Discussion of “The Decline of Secure Debt” by Benmelech, Kumar & Rajan

Juliane Begenau

WFA Meeting 2020

Stanford GSB & NBER & CEPR

Summary

Two stylized facts:

1. Decline in the corporate secured debt share / corporate debt
2. Secured debt share is countercyclical

Why?

- Close to exhaustive list of potential drivers
- "Multifactorial answer" favored
- Secured debt share equilibrium amount determined by
  - Borrowers' demand (benefits of secured debt)
  - Creditors' supply (costs of secured debt)
- Paper's narrative: costs have presumably risen, benefits presumably declined

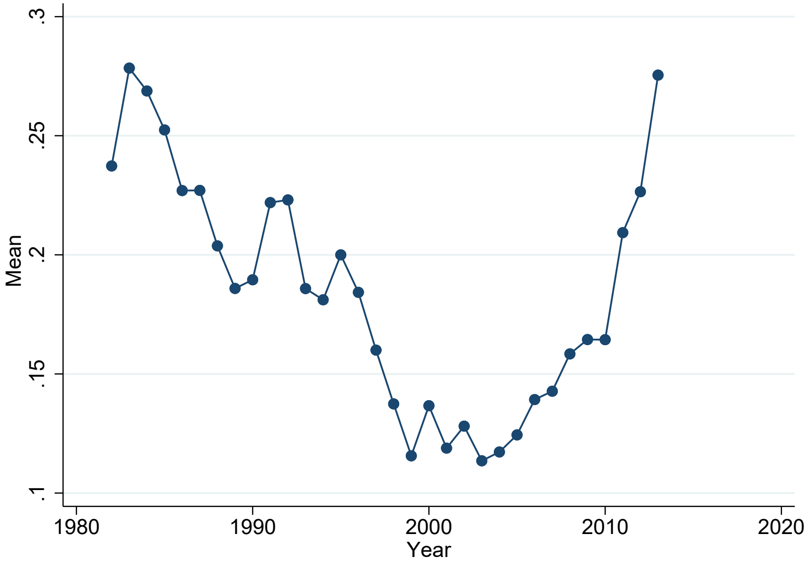
Determinants of secured debt share equilibrium

- Borrowers' demand & creditors' supply for secured debt
- Benefits for creditors
  - Protects lenders against strategic default
    Especially when bankruptcy laws and acounting information are weak
  - Improves unclear seniority in case of default (e.g., Donaldson, Grombs, Piacentino (forthcoming))
- Costs for borrowers
  - Loss of financial flexibility
  - Loss of operational flexibility
- Other explanations
  Lack of collateralizable assets, safe assets, etc

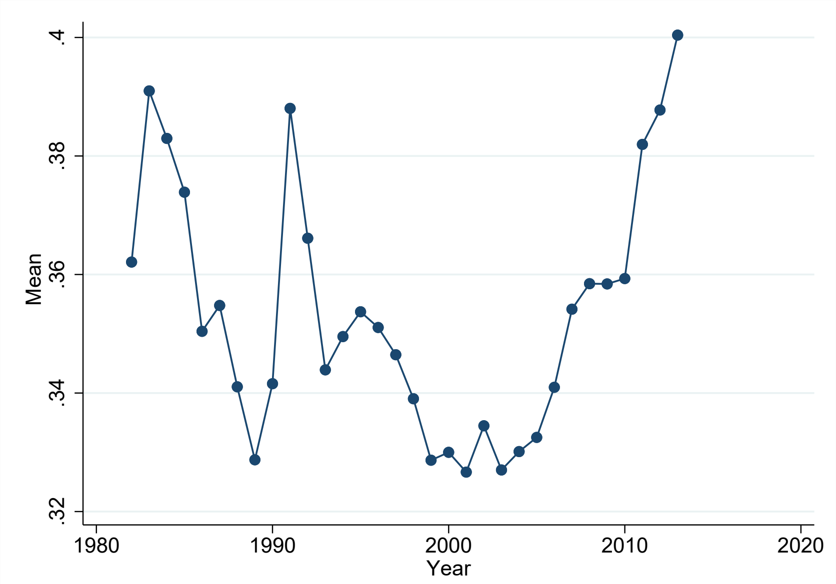
Discussion

- Suggestive evidence that benefit/cost ratio of secured debt has declined, driving decline in secured debt / debt ratio
- Comments:
  - Revisiting the fact post 1980s: Has the secured debt / debt share really declined?
  - Potential driving force: change in the composition of firms in Compustat

