Creditor Control Rights and the Pricing of Private Loans

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Introduction

Creditor’s primary motivation for creditor governance is to protect or increase the value of their loan claims. Despite the recent surge in attention on creditors’ influence on firms, little is known about how creditor governance affects the pricing of private loans. We highlight a crucial channel through which creditors extract rents from the borrowing firm, which is of first order importance to explain the pricing and design of private loans.

Objectives

This paper investigates the influence of creditor control rights on the pricing of corporate loans:

- novel dataset, which combines individual borrower, lender, and loan characteristics with covenant violation data
- show that creditors exploit their control rights to overprice new loans
- overcome endogeneity concerns introduced by unobserved borrower characteristics by exploiting information about borrowers in violation with only some of their multiple creditors
- uncover novel cross-sectional loan pricing patterns that can be explained by creditor control rights

Empirical Design

- standard quasi-regression discontinuity design
- covenant violations to identify shifts in control rights from the borrower to the lender [1, 2]
- dataset structure allows us to overcome the endogeneity concerns of the standard quasi-regression discontinuity design

Data

- loan information from DealScan
- balance sheet data from Compustat
- hand-collected loan-level covenant violations

Important Result

Our results are important because they improve our understanding of the level and cross-sectional variation of observed loan prices, the impact of creditor governance on firms, and how relationship banking induces rent extraction.

Results I

standard quasi-regression discontinuity design:

\[
\begin{align*}
\text{Creditor Control} & \quad 75.00^{***} \quad 49.44^{***} \quad 30.38^{***} \quad 29.48^{***} \\
(6.094) & \quad (6.096) & \quad (5.990) & \quad (6.094) \\
\text{Covenant Controls} & \quad X \quad X \quad X \\
\text{Higher Order Covenant Controls} & \quad X \quad X \quad X \\
\text{Quarter FEs} & \quad X \quad X \quad X \\
\text{Borrower Controls} & \quad X \quad X \\
\text{Lender Controls} & \quad X \quad X \\
\text{Loan Controls} & \quad X \quad X \\
\text{Quarter-Quarter FEs} & \quad X \\
\text{Adjusted R-squared} & \quad 0.020 \quad 0.435 \quad 0.688 \quad 0.687 \\
\text{Observations} & \quad 38,781 \quad 38,781 \quad 38,781 \quad 38,781 \\
\end{align*}
\]

Table 1: All Covenant Violations and Loan Spreads

Results II

overcoming endogeneity by exploiting borrower observations that have violated and non-violated loans at the same time:

\[
\begin{align*}
\text{Creditor Control} & \quad 80.17^{**} \quad 112.96^{***} \quad 116.07^{***} \quad 115.49^{***} \\
(1.985) & \quad (2.742) & \quad (2.742) & \quad (2.765) \\
\text{Borrower-Quarter FEs} & \quad X \quad X \quad X \\
\text{Quarter FEs} & \quad X \quad X \quad X \\
\text{Lender Controls} & \quad X \quad X \\
\text{Loan Controls} & \quad X \quad X \\
\text{Lender-Quarter FEs} & \quad X \\
\text{Adjusted R-squared} & \quad 0.936 \quad 0.947 \quad 0.947 \quad 0.947 \\
\text{Observations} & \quad 37,843 \quad 37,843 \quad 37,843 \quad 37,843 \\
\end{align*}
\]

Table 2: All Covenant Violations and Loan Spreads

Cross-sectional Results

results are robust to the following alterations:

- total cost of corporate borrowing as pricing measure [5]
- new covenant violations

Additional Information

main results are stronger for:

- bank-dependent borrowers
- smaller borrowers
- borrowers closer to default

References


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