

A Bank on Every Corner: Relationship Contracting and Firm Dynamics

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Abstract

Retail firms in India are one of the largest sources of short-term consumer loans. What is the impact of bundling financial and real products on firm dynamics? By combining an experiment with a novel transaction level dataset of micro, small and medium sized enterprises, we document that 1) firms learn customer creditworthiness over time, 2) private information about creditworthiness generates monopolistic power, and 3) small firms have a comparative advantage in gathering private information. We develop a dynamic model of firm-customer lending and derive conditions under which it is efficient for firms to remain small. We then study how a counterfactual de-bundling of financial and real products through the introduction of credit cards affects the size and number of retail firms.

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