Declining Median Secured Debt Share



No clear trend: Average Secured Debt Share

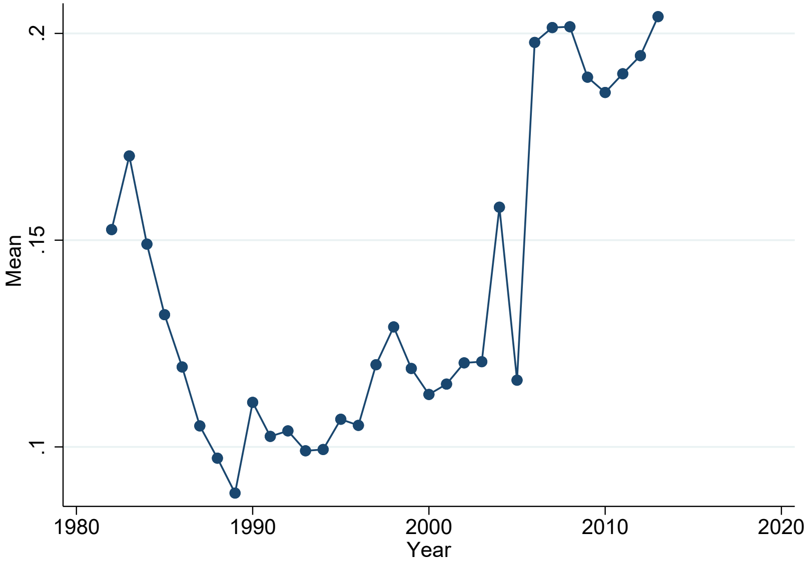


Within-firm Secured Debt Share Regressions

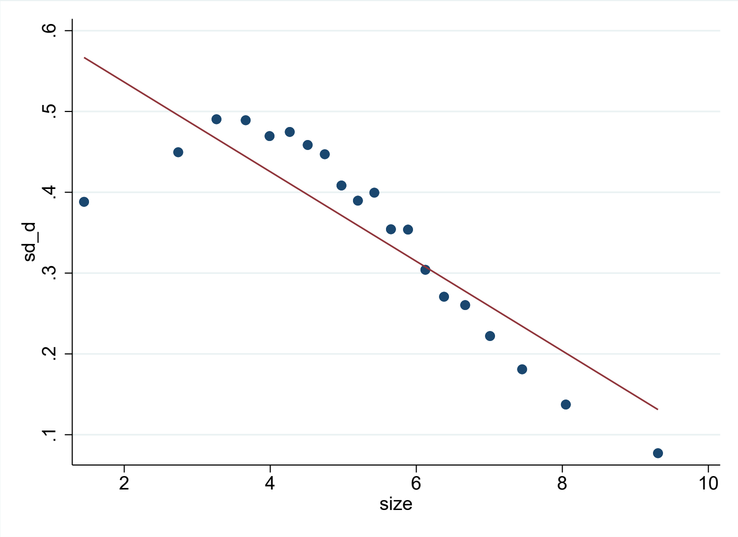
	coef.	t stat.
time	0.030**	(2.60)
Adjusted R^2	0.35	
R^2-Within	0.01	
N	61,787	

- Positive within firm time trend
- Potentially suggests selection effect: small new entrants drive decline in median secured debt share

