Credit Control Rights and Resource Allocation within Firms
by Nuri Ersahin, Rustom Irani and Hanh Le

Discussion by Elisabeth Kempf

The University of Chicago, Booth School of Business

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Big picture

- **Traditional view**: Creditor influence limited to bankruptcies

  - Recent view: Creditor influence occurs much more frequently, e.g., following covenant violations (10-20% of firm-years) (Chava and Roberts (2008), Nini et al. (2012), Ozelge and Saunders (2012))

  - Main finding (Nini et al. (2012)): creditor intervention adds value by improving operating performance
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- Main finding (Nini et al. (2012)): creditor intervention **adds value** by improving **operating performance**
This paper

- **Question**: How do creditors improve operating performance?

  - **Key ingredient**: use establishment-level data to analyze resource allocation within firms

  - **Main findings**:
    - Covenant violators reduce employment and increase sales and closures of establishments in peripheral industries
    - Unproductive establishments

  - More broadly: provides direct link between corporate financing and labor policies (see also Falato and Liang (2016))
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Main comments

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   1. Identification
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2 Timing
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2 Implications
Comment I: Identification

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- **Approach II**: RDD based on imputed violations
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  1. Apply a more rigorous RDD approach
  2. Visualize the discontinuity
     Use local linear regression and/or non-parametric approaches
     Compute optimal bandwidths
  3. Perform additional checks
     Densities of accounting ratios just below and above the threshold
     Orthogonality of covenant violation with other measures of investment opportunities, industry cycles, etc.
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Creditor Control Rights
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- Baseline result:

<table>
<thead>
<tr>
<th></th>
<th>(1)</th>
<th>(2)</th>
<th>(3)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Δ Log(Employment)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Covenant violation</td>
<td>-0.068</td>
<td>-0.044</td>
<td>-0.034</td>
</tr>
<tr>
<td></td>
<td>(-3.90)</td>
<td>(-5.54)</td>
<td>(-3.75)</td>
</tr>
<tr>
<td>Industry fixed effects</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Year fixed effects</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Controls</td>
<td>No</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Firm fixed effects</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>N</td>
<td>43,480</td>
<td>31,071</td>
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</tr>
</tbody>
</table>
Comment II: Timing

- What about the dynamics?
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○ What about the dynamics?

![Graph showing Annual Change in Log(Employment) vs Years to violation]

- Mean
- Median
Comment II: Timing

- Problematic if employment change also spans the period prior to a covenant violation

Census variables are measured as of March 12 each year. For this reason, if a violation occurs at first or second (third or fourth) quarters of year $t$, we measure the annual change in employment from year $t$ to $t+1$ ($t+1$ to $t+2$).
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Comment III: Implications

- Paper shows **how** creditors achieve turnaround in operating performance
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Suggestions:

1. Competing hypotheses and their implications for the sustainability of the value creation?

2. Can you use the data to explore why creditors add value over and above shareholders and boards and when (vs. Falato and Liang 2016)?

Do creditors have superior turnaround experience (“worst-case-experts”)? Do they have expertise with establishments of certain type, industries or geographies?
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