

What Happened to Corporate Financing in
Asia Before the Sub-Prime Shock? A Case
Study of Institutional Change in Indonesia
(by Professor Okuda and Take)

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Summary of the Paper

- This paper investigates determinants of the capital structure of Indonesian listed companies before and after the economic reforms following the Asian financial crisis. They find that the corporate financing activities of Indonesian listed companies became more rational as a result of post-crisis reforms.



Major Contribution of the Paper

- This is the first econometric study that examines how the post-crisis reforms influence the fund raising activities (or corporate financing activities) of Indonesian listed companies. This paper explores an understudied, but important issue. It helps us understand various post-crisis reforms and their potential impacts in one of the largest developing economies, Indonesia.

Methodology

- This paper uses a two-step estimation process.
- In the first step, due to employing an unbalanced panel data, a fixed effect regression model is estimated.
- In the second step, the estimated coefficient of individual company fixed effect from the first step is regressed on fixed attributes of the company.



Variables of Interest in the First Step

- Dependent variables: Debt ratios
- Independent variables: Time-related company variables (e.g. Retained Earnings, Corporate Tax, Ability to Provide Collateral, Creditworthiness, Business Risk), Dummy for Post-crisis period * Time-related company variables, Dummy for Mini-boom period *Time-related variables, Year dummies, and fixed company effects.



Variables of Interest in the Second Step

- Dependent Variables: Estimated fixed effects of company
- Independent Variables: Time-invariant Corporate Attributes (e.g. Ownership attributes, Core Company, Restructured Company), Dummy for Post-crisis period
* Corporate attributes, Dummy for Mini-boom period*
Corporate attributes, and Industry dummies.

Major Empirical Results I

- First step estimation results find that most time-related company variables have either wrong signs or insignificant impacts. Therefore, authors suggest that fund raising activities in Indonesia prior to financial crisis differed from those predicted by financing theory.



Major Empirical Results II

- On the other hand, estimation results in the first step find that most cross terms of dummy for post-crisis period and time-related company variables have more consistent signs and significant effects. Therefore, authors suggest that corporate financing activities in Indonesia became more rational as a result of reforms in the post-crisis period.

Major Empirical Results III

- The second-step estimation results find that ownership attributes play significant roles in affecting a company's fixed effect. However, the results also find that the cross-terms of dummy for post-crisis and ownership attributes have insignificant impacts. Therefore, authors suggest that fund raising activities of listed companies are strongly affected by social and political networks they possess in the pre-crisis period. However, the effects of ownership become very weak in the post-crisis period.

Major Comments I

- Authors use the coefficient of an explanatory variable to indicate the effect of this variable in the pre-crisis period, whereas authors use the coefficient of cross term of dummy for post-crisis period and an explanatory variable to indicate the effect of this variable in the post-crisis period. Is this reasonable?

Major Comments II

- Authors regress estimated fixed effects on a company's time-invariant attributes (e.g. ownership and core) in the second step. The number of estimated fixed effects in the first step is equal to the number of listed companies, so the number of observations in the second step should be only equal to the number of sampled companies. However, in order to include the cross term of dummy for post-crisis period and time-invariant attribute, authors include the same number of observations as the one in the first step estimation. Is this reasonable or necessary?



Major Comments III

- Because the paper uses a two-step estimation process, it is relatively more complicated to interpret the estimated coefficients of ownership attribute obtained from the second step estimation. In fact, the coefficient indicates how the ownership attribute affects a company fixed effect. However, based on the first step estimation, different companies have different fixed effects on debt ratios. Therefore, the marginal impact of ownership attribute on debt ratios varies across companies.

Major Comments IV

- In the first step estimation, authors also control year dummies. In fact, authors can alternatively use the two-way fixed effect model to capture both individual company fixed effect and time (year) fixed effects. Can the coefficients of year dummies (or time fixed effects) be explained by macroeconomic conditions or policies?

Minor Comments

- 1. I suggest authors to rewrite both equations (1) and (2). Authors should try to express the cross term like $AF \cdot X$ or $MB \cdot X$.
- Is the “restructured” variable missing in the second-step estimation?