Discussion: Distortion in Credit Availability in India's Lead Bank Scheme: A Transaction Costs-based Approach

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Lead Bank Scheme

- ▶ Lead Bank Scheme: Introduced in 1969 with the purpose of expanding financial services in overlooked regions of the country.
- ▶ Each district is assigned a bank (Lead bank) to identify bottlenecks in financial service delivery, and coordinate with other agents to overcome them.
- ▶ Each state is assigned a bank (Convenor bank) to monitor the efforts of lead banks in the state.

Paper - Empirical Findings

- ▶ Aligned districts: Convenor and Lead banks belong to the same corporate entity.
- ▶ Paper finds credit disbursal in aligned district is 9.9% higher.
- ▶ Effect found after controlling for temporal variations, supply side and demand-side factors.
- ▶ Higher credit availability in aligned districts helps to offer protection from negative income shocks.

Paper - Theory

- ▶ Theoretical explanation: Incentives [monitoring costs (Williamson (1981) and higher career concerns (Holmstrom and Roberts (1998)] are different in aligned districts.
- ▶ Intuition: When lead bank and convenor bank fall within the same corporate entity, monitoring costs are low and rewards for effort exertion are high. This compels lead banks in aligned districts to perform better.

Comment - Career Concerns

- ▶ Helpful to go into a bit more detail about how career concerns channel operates, for instance
    - ▶ How is promotion affected by performance in this scheme?
    - ▶ How strong are incentives for the Convenor bank to monitor properly?
- ▶ Paper: "since the aligned lead banker reports directly to the chairman of her own bank once every quarter, but the non-aligned lead banker does not, the incentive for lead banker changes across aligned and non-aligned districts."
- ▶ Information on banker in district would be available to the chairman of the bank even if the bank is not Convenor bank - one advantage of being a Convenor bank is it has access to information about other banks with which to benchmark performance?

Comment - Career Concerns

- Whose career concern matters?

Table: Payoff matrix

		$1-\beta$	β
		M	NM
α	E	$V - C_E, b_M - c_M$	$-C_E, b_{NM}$
$1-\alpha$	NE	$-C_{NE}, v$	$-\delta C_{NE}, -\delta c$

- Probability with which Lead bank plays E:

$$\alpha = \frac{v + \delta c}{v + \delta c + b_{NM} - (b_M - c_M)}$$

Comment - Career Concerns

▶ Comparative statics:

$$\frac{\partial \alpha}{\partial v} = \frac{b_{NM} - (b_M - c_M)}{(v + \delta c + b_{NM} - (b_M - c_M))^2} > 0$$

▶ v is the value received by Convenor bank when it monitors a Lead bank which does not exert effort: seems to capture career concern incentives of the Convenor bank.

Comment - Interpretations

- ▶ Paper: how organizational pressure within commercial banks in India may distort credit lending, links with literature on resource misallocation due to industrial policies in developing countries.
- ▶ Direction of distortion - Excess lending in aligned districts? Too little lending in non-aligned districts?
- ▶ Issues with data collection - discrepancy in the data supplied at the State Level Bankers Committee (SLBC) and that available through the Core Banking Solution - correlation with alignment?
- ▶ Alternative explanations - better co-ordination?

Minor Comments

- Useful to state assumptions on parameters together.
- Probability with which Convenor bank plays NM:

$$\beta \;=\; \frac{V + C_{NE} - C_E}{V + C_{NE} - \delta C_{NE}}.$$