Discussion of
Local Investors' Preferences and Capital Structure

by

Vidhan K. Goyal

HKUST

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What is This Paper About?

Local Age and Sex Composition Index (Local ASC Index) ➡ Local Investor's Risk Preferences ➡ Local Capital Supply Conditions (Amount and Stability of Capital)

High ASC Index ➡ Higher average age and higher women/men ratio

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Local Banks Increase Lending (Quantity ⬆ and Price ⬇).

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Matters more for firms that rely on bank debt.

D/V ratio of firms HQ in that county ⬆

Mechanism

- Local investor preferences matter for capital structure of firms.
- High ASC Index implies:
    - More cash and bank deposits with local banks.
    - Bank deposits are more stable.
- Banks lend locally.
- In High ASC index counties, loan supply shifts outwards. Supply is more stable.
- Firms borrow more – and it is easier to refinance debt.
- Leverage goes up.

Implications of Shift in Supply

Price

Supply$_1$

Supply$_2$

Demand
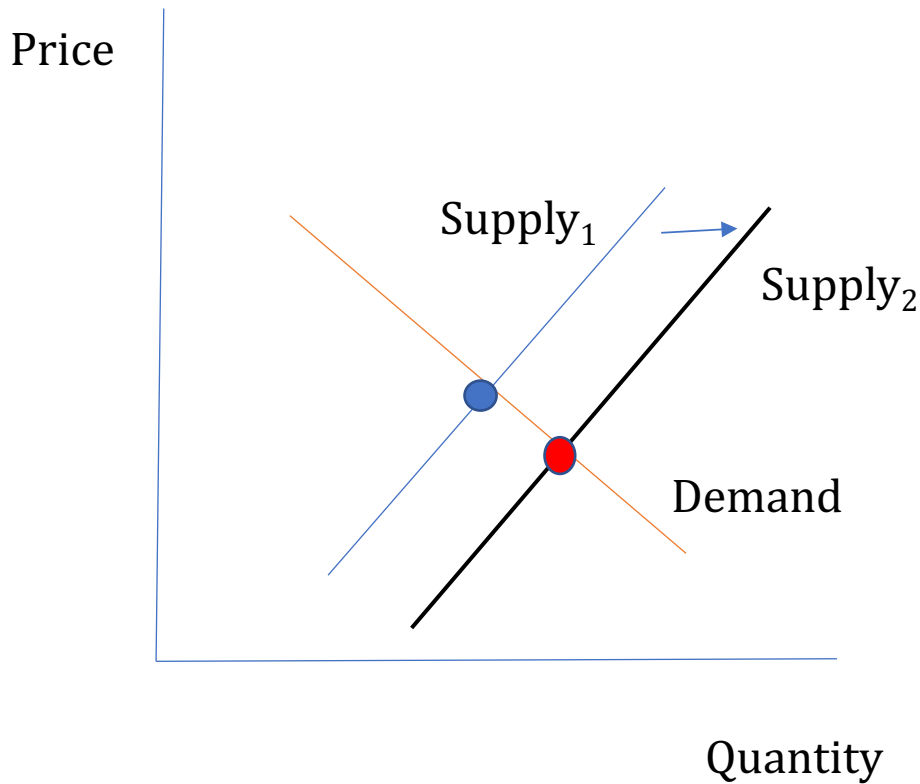
Quantity

Quantity Increases.
Price Decreases (?)

Comments

- Alternative Prediction
  - Home bias: local investors buy equities of local firms.
  - Firms with less risky technology locate in areas with high ASC index.
    - To cater to local populations' risk preferences.
  - Firms with less risky technology have higher leverage.
- Could we rule out demand side explanations completely?
- Headquarter location is a choice variable.
  - Firms may not change headquarters but initial choice is endogenous.

Comments
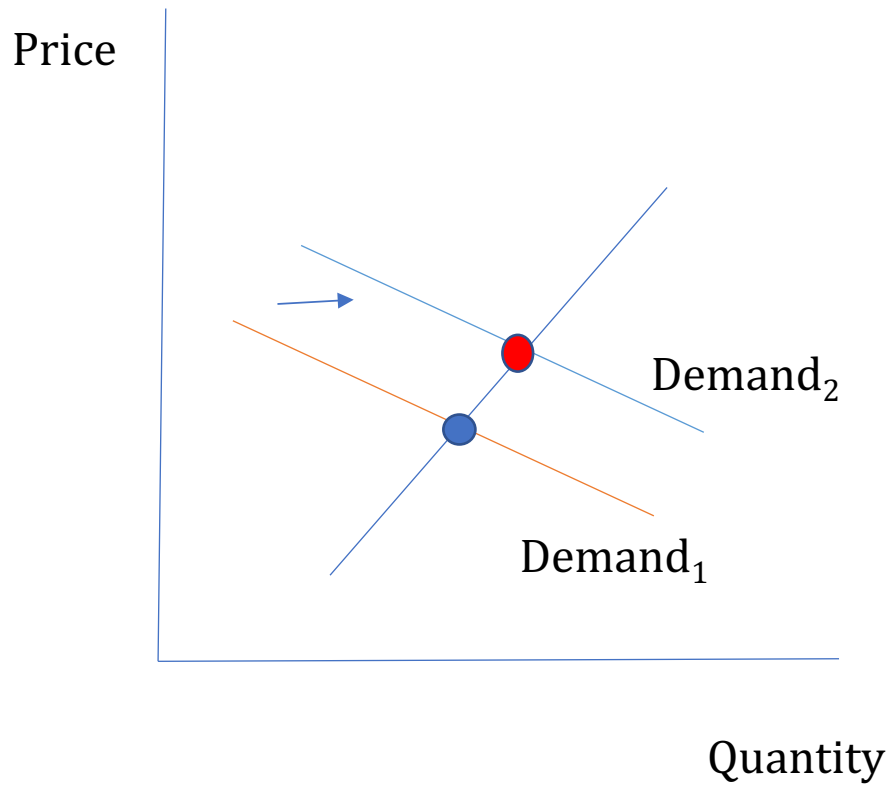
Identification Strategy: Interstate Banking Deregulation

