

Inheritance Law and Investment in Family Firms

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Discussion

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Intergenerational transfer of control in family firms

- Heir may not be so talented as founder (much evidence)
- Family firms must optimally switch to professional manager (Burkart, Panunzi and Shleifer 2003; Caselli and Gennaioli (2005))
- Evidence that heir may pressure for assuming control even when not efficient
- Infighting among family firms disturbs transfer (Bertrand et al, 2005)

Let me confess my prejudices

- I am a great fan of the work by these authors
- Yet I believe in progressive taxation
- This feeling did not change as I am now in a top tax bracket in a country with high fiscal enforcement

Personal view (part II)

- Recent moves to dismantle inheritance tax in Italy and the US have been
 - justified in very populist terms and
 - may lead to destruction of future enforcement capacity upon repeal
 - Miles Ferretti (1996) a political economy model of deliberately inefficient tax collection

A better argument

- Inheritance law may reduce the capacity of families to retain complete control
- Inheritance law may impede the transfer of control within the family, forcing to sell out upon the death of the founder, which endangers their business model
- Why ?

Why inheritance laws affect family firms ?

- Not because of increased agency costs as the stake held by the family is reduced
- Instead, the effect is due to legal constraints on the maximum stakes bequeathed to each heir.
- Inheritance constraints make difficult to retain control; the family may be forced to sell out
- The firm is assumed to be indivisible
- The chance of having to sell out is increased by poor investor protection

Model is a bit contorted

- Prediction: family firms invest less in countries with poor investor protection and high inheritance constraints
- Reason: Inefficient liquidation occurs as a result of high taxation because the family heirs receive a minority stake which is worth little (because the (new) controlling shareholder expropriates a lot)

I find hard to believe the model

- The paper assumes that retaining control implies raising external capital
- Its results are due to financing constraints, caused by exogenous investor protection
- Why should this not be overcome during the life of the founder ? Death is to be anticipated
- It also assumes that stakes inherited by family members cannot be pooled; yet this seems common among family firms
 - Family firms use especially designed corporate forms (società in accomandita) to assign control to a single heir

Use comparative statics

- Good models are useful as they offer nontrivial comparative statics, and this one does
- The authors use variation in external dependence to prove that family firms invest less under SIL than other firms
 - Note that family firms may be specializing in more capital intensive segments
- I think this presumes that SIL and investor protection are independent
- Which I do not believe

Plausibility

- How many family firms operate, by the death of the founder, in high growth segments with high external dependence ?
- My impression is that most family firms are in mature industries or in mature segments, whose assets are more easily pledged; In any case, this is testable
- I also think family firms are more common in low investor protection countries

Evidence

- ***Very strong negative correlation*** between the SIL and investor protection
- Probably much stronger than with average firm investment rates
- Do strict inheritance laws (SIL) simply proxy for civil law countries ?

Related issues

- I would have thought that the frequency of family firms be higher when
 - private benefit of control higher
 - investor protection is weaker
- This would be consistent with Pagano Volpin (2005), Perotti von Thadden (2006)

My work

- In the context of the Great Reversal, family firms may have reacquired significance in some countries heavily affected by war
- Countries where the middle class became impoverished experienced a major political shift
- They shifted from a corporate governance model based on market investors, towards a central role for banks and large investors (Perotti and von Thadden, 2006; Roe, 1007; Volpin)

Political role of family firms

- Family firms tend to have strong political connections
- Part of their preeminence may be due to an understanding: political support in exchange for corporatist policies (e.g. investment in domestic plants)

Conclusions

- Important theme
- The authors have set up an important question and sought to answer it conceptually and empirically
- I am not convinced, although I should add that I have strong priors on family firms
- Approach does not incorporate alternative or broader explanations, strongly suggested by empirical correlations.