

Box 2

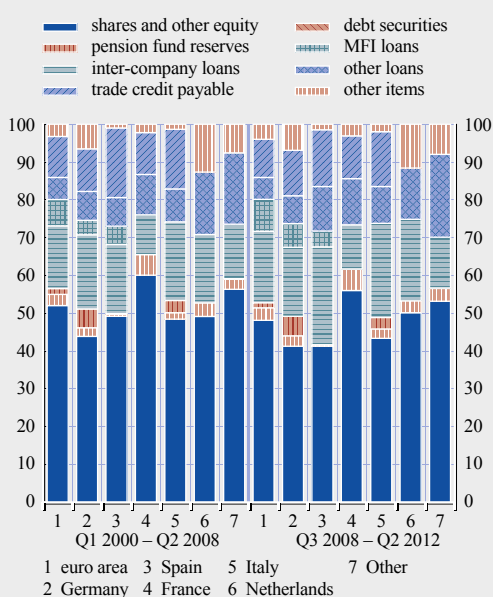
THE FINANCIAL CRISIS AND EXTERNAL FINANCING OF EURO AREA NON-FINANCIAL CORPORATIONS

As bank-related strains have been a key feature of the financial crisis, access to other financing sources has provided important support for non-financial corporations (NFCs) in the euro area. This has included a broad range of external financing instruments, such as equity, debt securities and, in particular, also inter-company loans and trade credit. This box explores this issue first on the basis of changes in the balance sheet structure, then by examining patterns across euro area countries.

In examining firms' capital structure, equities generally remain the most important source of external financing for NFCs in the euro area despite a fall in their share during the crisis (see Chart A). A fall in this share from 52% over the pre-crisis period (Q1 2000-Q2 2008) to 48% over the crisis period (Q3 2008-Q2 2012) has occurred exclusively due to transactions, i.e. more limited equity issuance compared with other financing sources, while there was a small valuation gain. By contrast, when investigating the change in the equity share during the financial crisis, there was also a decline (from 50% to 47%), but this was largely related to losses in the valuation of equity. Across large euro area countries, French firms exhibit a structurally high share of equity finance, contrasting with a low share for their German peers. For Italian and Spanish NFCs, the equity share was lower in the crisis compared with the pre-crisis period, resulting from high use of other (i.e. debt) financing sources, which led to a moderate change in the NFC capital structure over time. Loans (MFI loans, inter-company loans, and other loans such as from other financial intermediaries) and trade credit also play a very relevant role in the capital structure of euro area NFCs, with varying importance across euro area countries. Inter-company loans are relatively important in Germany and, from the smaller countries, in particular in Belgium (partly due to an advantageous tax treatment of corporate treasury centres). Trade credit payable, which represents the third largest component of NFCs' external liabilities, is especially important for Spanish and Italian NFCs.

Chart A Composition of external financing of non-financial corporations across selected euro area countries

(Q1 2000 – Q2 2012; share in the outstanding amounts of external financing; percentages; based on market valuation)



Source: ECB.

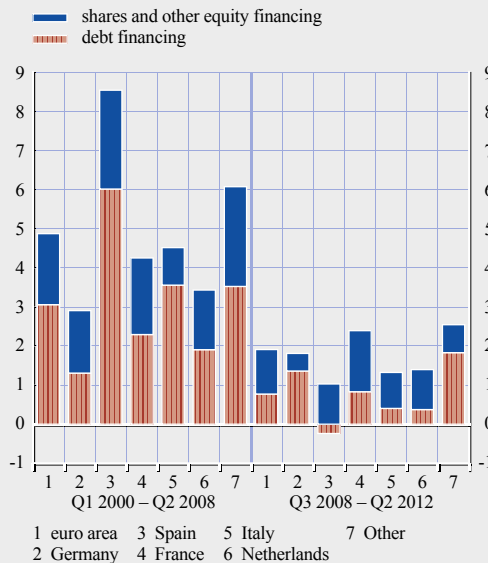
Notes: "Other loans" are defined as loans excluding MFI loans and inter-company loans where available (i.e. BE, DE, EE, ES, FR, IT, LU, AT, PT, SI, SK and FI). "Other items" include other accounts excluding trade credit where available (but including trade credit in countries where this item is not available separately) and financial derivatives. Quarterly trade credit data are available for DE, EE, ES, FR, IT, AT, PT, SI, SK and FI.

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The financial crisis has significantly affected the balance between debt and equity finance, particularly at the country level (see Chart B). In the pre-crisis period, debt financing contributed considerably to the external financing growth of NFCs. On average during this period, the contribution of debt financing

Chart B Equity and debt financing of non-financial corporations in selected euro area countries

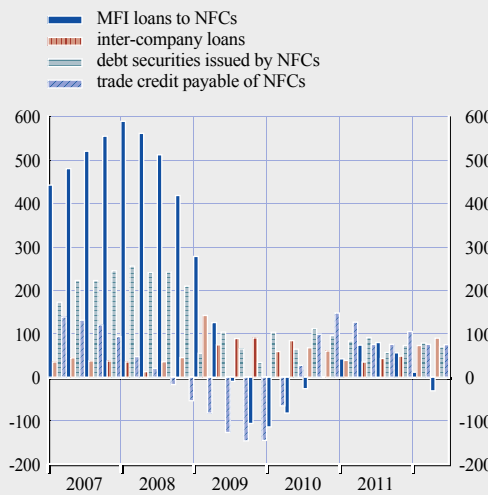
(Q1 2000 – Q2 2012; contributions to annual growth of the sum of equity and debt financing in percentages)



Source: ECB.
Notes: "Debt financing" is defined as loans, debt securities and pension fund reserves. "Other" includes the euro area countries for which data are available, except for the largest five countries. Data for EE are available only from Q4 2004, for IE since 2002, for CY, SI and SK since 2005 and for LU and MT since 2006. The calculation of annual growth rates is based on the data ranges shown in the chart.

