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Family firms, soft information and bank lending in a financial crisis☆

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ABSTRACT

This paper studies differences in family and non-family firms' access to bank lending during the 2007–2009 financial crisis. The hypothesis is that the former's incentive structure results in less agency conflict in the borrower–lender relationship. Using highly detailed data on bank–firm relations, we exploit the reduction in bank lending in Italy following the crisis in October 2008. We find statistically and economically significant evidence that credit to family firms contracted less sharply than that to non-family firms. The results are robust to observable *ex-ante* differences between the two types of firms and to time-varying bank fixed effects. We show, further, that the difference is related to an increased role for soft information in some Italian banks' operations, following the Lehman Brothers failure. Finally, by identifying a match between those banks and family firms, we can control for time-varying unobserved heterogeneity among the firms and validate the hypothesis that our results are supply-driven.

1. Introduction

The global financial crisis of 2008 and the subsequent global recession made it clear that capital markets can be a major source of business cycle fluctuations[1]. Shocks to the banking sector are propagated to the real economy via reduced credit supply. In particular, a heightening of problems of asymmetric information in bank–firm relationships tends to amplify the shocks, affecting some types of borrower disproportionately (Bernanke et al., 1996). Problems of moral hazard (Holmstrom and Tirole, 1997) and adverse selection (Stiglitz and Weiss, 1981) tend to discourage lenders from supplying credit to firms with high agency costs. Information asymmetry is typically less severe for banks than for bondholders; while the latter must rely chiefly on publicly available information (balance sheets, ratings, etc. — so-called hard information), the former have access to "inside" information, which is transmitted through repeated interactions between the loan officer and the firm's manager (Diamond, 1989; Fama, 1985; Petersen and Rajan, 1994). Such information relates to the lending officer's subjective evaluation of the firm's creditworthiness and is commonly labeled as soft

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[1] See Quadrini (2011) for a review.

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Table 1
Summary statistics for family and non-family firms, prior to the shock.

	Non-Family			Family			Mean diff.	
	Mean	St. dev.	Median	Mean	St. dev.	Median		Obs.
Panel A: Firm characteristics								
Foundation	1976.88	22.79	1981.00	1973.88	24.20	1979.00	3.00***	2909
Employees (2008)	421.63	1324.20	100.00	170.06	422.20	60.00	251.60***	2909
SMEs (%)	.63	.48	1	.78	.41	1	−0.15***	2909
North (%)	.46	.50	0	.39	.49	0	0.07***	2909
Center (%)	.24	.43	0	.22	.41	0	0.02	2909
South (%)	.31	.46	0	.40	.49	0	−0.09***	2909
Roe (2007)[a] (%)	6.25	6.97	4.9	6.40	6.13	5.26	−0.15	2741
Leverage (2007)[a] (%)	.44	.49	.31	.51	.51	.40	−0.07***	2200
Cashflow/revenues (2008)	.06	.12	.05	.04	.42	.05	0.02*	2781
Change in sales$_{2008-09}$ (%)	−.14	.29	−.09	−.16	.27	−.12	0.02*	2909
Panel B: Bank–firm relation								
Zscore (2008)	4.50	1.82	4	4.30	1.76	4	0.20***	2641
Bank Leverage (2007) (%)	.39	.46	.27	.44	.42	.35	−0.05**	1710
N bank relations	6.64	5.01	5.00	7.60	5.03	6.00	−0.96***	2848
Share first bank (%)	.56	.24	.51	.48	.21	.44	0.08***	2909
Share second bank (%)	.22	.11	.21	.22	.09	.22	−0.00	2763
Share third bank (%)	.12	.07	.12	.13	.06	.13	−0.01***	2535
Share fourth bank (%)	.08	.05	.08	.09	.05	.09	.01***	2253
Herfindahl index	.45	.21	.30	.36	.23	.32	0.09***	2909

SMEs are defined as having 250 employees or less and annual sales less than 50 million. Z-score takes values between 1 and 9. Extreme values were recoded at the 1st and the 99th percentiles to eliminate outliers. Leverage is measured as total debt over total assets in 2007; ROE is calculated as net profit over total equity in 2007. Number of bank relations and Herfindahl index (measured in terms of loan concentration at the firm level) were measured at the end of September 2008.

* $p < 0.10$.
** $p < 0.05$.
*** $p < 0.01$.

(Berger and Udell, 2002; Petersen, 2004). Soft information is an important determinant of corporate lending, especially to small businesses (Garcia-Appendini, 2011). In addition, it has been shown that soft information mitigates the repercussions of aggregate credit contractions (De Mitri et al., 2010; Jiangli et al., 2008). The reason is that hard information, such as past performance and standardized risk measures, are less reliable in predicting firm risk profiles during a crisis. Soft information about a firm's current results and future plans, which is continuously updated and better targeted to the characteristics of the borrower, can reduce such uncertainty.

Yet despite the academic interest in the importance of soft information in banks' lending decisions, it is still unclear which types of firm benefit most from an established banking relationship. We address this issue by focusing on the heterogeneity in firms' ownership structure, namely the presence or absence of a family block-holder. In particular, we pose an empirical question: does the presence of a family block-holder mitigate bank–firm agency conflicts during a financial crisis? The answer is closely related to differences in the incentive structures of family and non-family firms, hence to the banks' potential risk-shifting problem (Jensen and Meckling, 1976).

Burkart et al. (2003), and more recently Bandiera et al. (2012), have observed that family block-holders attach a value to control that is not merely monetary but also comprises an amenity component, *i.e.* utility gained from the control *per se*. This amenity component can be thought of as the personal status acquired thanks to the identification of the family name with the firm or the desire to pass the firm on to descendants. This translates into higher non-monetary costs of default, which reduces the incentive for strategic default (Anderson et al., 2003). On the other hand, as is pointed out by Villalonga and Amit (2006), Ellul et al. (2009) and Lins et al. (2013), family block-holders may have more incentive to extract private benefits at the expense of the other shareholders and stakeholders generally[2]. In contrast to the case of non-family block-holders, the gains from misconduct are concentrated in a single family group.

In a financial crisis, the lower expected return on investments can aggravate the incentive to divert resources out of the company, reducing a family firm's investment in the future and decreasing the probability that it will repay its debt. On the other hand, family firms may be perceived as more creditworthy because they have less incentive to default in the future. The evaluation of the overall impact of family ownership on credit allocation thus depends on the relative numbers of "good" and "bad" family and non-family firms. Therefore, even if the family status of firms is observable to all banks, only soft information gathered through personal contact with firms' managers can enable a loan officer to assess whether — for the same publicly available characteristics — a family firm is more creditworthy than a non-family one. In other words, soft information supplements hard information by revealing the possibly different objective functions of family and non-family firms.

We answer our empirical question on the basis of highly detailed data from the Italian Central Credit Register (CCR), which covers all loans to non-financial firms by banks operating in Italy. These data are matched with firm-specific data, including family ownership

[2] All these papers focus on listed firms, with their agency conflicts between controlling and minority shareholders. Our analysis, instead, concerns smaller firms that have generally not gone public, so this type of agency conflict is less of a concern here.

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