The quality of the judicial system has proven to be a key determinant in enabling firms’ access to external finance. Indeed, when compliance with legal norms is high and the judicial system is effective in enforcing creditor’s rights, it becomes easier for investors to recover loans in case of borrower’s default. This, in turn, makes it ex-ante easier for lenders to grant finance to firms reducing the expected loss in case of bankruptcy, and finally, it enhances firms’ growth prospects.

A long-lasting strand of literature has tried to offer empirical support to this relationship. Demirguc-Kunt and Maksimovic (1998) show that a well-developed legal system with high levels of compliance with the legal norms brings about higher amounts of external finance granted to firms. Similar results are found by Bae and Goyal (2009) who offer support for the hypothesis that stronger creditor rights imply more efficient contracting, and therefore banks’ willingness to lend more and at a lower cost. Haselmann and Wachtel (2010) use banks’ level data to illustrate the association between banks’ positive perception of the legal environment and their increased readiness to finance informationally opaque borrowers like SMEs. Chemin (2010) evaluates the impact of judicial inefficiency analysing the effects of a reform implemented in India and aimed at speeding up trials resolution. He finds that the reform positively impacted on SME’s investment decision in fixed assets and that the effect was favoured, among other things, by the greater access to credit resulting from the speedier judiciary.

Drawing attention on the regional dimension, Jappelli et al (2005) study how heterogeneity in the judicial efficiency between Italian regions shapes regional lending behaviours. In particular, they find that in those provinces in which courts have a large backlog of trials, banks are less willing to grant finance and credit volumes are lower.

This paper wants to contribute to this strand of literature by shedding light on the impact that a change in the efficiency of the national judicial system could have on firms’ access to external finance. To this end, we exploit the variation triggered by the judicial system reform approved by the Italian government in 2013.

The intervention was aimed at reforming the geography of the Italian courts (Judicial System Reform: JSR henceforth) by merging some courts and by abolishing all the “sezioni distaccate” (local branches). As a result, the number of courts was severely reduced from 165 to 140, with 23 courts including one or two courts. The merger decision was centrally adopted by the government and was supported neither by a preliminary analysis on the existing level of efficiency of the hosting courts nor by a feasibility study on the potential impact of the merger. Therefore, the reform introduced an exogenous variation in the functioning of those courts interested by the merger, whilst other courts were not affected.

1 In this sense, the enforcement of legal rights mitigates the adverse selection problem.
This scenario allows us to set a quasi-experimental framework to pursue a twofold objective: (i) disentangle the direct effect of the reform on courts’ efficiency, (ii) investigate whether it has indirectly affected firms’ access to credit.

We measure courts’ efficiency by resorting to a yearly duration measure of the functioning of a single court which is based on pending and closed procedures, on three main fields of intervention: bankruptcy, labour and executive processes.

To design a counterfactual framework we follow an empirical approach widely adopted in several contributions studying firms’ merger. Since we do not observe the abolished courts after the reform, the idea is to define, for the merged courts, the respective unit in the pre-period by summing up the two donors.

We came up with a strongly balanced panel dataset of courts over a period of nine years (2009-2017).

As mentioned above the JSR affected mainly those courts that had to include an abolished court, allowing us to identify the impacts of the JSR on courts’ efficiency and on firms’ access to credit in a standard difference-in-differences design. Therefore, in the first part of our empirical analysis, we compare the average change in courts ‘effectiveness before and after the reform, for the merged courts and for those that were not affected by the reform.

We estimate the following equation using OLS:

\[ \text{JudEff}_{itk} = \alpha_1 T_{it} + \alpha_2 Post_{it} + \alpha_3 (T_{it} \times Post_{it}) + f_i + f_t + u_{it} \]  

Where \( \text{JudEff}_{itk} \) is the efficiency indicator for court \( i \) in year \( t \) for the field of intervention \( k \), \( T_{it} \) is a binary variable equal to \( 1 \) for the courts that had to include another court in year \( t \); \( Post_{it} \) is a binary variable that is equal to \( 1 \) after the implementation of JSR, and \( u_{it} \) is an error term. Furthermore, \( f_i \) and \( f_t \) are year and courts fixed effects, respectively. They allow capturing any time variant unobserved heterogeneity common to all courts and any time invariant unobserved heterogeneity at the court level, respectively. Standard errors are clustered at the court level. Moreover, we assume that the effect is likely to heterogeneously vary according to the size of the courts. Consequently, the analyses are performed on four strata of the sample defined over the number of procedures handled by the court before the study period.

In the second part of the analysis, we focus on the indirect effects of a change in the court’s efficiency on firms’ access to credit. We move the attention from the courts to the firms operating in a court’s catchment area and we link our data on courts with a panel of Italian firms using the municipality zip code as a key variable. Firm-level data are extracted from the historical ORBIS dataset, which provides information on both firms’ details and balance sheet information.

The baseline regression equation becomes:
\[ CredAccess_{it} = \alpha_1 T_{it} + \alpha_2 Post_{it} + \alpha_3 (T_{it} \times Post_{it}) + JudEff_{itk} + f_i + f_t + u_{it} \] (2)

where, differently from equation 1, subscript \( i \) identifies the firms and the outcome variable \( CredAccess_{it} \) is a measure of the firm \( i \) capacity to access to external finance at time \( t \); the efficiency of the judicial system is now used as a control variable.

Preliminary results suggest that the JSR had a different effect on the court’s efficiency in relation to the size of the merged courts, with a higher duration of the proceedings when the merger involved two courts of a similar size (either small or big) and fewer economies of scale and/or operational skills could be exploited. On the firms’ side, a more efficient judicial system is likely to ease firms’ accessibility to finance and debt collection procedures.

References