- Removal of restrictions on bank entry and expansion
  - Facilitated M&A, promoted competition, and increased bank efficiency.
  - This helped local economic growth.
  - Jayaratne and Strahan (1997) find that the relaxing of restrictions on bank expansion led to greater bank efficiency
    - But no increase in credit supply.
  - Banking deregulation could be induced by an expectation of future growth paths.

Comments: Leverage Regressions

	(1) Mkt Lev	(2) Mkt Lev	(3) Mkt Lev	(4) Book Lev	(5) Book Lev	(6) Book Lev
Local ASC Index	0.005***			0.004***		
	(5.34)			(4.48)		
High ASC		0.015***	0.028***		0.015***	0.023***
		(3.16)	(5.01)		(3.53)	(4.48)
Low ASC		-0.011**			-0.005	
		(-2.38)			(-1.16)	
Log Income	-0.024***	-0.021**	-0.014	-0.016*	-0.014	-0.008
	(-2.59)	(-2.29)	(-1.34)	(-1.79)	(-1.58)	(-0.83)
Log Population	-0.005**	-0.006**	-0.006**	-0.006***	-0.006***	-0.006**
	(-2.21)	(-2.31)	(-2.15)	(-2.71)	(-2.94)	(-2.48)
Log Religious	0.004	0.005	-0.008	-0.001	-0.001	-0.012
	(0.41)	(0.51)	(-0.75)	(-0.11)	(-0.09)	(-1.14)
Rural Urban Continuum	-0.003	-0.003	0.001	-0.004**	-0.004**	-0.001
	(-1.39)	(-1.39)	(0.27)	(-1.98)	(-2.03)	(-0.49)
Size	0.027***	0.027***	0.028***	0.026***	0.026***	0.027***
	(21.87)	(21.83)	(19.42)	(23.32)	(23.28)	(19.83)
Market-to-Book	-0.044***	-0.044***	-0.043***	-0.014***	-0.014***	-0.015***
	(-39.28)	(-39.31)	(-33.02)	(-12.83)	(-12.85)	(-11.74)
Profitability	-0.134***	-0.134***	-0.131***	-0.160***	-0.160***	-0.162***
	(-21.26)	(-21.24)	(-17.74)	(-19.93)	(-19.93)	(-16.82)
Tangibility	0.195***	0.195***	0.191***	0.206***	0.207***	0.213***
	(16.40)	(16.40)	(14.00)	(18.51)	(18.54)	(16.13)
Stock Return	-0.033***	-0.033***	-0.033***	-0.015***	-0.015***	-0.015***
	(-27.18)	(-27.16)	(-23.22)	(-13.72)	(-13.69)	(-11.27)
Stock Volatility	0.319***	0.319***	0.322***	0.233***	0.232***	0.239***
	(19.83)	(19.81)	(16.99)	(15.41)	(15.38)	(13.18)
Firm Age	0.000	0.000	-0.000	-0.001***	-0.000***	-0.001***
	(0.09)	(0.17)	(-0.67)	(-2.86)	(-2.77)	(-3.19)
Dividend Payer	-0.088***	-0.088***	-0.087***	-0.069***	-0.069***	-0.067***
	(-19.36)	(-19.32)	(-16.65)	(-17.19)	(-17.16)	(-14.04)
R&D/Sales	-0.004***	-0.004***	-0.005***	-0.005***	-0.005***	-0.006***
	(-4.26)	(-4.23)	(-4.43)	(-3.09)	(-3.07)	(-3.14)
Constant	0.508***	0.502***	0.464***	0.362***	0.366***	0.236**
	(4.66)	(4.57)	(3.82)	(3.54)	(3.57)	(1.97)
Year and Ind Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes
N	81,267	81,267	54,573	81,290	81,290	54,587
Adj. R^2	0.317	0.317	0.321	0.213	0.213	0.218

Leverage Specifications

- Frank and Goyal (2009) show that industry median leverage is the most important factor in explaining leverage.
    - Sign on stock volatility (not a robust factor in Frank and Goyal (2009).
- Lemmon, Roberts, and Zender (2008) show that firm fixed effects are important.

Conclusions

- The paper is addressing an important question.

- Disentangling demand from supply effects would be important.

- Leverage specification.