Creditor Control Rights and the Pricing of Private Loans

Marc Arnold[1] Nicola Kollmann[1] Angel Tengulov[2]

[1]University of St.Gallen [2]University of Kansas

ASSA 2022

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

Introduction

Creditors' 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.

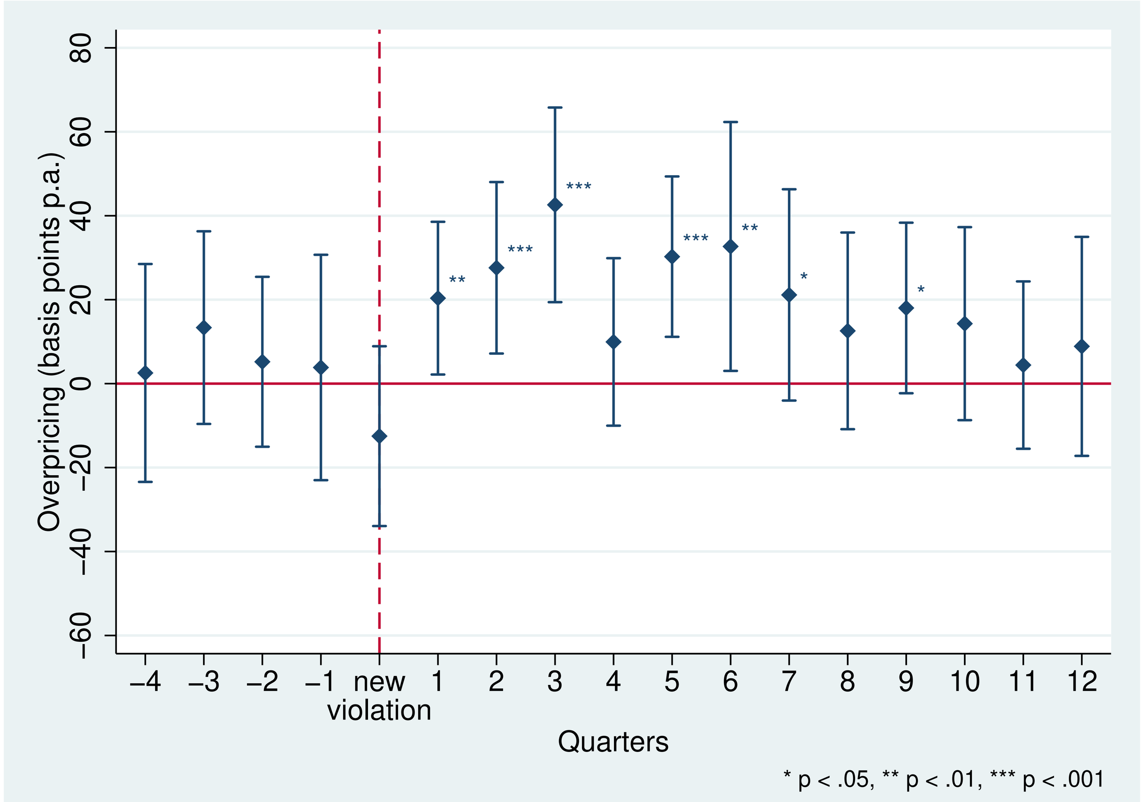

Figure 1: Additional spread from shift in control rights

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

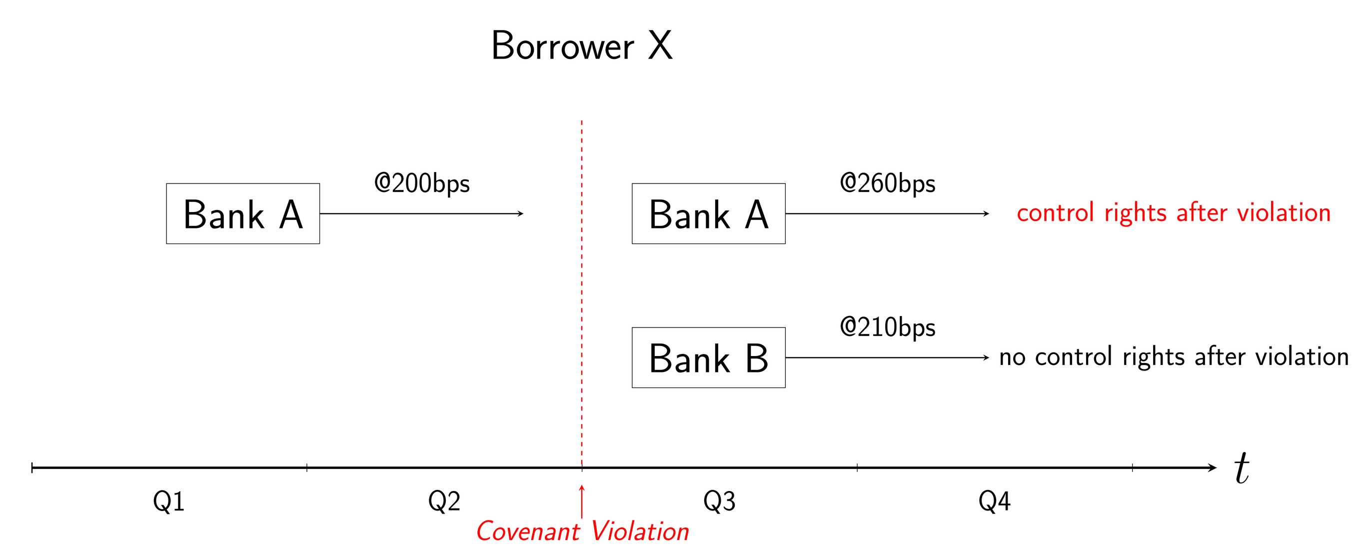

Figure 2: Loan-level Covenant Violations

Data

1. loan information from DealScan
2. balance sheet data from Compustat
3. linking tables provided by Michael Roberts [3] and Michael Schwert [4]
4. 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:

	(1)	(2)	(3)	(4)
Creditor Control	75.00***	49.44***	30.30***	29.08***
	(6.904)	(6.696)	(5.990)	(6.094)
Covenant Controls		X	X	X
Higher Order Covenant Controls		X	X	X
Quarter FEs		X	X	X
Borrower Controls			X	X
Lender Controls			X	X
Loan Controls			X	X
Lender-Quarter FEs				X
Adjusted R-squared	0.020	0.433	0.680	0.687
Observations	38,781	38,781	38,781	38,781

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:

	(1)	(2)	(3)	(4)
Creditor Control	98.17*	115.98***	116.05***	115.49***
	(1.985)	(2.742)	(2.742)	(2.765)
Borrower-Quarter FEs	X	X	X	X
Quarter FEs		X	X	X
Loan Controls		X	X	X
Borrower FEs		X	X	X
Lender Controls			X	X
