Discussion: Survival

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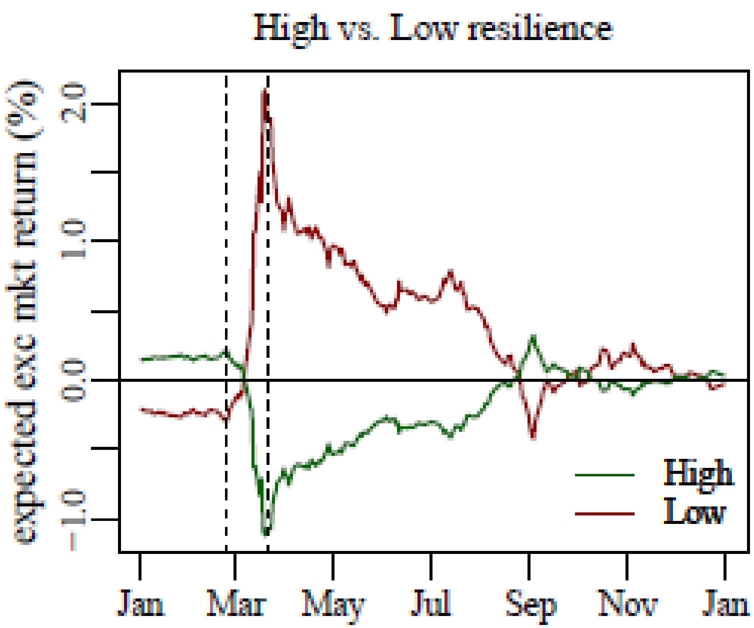
Corporations and COVID-19

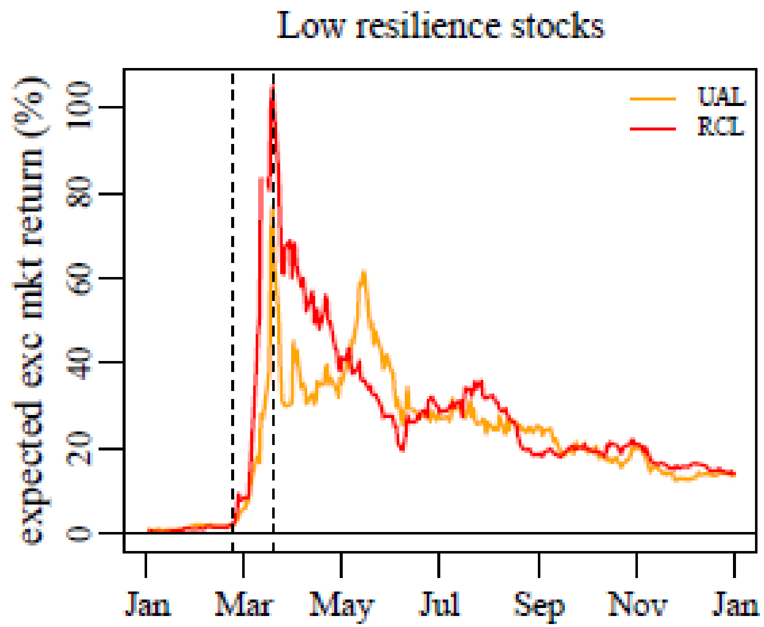
Distinctive features of the shock:

1. Phasing:
   - **late February-late March 2020** ("fever period"): sudden cash flow dry-up ⇒ firms' scramble for liquidity
   - **after March 2020**: Fed intervention, vaccine news ⇒ bond and stock market recovery; fiscal support (grants, loan guarantees, etc.)
2. Asymmetry:
   - mainly hit firms **vulnerable to social distancing**
   - hit **SMEs** (much) more than large firms
3. Persistence?
   - When and how much will **growth** resume? Potential **persistence** of the pandemic and/or its effects (virus mutations, change in habits)
   - What happens when **support programs** (e.g. loan guarantees) are **over**? Were **bankruptcies** avoided or postponed? **Scarring effects?**

Evidence from asset prices' response to COVID

- Option-implied 1-year horizon expected stock returns *minus* the expected S&P500 market return:





From Pagano, Wagner and Zechner (2021), "Disaster Resilience and Asset Prices", SSRN WP no. 3603666

Has research exploited these features so far?

