The Impact of Interpersonal Trust on Firm size

Alejandro Gobierno*

Department of Applied Economics

Universitat Autònoma de Barcelona, Barcelona, Spain

Alejandro.Gobierno@uab.cat

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Short abstract. Firm size—measured by the number of employees—plays a central role in determining economic performance. This paper examines a potential determinant of firm size: interpersonal trust. I estimate the causal impact of local trust on the size of Spanish firms by exploiting latent patterns of mistrust across Spanish regions and using trigger variables as instruments for variation in trust levels across municipalities. Using balance sheet data from Spanish firms, I identify a positive causal relationship between trust and firm size, with effects that are significantly more pronounced among smaller firms. I document two mechanisms through which trust expands firm size: improvements in total factor productivity and greater access to credit. Overall, the results underscore the role of interpersonal trust as a fundamental driver of firm scale and economic performance.

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Extended Abstract

Firm size—here, defined as the number of employees—is a key determinant of economic performance. Empirical evidence indicates that larger firms tend to be more productive and are more likely to engage in export activities, while smaller firms often face greater inefficiencies and misallocation of resources (Moral-Benito, 2016). In this paper, I study the effect of an unexplored determinant of firm size: Interpersonal trust. I argue that local interpersonal trust enhances firms' organizational structures and provide causal evidence that higher local levels of interpersonal trust lead to larger firms in the Spanish context.

The relationship between interpersonal trust and firm size is grounded in the role trust plays in shaping organizational efficiency and contractual arrangements. Higher levels of trust reduce transaction costs, ease delegation, and mitigate agency problems within firms, allowing entrepreneurs to adopt more complex organizational structures and scale their operations. In low-trust environments, by contrast, firms may optimally remain small to limit monitoring costs, reduce exposure to opportunistic behavior, and rely on informal or family-based management structures. Trust can therefore affect firm size not only through market interactions, such as access to finance or supplier relationships, but also through internal firm dynamics that determine the feasibility of growth. If interpersonal trust varies systematically across localities, these mechanisms suggest that firms operating in higher-trust municipalities should be able to grow larger and overcome size-related constraints more effectively.

Using a balanced panel of Spanish firms, I find a positive causal relationship between municipal trust and firm size, especially for small firms. The primary challenge to identifying the causal effect of trust on firm size is endogeneity (due to potential measurement errors, reverse causality, and/or omitted variable biases); to deal with this, I adopt an instrumental variable approach to generate a well-defined local average treatment effect. My approach consists of instrumenting variations in trust levels with a combination of latent patterns of mistrust prevalent in Spain together with a trigger variable (Bellodi et al., 2024; Fouka and Voth, 2023). I posit that the 2008 financial crisis led to distrust among people, which is more likely to translate into a reduction in trust in municipalities where there is latent mistrust. As a proxy for the latter, I use municipality-level data on victims of the Spanish Civil War and the subsequent repression.

The instrument, similar to a shift-share IV, accurately predicts the variation in trust levels after the 2008 crisis. To justify the use of this instrument, I rely on the literature on shift-share IVs (Goldsmith-Pinkham et al., 2020); Borusyak et al. (2025), which clarifies the contexts in which these instruments can be used, outlines the identification assumptions, and recommends a series of tests to assess the validity of the identification assumption—all of which are satisfied in the case of my instrument.

There are several reasons why Spain is an interesting setting to study the potential effect of trust on firm size. First, Spain exhibits substantial and well-documented variation in interpersonal trust across regions and municipalities, shaped by historical, cultural, and institutional factors, which provides rich within-country heterogeneity (Soto-Oñate, 2021). Second, the Spanish economy is characterized by a large share of small and medium-sized firms and a pronounced skew in the firm size distribution, making firm size a central economic issue and allowing meaningful variation in the outcome of interest (Moral-Benito, 2016). Third, detailed administrative balance sheet data at the firm level, combined with high-quality survey and municipal data on trust, enable a local empirical analysis of the relationship between trust and firm size. The availability of Spanish data allows me to follow Durante et al. (2025), who emphasize the importance of studying trust at the appropriate geographical level—namely, the local community—where most social interactions typically occur. Finally, Spain experienced a large decline in interpersonal trust following the 2008 economic crisis; this provides an opportunity to make a causal statement about the effect of trust on firm size.

In relation to the mechanisms that rationalize the relationship between within-firm trust and firm size, I find two key mechanisms when exploring the balance sheets of firms operating in the service sector. First, I find that improvements in interpersonal trust lead to improvements in total factor productivity of firms. This is possibly because greater trust among the individuals who make up the company leads to organizational improvements within the company, likely improving coordination and communication. Secondly, I identify a complementary mechanism that also explains the relationship between trust and firm size: access to credit. I observe that firms experiencing larger increases in interpersonal trust also experience larger gains in credit availability. This pattern can be attributed to lenders' perceptions of lower default risk in high-trust firms, as internal cooperation facilitates compliance, transparency, and enforcement. Moreover, I incorporate these two mechanisms into a simple structural model to better understand the quantitative relevance of interpersonal trust and show that if firms in the bottom decile of trust converge to the regional mean, their size would increase by 11 percent on average.

This paper delivers several contributions to the literature. First, in relying on firm-level data, it provides novel evidence of the role of trust as a determinant of firm size. While previous studies have documented correlations between organizational practices and firm outcomes, to the best of my knowledge this paper is the first to identify a causal link between trust and firm size. Another important contribution of my study is its empirical strategy, which leverages fine-grained, municipality-level trust data. By focusing on localized analyses of social capital, my approach directly responds to recent calls in the literature for more context-specific investigations (Durante et al., 2025). This allows me to overcome the well-documented limitations of cross-country studies that have dominated research and offer a more nuanced and precise understanding of social capital's role at the local level.

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