Collateral Damaged? On Liquidation Value, Credit Supply, and Firm Performance

Geraldo Cerqueiro, Steven Ongena, and Kasper Roszbach

Discussant: Jean-Edouard Colliard, HEC Paris

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In a nutshell

- Natural experiment in Sweden, 2004: creditors can seize a lower fraction of firms' collateral in case of default.
- In principle, affects the share of the "pie" that goes to creditors, not its total size.
- Akin to removing the creditors' seniority over other stakeholders.
- Diff-in-diff: firms not using floating lien collateral before 2004 form a control group.
- Impact on firms in line with an increase in financing constraints: less debt, shorter maturity, lower investment, etc.

Example - The Ski School - Pre 2004

- Skis and boots pledged as collateral to creditors.
- In case of default, creditors can seize this collateral before bankruptcy is declared.
- In particular, creditors do not have to share the liquidation proceeds with:
  - Employees (ski instructors).
  - Tax authorities.
  - Suppliers.

Example - The Ski School - Post 2004

- Lien holders can seize the skis and boots only in bankruptcy.
- Reduces the value of the collateral to creditors.
- Transition period for floating liens granted before 2004:
  - One year to renegotiate with creditors.
  - Typically extension of more collateral.
  - Without agreement, the creditor can require full repayment.

Figure: Norwegian manager running away with the firm's assets.

Interpretation - Modigliani-Miller

- If only the sharing of the pie is affected, not the size,
- then the total value of the firm to shareholders, creditors, and other stakeholders should not be affected.
- Still, this reform has a real impact on firms' investment.

  $\Rightarrow$ The "claims" of stakeholders are probably not well priced:

  - Downwards wage rigidity.
  - Tax authorities don't adjust for higher probability of payment.
  - Do suppliers adjust their prices?

Consequences

- Evidence of a real impact means that the sharing rule is not neutral.
- Can we deduce that bankruptcy rules should favor "more elastic" stakeholders?
- Maybe suppliers are even more elastic (trade credit)?
- Difficult to conclude here: we don't observe the total value of firms to all stakeholders.
- Maybe post-2004 the gains of employees, tax authorities, suppliers, etc. overweight the losses to shareholders?

Is it only the sharing of the pie?

- The Skis/Boots game:

		Creditor 2	
		Seize boots	Wait
Creditor 1	Seize skis	$(0.5, 0.5)$	$(0.5, 0)$
	Wait	$(0, 0.5)$	$(1, 1)$

- Point is precisely to avoid inefficient liquidation, so the size of the pie can be affected.
- Not sure it's a problem for the paper:
  - Why is it important to distinguish size vs. sharing?
  - How would theoretical predictions differ in both cases?

Real effects

- Decrease in investment, asset growth, etc.
- No differential impact on investment in real vs. movable assets.
- At such a detailed industry level I would expect the production technology to be Leontieff in the short-run (e.g., ski school).
- Rather, industries that rely more on real assets should grow relative to industries relying on movable assets.
- Compare industries with different levels of movable/real assets before the treatment? Even though the identification will be less clean.

The treatment

- There are two components in the treatment:
  - Long-run: new floating liens will obey different rules.
    Affects both treated and control firms.
  - Short-run: old floating liens have to be renegotiated, creditor seems to have a lot of bargaining power.
    Affects treated firms only.
- Diff-in-diff identifies the short-run effect, but the paper offers some interpretations more in line with the long-run effect.
- Drop in collateral value could be explained by creditors asking for a repayment in full
  $\Rightarrow$ then the treatment is akin to a negative shock on credit supply.
- Maybe this interpretation also makes the large magnitude of the treatment effect more credible?

Details

- Overall the methodology is great.
- DiD graphs very convincing and clean.
- Can you give more details about the timing? When was the policy announced?

Conclusion

- Very interesting topic.
- Extremely well-written.
- Interesting theoretical insights, but maybe the authors could develop one fully consistent story.
- Thought-provoking paper.

Conclusion - Why thought-provoking?

- What are the optimal bankruptcy rules?
- Should we actually protect creditors more in bankruptcy? Make them senior to other stakeholders?
- When are such rules necessary? Why can't we let market participants contract on who seizes the collateral first? What is the market failure?

Thank you!