Discussion of:

The Relationship between Borrower Risk and Loan Maturity in Small Business Lending

by

Karolin Kirschenmann and Lars Norden

Literature – signaling models and relationship lending:

Flannery (*JF*, 1986), “Asymmetric Information and Risky Debt Maturity Choice”

Diamond (*QJE*, 1991), “Debt Maturity Structure and Liquidity Risk”

Elsas & Krahnen (*JB&F*, 1998) “Is Relationship Special?”

Chemmanur & Fulghieri (RFS, 1994) ”Reputation, Renegotiation, and the Choice...”

... but what about:

Asea & Blomberg (*J.Econometrics*, 1998), “Lending Cycles” – *business cycles*

Diamond (*JF*, 2004), “Committing to Commit” – *strategic default*

Gorton & Kahn (*RFS*, 2000), “The Design of Bank Loan Contracts” – *contracting*

Helwege & Turner (*JF*, 1999), “The Slope of the Credit Yield Curve...” – *bonds*

Park (*JF*, 2000), “Monitoring and Structure of Debt Contracts” – *priority and maturity*

Saunders (*Wiley*, 1999), *Credit Risk Measurement – KVM, marginal mortality, ...*

Hypotheses:

H1 (*Signaling*): There is a *positive and monotonic relation* between borrower risk and loan maturity *if asymmetric information is relatively high*.

H2 (*Helping hand*): There is a *positive and monotonic relation* between borrower risk and loan maturity *if asymmetric information is relatively low* because high-risk firms benefit most from borrowing from relationship lenders.

Alternative Hypothesis:

Credit ratings correlate with duration of borrower assets (e.g., cumulative mortality measure). Borrowers match-fund to achieve a natural hedge. Thus:

- ***H*x** (*Match-funding*): There is a *positive and monotonic relation* between borrower risk and loan maturity *regardless of asymmetric information* because borrowers match-fund, and borrowers with long-duration assets are scored as riskier by the bank.

Data:

Data set

- Very nice; this is the hard part

Rating calculations – more details please!

- Scoring model? Human judgment?
- Borrower characteristics are used?

Borrower

- Capital structure?
- Short-term loans? Credit lines?

Asymmetric information

- Too complicated
- Assumed SHORTDUR was the main factor.

Empirical results:

Main result

- Correlation between credit rating and loan maturity
- Appears quite robust

Simultaneous equations

- Cannot ignore other loan terms: omitted-variable bias
- Should *test* for endogeity (e.g., Wu-Hausman). Identification may be useful.

Collateral

- Why is it not more important? Multicollinearity? Do you have LTV?
- Collateralized borrowers have a better credit rating – why?

Asymmetric information

- Rating coefficients bigger for high asymmetries, *but* intercept smaller
- Possible significance of other loans.

Bargaining power

- Convincing rationale here