- Recognition that this shock differs greatly from Great Recession shock: it does not originate from financial sector, actually in early 2020 banks had a strong capital basis and acted as stabilizers
- Yet, still a long way to go:
- Phasing: research has focused mostly on initial impact of the COVID shock
- Asymmetry: so far limited recognition of the asymmetric nature of the shock, especially regarding heterogeneity in firm resilience to social distancing – missed identification opportunity
- Persistence: we still know little about the extent of reversal and scarring effects – likely due to lags in accounting data production

These papers: focus and contribution

- Vinas: focus on the liquidity dry-up, and bring in the trade credit element (for French companies)

- Severino: focus on growth, and highlight the company size element (for large listed US companies)

- Sabbatucci: focus on the liquidity dry-up as well, but bringing in the dividend/buyback and capital structure response (for US listed companies)

Vinas: trade credit channel

- This paper brings in the ability of trade credit to fund the economy's supply chain
- Important: the COVID shock hit firms, not banks, and deprived trade debtors of the cash flow needed to repay trade creditors
- **Findings**: trade debtors that are (i) more levered and (ii) in downstream sectors are more likely to default
- **But** the data would allow to do more:
  - exploit asymmetric nature of the shock: trade debtors differ not only in terms of leverage and downstream position of the sector, but also in terms of their exposure to social distancing
  - use trade credit to trace out the "financial plumbing" of supply chains and identify the indirect effects of the liquidity dry-up: firms entering distress because their trade debtors defaulted on them

$\Rightarrow$ study the **propagation/multiplier** effect of the dry-up (e.g., retail chain may destabilize upstream producers)

Severino: firm growth and firm size

- Not sure how relevant to firms' survival to the COVID shock:
  - small firms grow more than large ones, but the differential shrinks or disappears in recessions, more so in the COVID one
  - this different response in recessions does not arise from financial frictions (leverage) but from larger growth options (though they also show that smaller firms also have greater cash flow sensitivity)
- But focus on large listed firms overlooks that the COVID-19 shock was much larger for **smaller and more levered** firms:
  - Bloom, Fletcher, and Yeh (2021): "the smallest offline firms experienced sales drops of over 40% compared to less than 10% for the largest online firms"
  - Carletti, Oliviero, Pagano, Pelizzon and Subrahmanyam (2020): "distress is more frequent for small and medium-sized enterprises and for firms with high pre-COVID-19 leverage"

Severino: concerns about methodology

- Firm size is not measured at an initial date, but based on firms' assets 1 year before: small & large firms change at each date
- Endogeneity concern: firm whose sales grow more are likely to grow also in total assets $\Rightarrow$ if sales growth and size are serially correlated, the LHS variable affects the RHS
- It may mechanically generate the observed convergence of small and large firm growth: high-growth small firms gradually turn into large firms, and low-growth large firms into small firm
- If this "migration" happens especially during recessions, it may explain results that convergence is stronger in those periods
- This may be amplified by different attrition: if in recessions there is greater exit of small firms (bankruptcies, takeovers), surviving small firms are larger than before $\Rightarrow$ more similar to large ones

Sabbatucci: corporate cash-saving response

- Very nice paper on the corporate policies enacted by US firms especially during the initial phases of COVID: dividend and buyback suspensions, bond and equity issuance
- It shows that these cash-saving or cash-raising policies respond to
  - drops in profitability & revenue growth and size of the uncertainty shock (increase in idiosyncratic return volatility)
  - "chain of corporate actions" is consistent with pecking order theory
- **But**
  - the cash dry-up (drop in revenue) varied greatly depending on firm exposure to social distancing $\Rightarrow$ explore whether cash-preserving strategies were adopted primarily by low-resilience firms
  - end-point of the process? To what extent are these corporate policies being rolled back? Are some firms "persistently scarred" in terms of capital structure (leverage), e.g. cruise lines or airlines?