Discussion of

Cultural Proximity and Loan Outcomes
Raymond Fisman, Daniel Paravisini, and Vikrant Vig

Vidhan K. Goyal

HKUST

May 20, 2012

What is this Paper About?

- What is the effect of cultural proximity on loan contracting and outcomes?
  - Total debt
  - Number of borrowers
  - Fraction of loans past 60 days late
- What explains the preferential in-group treatment? Is it due to:
  - Favoritism
  - Lower information asymmetry that results in better screening
  - Improved enforcement
- Efficiency implications

What Does It Find?

- When the officer assigned to the branch belongs to a particular group, then:
  - the total amount of credit to borrowers in that group increases by 18.6%,
  - the number of borrowers in that group increases by 6.2%, and
  - the probability that the group receives any credit increases by 1.6%.
- Loans made to in-group borrowers have better repayment performance.
- In-group loans are made with lower collateral ratios.
- Cultural proximity increases dispersion of lending across borrowers.

What do the Authors Conclude?

- Cultural proximity:
  - Results in better screening (mitigates problems of asymmetric information in lending)
  - Improves the efficiency of the bank's credit allocation and borrower welfare.
- *Policy implications:* Banks should encourage caste- or religion-based preferences to work in allocation of credit.
  - Assign minority officers to regions with a high concentration of those minorities.

Comment #1: Cultural Proximity and Information Asymmetry

- How does cultural proximity reduce information asymmetry? It is not clear what information advantage caste or religion gives to bank officers in lending to in-group borrowers.

  - Most likely channel is through social interactions. But the paper completely rules this out.

    > "the effect of cultural proximity that we document here is distinct from the effect of social ties or networks, which results from parties' past interactions.

  - The effects show up immediately upon the arrival of head-officer to the branch.
  - The officer rotation policy ensures that officers are unlikely to "have had any prior interaction with any of the potential borrowers in their new location".

- The paper argues that cultural proximity provides the officer "a better signal of borrower's creditworthiness". But how?

Existing Borrowers and First Time Borrowers

- The paper partitions borrowers into two groups:
  - *Existing borrowers:* Borrowers that established a credit relationship with the bank prior to the arrival of the current officer.
  - *First-time borrowers:* Borrowers that receive credit from the bank for the first time with the current officer.

- The bank should have information on the repayment histories of existing borrowers. If cultural proximity lowers information asymmetry, then the effect should mostly be in loans to first-time borrowers.

Table 6: Existing and First Time Borrowers

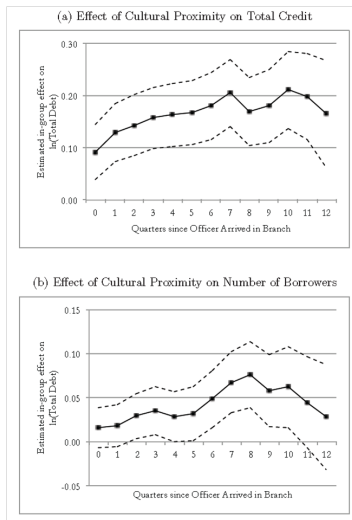| Dependent Variable	ln(Total Debt)	ln(# of Borrowers)	Dummy = 1 if Total Debt > 0
	(1)	(2)	(3)
Panel 1. Borrowers that had obtained Credit from Bank prior to Officer's Arrival			
SameGroup	0.1158***	0.0029	0.0162***
	(0.026)	(0.017)	(0.005)
Branch-Group Fixed Effects	Yes	Yes	Yes
Quarter Dummies	Yes	Yes	Yes
Observations	196,928	209,507	397,923
R-squared	0.828	0.905	0.820
Panel 2. Borrowers that Obtain Bank Credit for the First Time with the Current Officer			
SameGroup	0.1693***	0.1327***	0.0107
	(0.030)	(0.023)	(0.007)
Branch-Group Fixed Effects	Yes	Yes	Yes
Quarter Dummies	Yes	Yes	Yes
Observations	184,386	190,128	397,035
R-squared	0.786	0.841	0.732

