Family Firms, Bank Relationships and Financial Constraints: A Comprehensive Score Card[1]

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Abstract

We examine the effect of financial constraints on firm investment and cash flow. We combine data from the Spanish Mercantile Registry and the Bank of Spain Credit Registry to classify firms according to their number of banking relations (with none, one, or several banks) and according to whether they are family-owned, not family-owned, or belong to a family-based network of firms. Our empirical strategy is structural, based on a dynamic model solved numerically to generate the joint distribution of firm capital (size), investment and cash flow, both in cross-sections and in panel data. We consider three alternative financial market settings: financial autarky, borrowing/lending in a single asset, and moral hazard constrained state-contingent credit; estimate each via maximum likelihood; and compare across these financial regimes. We validate the structural approach by showing that it performs well in traditional categories by stratifying firms by size and age and finding that smaller and younger firms are more constrained. Formal financial arrangements through banks do help, but the evidence is mixed. For family firms, especially those belonging to networks based on ownership, we find that they are almost always associated with a more flexible market/contract environment and hence are less financially constrained than non-family firms. This result survives stratifications of family and non-family firms by bank status. Family firms are better able to allocate funds and smooth investment over states of the world and time, arguably done informally or through the cash flow generated at the level of the network.

JEL classification: C61, D82, D92, G21, G30
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