Lender FEs				X
Adjusted R-squared	0.936	0.947	0.947	0.947
Observations	37,843	37,843	37,843	37,843

Table 2: All Covenant Violations and Loan Spreads

Cross-sectional Results

main results are stronger for:

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

Additional Information

results are robust to the following alterations:

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

results are not driven by concessions in other major loan terms (e.g., maturity, amount or number of covenants)

References

[1] Greg Nini, David C. Smith, and Amir Sufi. Creditor Control Rights, Corporate Governance, and Firm Value. *The Review of Financial Studies*, 25(6):1713–1761, 2012.

[2] David A. Becher, Thomas P. Griffin, and Greg Nini. Creditor Control of Corporate Acquisitions. *The Review of Financial Studies*, (forthcoming).

[3] Sudheer Chava and Michael R. Roberts. How Does Financing Impact Investment? The Role of Debt Covenants. *The Journal of Finance*, 63(5):2085–2121, 2008.

[4] Michael Schwert. Bank Capital and Lending Relationships. *The Journal of Finance*, 73(2):787–830, 2018.

[5] Tobias Berg, Anthony Saunders, and Sascha Steffen. The Total Cost of Corporate Borrowing in the Loan Market: Don't Ignore the Fees. *The Journal of Finance*, 71(3):1357–1392, 2016.

Contact Information

- Web: https://aca.unisg.ch/en
- Email: nicola.kollmann@unisg.ch
- Phone: +41 71 224 71 40