this consistent with your story?
Comment V – Miscellaneous

- Table with non-parametric dif-in-dif estimates:
  - Average RR/concentration of loans to chaebols and non-chaebols in pre and post reform period.

- Some additional controls to capture transparency:
  - Number of previous loans by the firm
  - Rated/publicly listed

- Curiosity:
  - Number pre and post reform loans Tier 1 chaebols almost same, but post much higher for Tier 2 chaebols and non-chaebols. Why?
Conclusion

- Interesting and very relevant question
- Promising paper with nice data
- Already very rich, but some more can be done to strengthen results/interpretation
- Recommended read