

Discussion of:

”Fewer but Better: Sudden Stops, Firm Entry,
and Financial Selection”

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Motivation

- During sudden stops in emerging markets firm entry is depressed
- What are consequences of reduction in entry on:
 - ▶ Quality of entrants
 - ▶ Aggregate productivity
 - ▶ Long run growth

Ideas

- Scarce financing change the compositions of entrants, selecting the better ones
 - ▶ Related to the cleansing effects of recessions: better workers and firms
- New entrants shape long run growth through innovation
- Sudden stops have long lasting consequences

This paper

- Develop tractable model where financial conditions affect firm entry and long run outcomes
- Key idea: Sudden stops reduce entry but make entrants better
- Use Chilean firm level data to document this empirical prediction is present in the data

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Nice and important contribution!

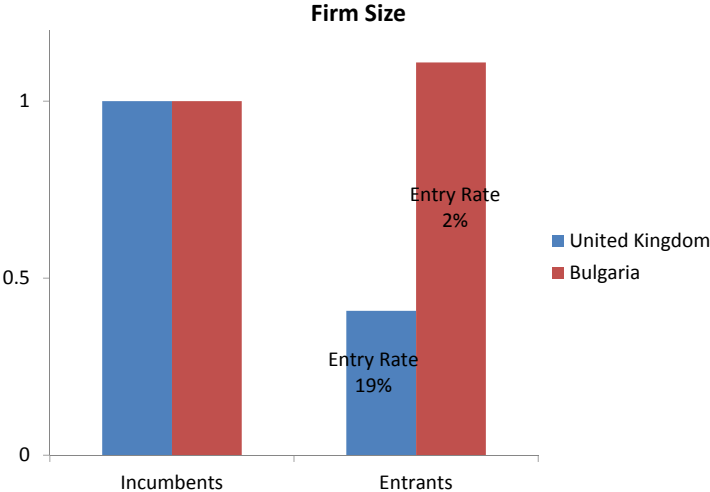
Main Comments

- Focus quantitative exercise on effects for entrants, less on aggregate effects
- Need better use of firm level data to evaluate model performance
- Make a case that financial considerations are key for entrants

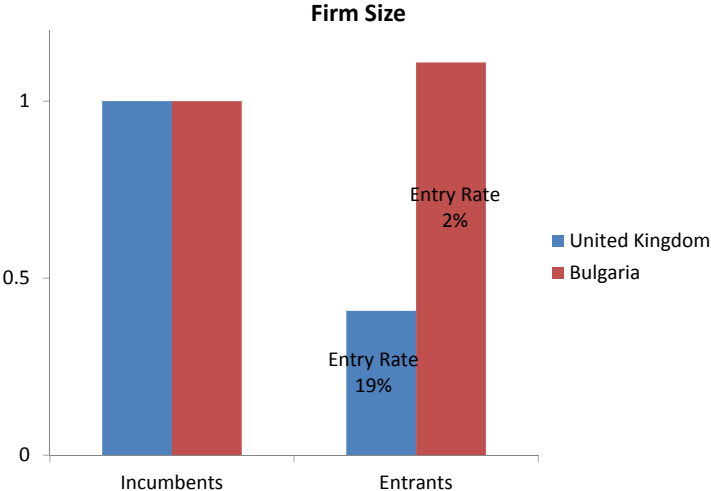
Entrants vs Incumbents

- Show you descriptive statistics for entrants and incumbents from Arellano, Bai, Zhang (JME 2012)
- Representative sample of over 65,000 British firms and 18,000 Bulgarian firms (Amadeus dataset)
- Entrants= Firms with less than 3 years of age