Table 8: Collateral for Existing and First Time Borrowers

Dependent Variable	ln(Total Collateral)	ln(Average Collateral/Loan)	ln(Std. Dev. Debt)	ln(IQR Debt)
	(1)	(2)	(3)	(4)
	Panel 1. All Borrowers			
SameGroup	0.1364***	-0.0474***	0.1832***	0.0879***
	(0.019)	(0.012)	(0.018)	(0.016)
Branch-Group and Quarter Dummies	Yes	Yes	Yes	Yes
Observations	232,126	223,621	197,094	195,321
R-squared	0.916	0.583	0.712	0.668
	Panel 2. Subsample of Borrowers that had obtained Credit from Bank prior to Officer's Arrival			
SameGroup	0.0739***	-0.0493***	0.1597***	0.0722***
	(0.024)	(0.015)	(0.022)	(0.021)
Branch-Group and Quarter Dummies	Yes	Yes	Yes	Yes
Observations	207,412	195,360	170,212	165,297
R-squared	0.889	0.584	0.709	0.642
	Panel 3. Subsample of Borrowers that Obtain Credit from the Bank for the First Time with the Current Officer			
SameGroup	0.1859***	0.0144	0.1197***	0.0298
	(0.033)	(0.014)	(0.024)	(0.022)
Branch-Group and Quarter Dummies	Yes	Yes	Yes	Yes
Observations	187,396	182,005	155,096	154,258
R-squared	0.808	0.499	0.640	0.586

Comment #2: Alternative Explanations of Results

- It is possible that all of this is due to borrower self-selection (and taste-based preferences).
    - Borrowers in smaller cities and rural areas have a preference for borrowing from an in-group branch officer.
    - In-group borrowers (both existing and first time) apply for loans when an in-group officer arrives at the branch.
    - Existing borrowers obtain loan approvals quickly.
    - First-time borrowers take time since the bank has to assemble a credit file on these borrowers.
        - We do not know how much time the bank takes to approve an application once it is submitted (but we expect this to be longer for first-time borrowers than for existing customers).

Figure 3: Dynamics of the In-Group Effect on Total Credit and Number of Loans

(a) Effect of Cultural Proximity on Total Credit

(b) Effect of Cultural Proximity on Number of Borrowers

Comment #3: Loan Repayments

- Fraction of borrowers 60 days past due co-mingles earlier borrowers (with loans approved by previous loan officers) and new borrowers (with loans approved by the new officer).
- It is unclear if we are looking at loan defaults on existing loans or new loans granted by the officer.
- Have something like Figure 3 for repayments.

Comment #4: What are the Loan Maturities?

- These appear to be long-term loans (the "officers are responsible for loans they approve for three years following their departure"). Then, how do we understand the repayment results?

- In addition, how much discretion do officers have over loan due dates?

- Loan maturities could differ for in-group loans versus out-group loans. How does this difference affect findings on collateral and repayments?

Comment #5: Taste-based Preferences and Heterogeneity

- Religion and caste are likely to be more important for lending in smaller tier-II cities and rural areas.
  - In-group effects are stronger for regions with fewer branches (represent rural areas or smaller cities).
  - In-group effects are stronger for smaller branches (most likely located rural areas or smaller cities)

Comment #6: Do the Effects Weaken Over Time?

- As cultural differences decline over time, the in-group effect should become weaker. What is the time-trend in the importance of cultural proximity for lending?

- Are the results stronger for the earlier part of the sample? Unfortunately, we don't have long enough time-series.

Possible Other Research

- Many family-owned firms in India appoint CEOs who belong to the same religion or caste. Some family-owned firms go so far as to match the CEO's horoscope with that of the firm.
- What effects do such preferences have on performance of firms run by these "in-group" CEOS?:
    - Favoritism
    - Lower information asymmetry and better enforcement

Conclusions

- Overall, an excellent paper.
  - Establishes large effects of cultural proximity on access to credit and the amount provided.
  - Explore the economic mechanism behind this result.
  - Results have significant economic and policy implications
- This discussion has raised some questions about the interpretation of results.