Rising Aggregate Secured Debt Share



Humpshaped Secured Debt Share to Size Relationship



Controlling for leverage

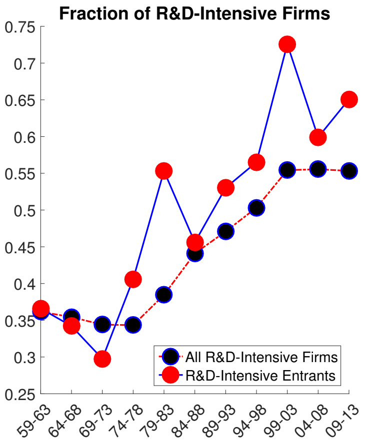
Summary of the facts

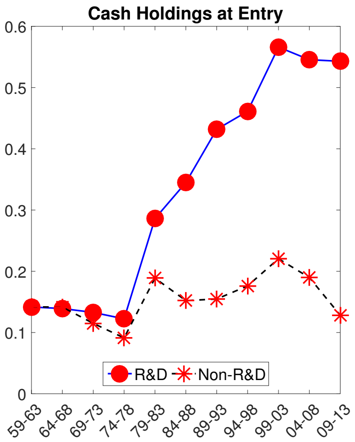
1. Median Secured Debt / Debt share is *falling*
2. Mean Secured Debt / Debt share shows no clear trend
3. Aggregate Secured Debt / Debt is *rising*
4. Within firm trend of secured debt share is positive
5. Larger firms have lower secured debt share

Suggests selection story: change in the composition and type of firms that drive median / mean / aggregate

- Different stories matter for median / mean / aggregate firm
- Focus of the paper is on the median

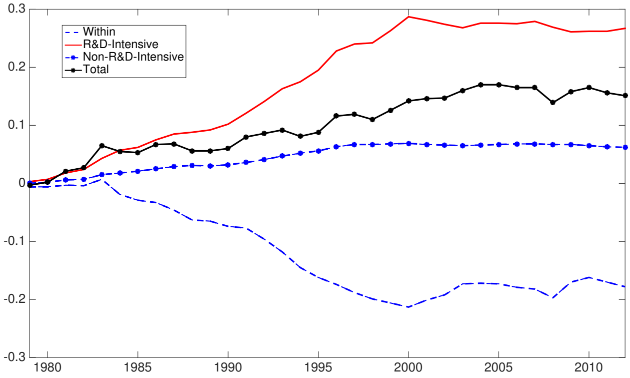
Emerging dominance of R&D intensive firms





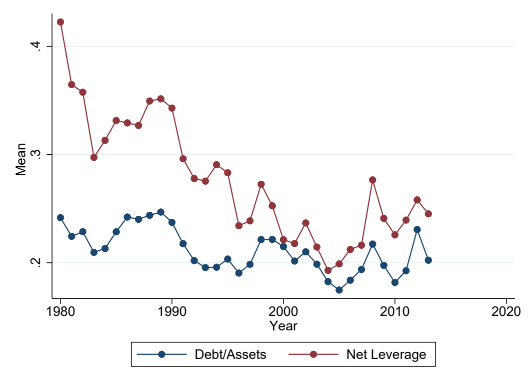
Begenau and Palazzo (forthcoming)

Entrants drive average cash-to-asset ratio up
Incumbent firms declining cash-to-asset ratio



Begenau and Palazzo (forthcoming)

Decline of Corporate Leverage



- Sun and Zhang (2019): deferred employee stock compensation increasingly used to finance intangible heavy firms
- Equity financing perhaps better mechanism to solve incentive problems between owners/employees of R&D intensive firms

Take-away

- Great read! Interesting stylized facts and coherent narrative
- Decline in median secured debt ratio potentially driven by selection of R&D–intensive (i.e. intangible heavy) entrants
- Fundamental changes in the firms' business model also drive fundamental changes in how firms finance themselves
- Aggregate secured debt share shows positive trend – consistent with rise in safe asset demand

Equilibrium Amount of Collateral

- Safe asset demand (e.g, Krishnamurthy and Vissing-Jorgenson 2012) would push against decline in secured debt share
- Rise of majority intangible (despite recent advances in patent collateralization etc) has likely *decreased* amount of available collateral
- Authors mention new legal developments that allow for a wider range of what counts as collateral
- Financial sophistication/innovation has increased the (efficient?) use of each unit of potential collateral
- Example: exploding CLO markets, close to a $ trillion oustanding loans [1]

Smaller points

- Page 9: why to skip years? You are documenting stylized data facts. If it's about trend and cycle, the justification to wait until capital structures have stabilized is not compelling. Presumably you could exactly explain any oddity of the data with the war and not stable capital structures. Why not show it?

- Page 30 misleading statement: "repaying interest has climbed since the early 1980s, .. b/c leverage has increased". Incorrect: Since the 1980s, leverage has *declined!* (Graham, Leary, and Roberts)

Non-linearity in Secured Debt / Debt wtr Leverage
Secured Debt Ratio over Leverage bins