Entrants vs Incumbents

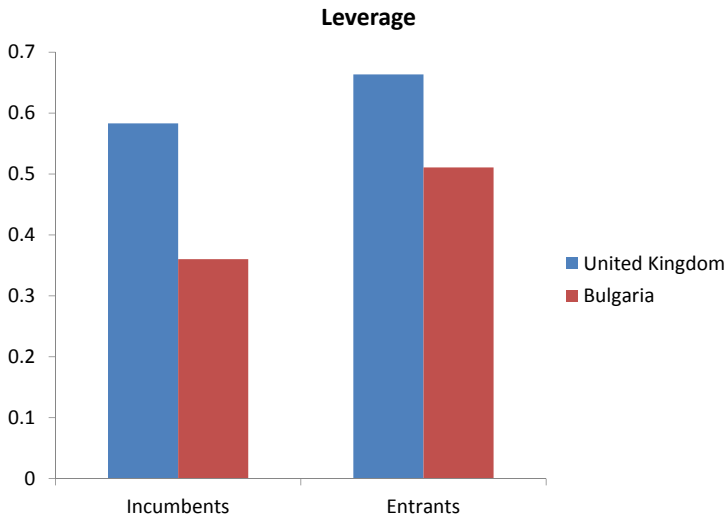


Entrants vs Incumbents

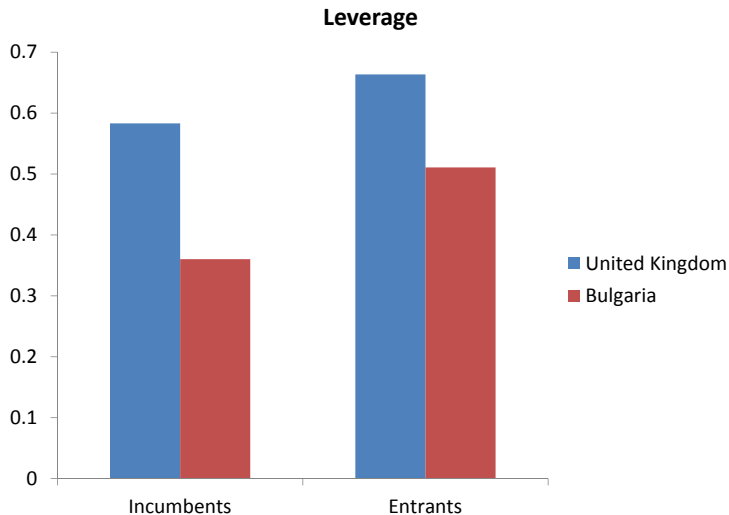


More and smaller entrants in the UK \Rightarrow more selection in Bulgaria

Entrants vs Incumbents

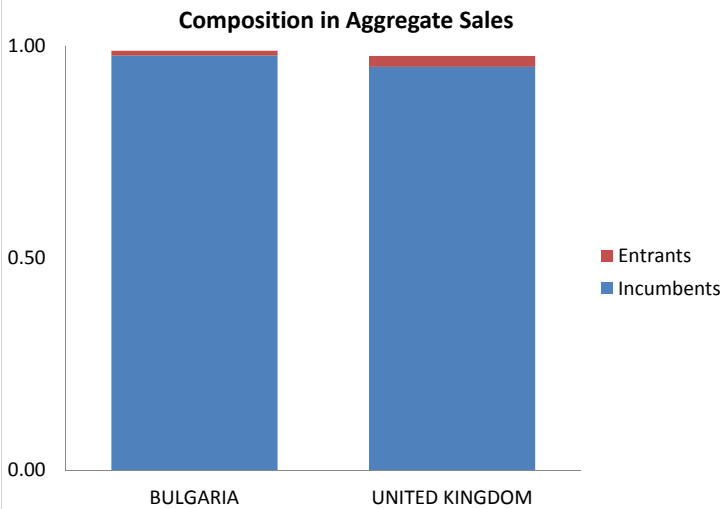


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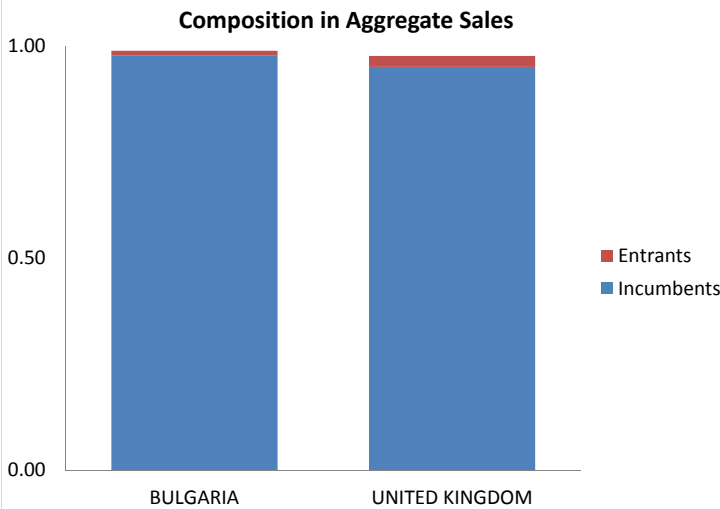


