Risk Management and Rating Segmentation in Credit Markets*

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Abstract

We study how lending to small and medium sized firms segmented into different rating classes is affected by banks' risk management policies between 2004 and 2011. We exploit a regression discontinuity design that compares credit conditions, investment and sales between firms that, based on a continuous assignment variable, fall into different risk classes. These firms feature similar observable characteristics, in terms of location and sector of activity. Yet, we show that the spreads applied to comparable firms in different rating classes vary over time. This in turn caused those firms that obtained worse credit conditions during the recent financial crisis to cut their expenditure in production inputs (investment, employment and intermediates) and thus reduce sales.

JEL classification: G24, G31.

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