Chart C Substitution between financing instruments of euro area non-financial corporations

(Q1 2007 – Q2 2012; annual transactions; EUR billions)



Source: ECB.

to NFCs' external financing was larger than that of equity financing especially for Italian and Spanish firms and, to a smaller extent, also in the "other" euro area countries. By contrast, during the financial crisis, euro area NFCs' external financing, in particular debt financing, decelerated substantially, in particular in Spain and Greece, but also Ireland and Italy.

At the same time, other sources of external financing have become more important as bank lending has exhibited signs of constraints in some countries – with inter-company loans and debt securities playing an important role as an offset (see Chart C). Across euro area countries, the decline in MFI lending to NFCs was strong over an extended period of time during the crisis in particular in Spain, Ireland and Greece, but also in Estonia. By contrast, the decline in annual MFI lending to NFCs was limited to the period of 2009-2010, when economic activity was very subdued, in Germany, France, Austria and Finland, and growth in MFI lending to NFCs became positive again in 2011-2012. Differences in the decline in MFI lending reflect both reduced demand for bank loans due to weak economic activity and supply-side factors affecting the provision of bank loans.

The extent to which decreasing availability and increasing cost of MFI lending during the financial crisis could be offset has clearly differed across countries – depending importantly on the level of financial market development and differences in traditional NFC financing patterns (see Chart D). First, internal financing of NFCs (i.e. retained earnings) became more important for NFCs in most euro area countries during the crisis relative to their external financing. Second, the relative importance of external financing instruments of NFCs changed during the crisis. While NFCs in some countries like Germany and France substituted MFI loans with other external financing sources like inter-company loans (from the countries for which data are

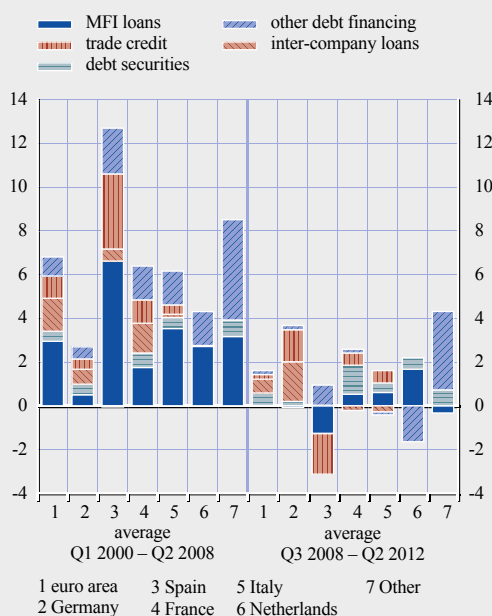
available¹ this was mainly Germany) or debt securities (France in particular), there was less substitution in other countries, notably Spain, and external financing transactions were very modest. For trade credit, which is linked to the exchange of goods, developments are closely related to the economic cycle. While annual trade credit transactions were mostly negative in 2009, i.e. due to the weakness in economic activity, trade credit became more important in NFC financing in many euro area countries in 2010-2012. From the larger euro area countries for which data are available, trade credit payable gained strength in the period 2010-Q2 2012, in particular in Germany and France, but remained weak in Spain and turned negative again in Italy in 2012, after a recovery in 2010-2011. Overall, external financing developments can partly be explained by weak economic activity, but also indicate constraints in the supply of external financing to NFCs during the crisis. The latter relate to deteriorated (bank) funding costs, but also to worsened creditworthiness of borrowers in an adverse macroeconomic environment.

Overall, marked changes in NFC external financing trends have been apparent during the financial crisis. First, equity remained the most important form of financing for euro area NFCs, based on NFCs' outstanding liabilities. Second, the ability of NFCs to substitute MFI loans with other external financing instruments has provided a buffer in an environment of bank deleveraging – though with considerable heterogeneity across countries. From a financial stability angle, a diversification of external financing sources has the potential to increase robustness of funding conditions to adverse shocks. At the same time, a higher use of trade credit increases the potential for contagion among NFCs. In addition, a move away from bank financing exposes firms to the whims of the market and, in particular, to potentially fickle sources of external finance.

¹ Data on inter-company loans are available for Belgium, Germany, Estonia, Spain, France, Italy, Luxembourg, Austria, Portugal, Slovenia, Slovakia and Finland.

Chart D Substitution between financing instruments of non-financial corporations across selected euro area countries

(Q1 2000 – Q2 2012; annual transactions, as a percentage of amounts outstanding of debt and trade credit payable)



Source: ECB.

Notes: "Other" includes all euro area countries except for DE, ES, FR, IT and NL. "Other debt financing" includes other loans, in particular loans from other financial intermediaries, and pension fund reserves. Trade credit and inter-company loan data are not available for some euro area countries. The calculation of annual transactions is based on the data ranges shown in the chart.