Entrants use more debt \Rightarrow sudden stops especially relevant

Entrants vs Incumbents

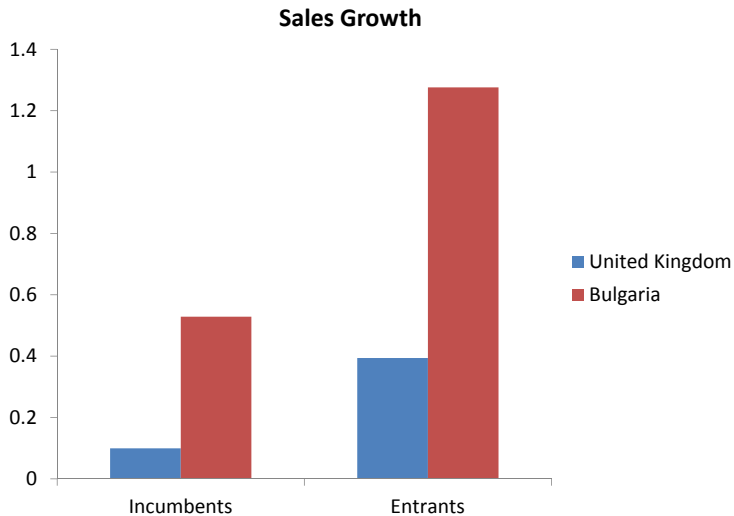


Entrants vs Incumbents

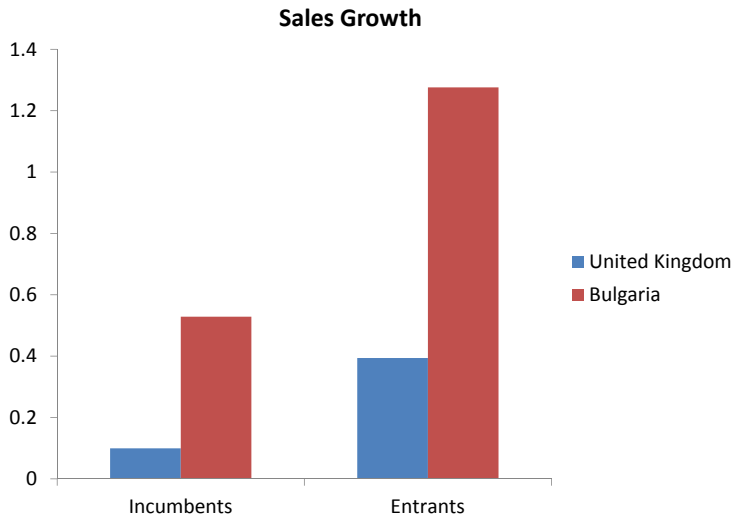


Entrants negligible in total sales \Rightarrow not so important for aggregates

Entrants vs Incumbents



Entrants vs Incumbents



Entrants grow faster \Rightarrow more so in Bulgaria

In Sum

- Financial conditions seem important for behavior of entrants
- Sudden stops in emerging markets perfect episodes to study such effects
- Aggregate effects seem minor

Model

- Economy faces stochastic interest rates
- Firms need to borrow to: pay wage bill for production and pay entry cost
- Growth by innovation of new entrants
- During high interest rate periods: fewer but better entrants

Model: Innovation Heterogeneity

- Firms heterogeneous in innovation ability $d : \{\sigma^H \text{ or } \sigma^L\}$
- Product productivity change with new entrants
- Intermediary goods produced with labor, Bertrand competition
- Value of product i depends on probability of surviving $(1 - \lambda M)$

$$V_i^d = \pi^d + Em'(1 - \lambda M)V_i^{d'}$$
$$V^H > V^L$$

- $\lambda M =$ mass of entrants that will take over the market

Model: Intermediaries

- Firms ex ante heterogenous in z : probability of being H type

$$P^H(z) = z^\nu$$

- Intermediary has signal over z and choose firms with better signals \tilde{z} with cutoff rule: $(1 - \bar{z})$

$$\max_{\bar{z}} \lambda(1 - \bar{z}) [\tilde{\mu}(\bar{z}) V^H + (1 - \tilde{\mu}(\bar{z})) V^L] - (1 - \bar{z}) R\kappa$$

$(1 - \bar{z})\lambda =$ mass of entrants

$\tilde{\mu}(\bar{z}) =$ probability that firm is H

High \bar{z} increases mass of entrants and decreases EV for each entrant

- Main insight: R high raises \bar{z} : fewer but better firms

Theory Comments

- 1 Intermediary problem:
 - 1 Intermediary owns all firms?
 - 2 Intermediary has profits, why is entry restricted?
 - 3 Intermediary could do better by setting $R(\tilde{z})$
 - 4 Result might be similar with competitive intermediary
- 2 Confused about differences between firms, product lines, and projects
- 3 Might not need both types of loans to get the mechanism.
Which loan is the more important for quantitative results?

Quantitative Exercise

- So far exploration of the model mechanisms with parameters guided with data
- Needs a sharper message that the model resembles data

Quantitative Findings

- Feed in sudden stop: rise in interest rate from 9 to 14%
 - ▶ Entry decrease by 17%, profitability of entrants rises by 6%
 - ▶ Accounts for 40% of decline in entry and 20% of rise in profitability
- Sudden stop has long run productivity costs of 0.2% of consumption
- Without selection
 - ▶ costs would be overstated by 50%
 - ▶ aggregate labor on impact rises

Quantitative Analysis: Comments

- What is the focus of the quantitative analysis? Going for entry dynamics, aggregate dynamics?
- Prefer focusing on entry dynamics: entry rate, entry profitability
 - ▶ Entrants account for little of aggregates
 - ▶ Compare time series for model and data directly
- Which parameters determine the magnitude of the mechanism and how they are identified?
 - ▶ Small probability of success $\lambda = 5\%$, R cost paid for all entrants, only 5% survive

Other Comments

- Why is endogenous growth important? Important for long run costs, but not essential for the main point: fewer but better entrants during sudden stops
- In data is innovation mostly conducted by entrants or incumbents?
- No evidence of financial channel for entrants

Conclusion

Nice contributions:

- Tractable model with selection in entry which responds to sudden stops
- Firm level evidence that in Chile during the sudden stop entrants were more profitable

Less convincing points:

- Importance of the entry margin for observed aggregates: productivity, output, investment, consumption, etc.
- Long run costs of entry disruption during sudden stops