

Box 6

NON-BANK FINANCING FOR EURO AREA NFCs DURING THE CRISIS

The financial crisis has raised concerns about the potential overreliance of euro area non-financial corporations on banks for external financing. This is particularly true for SMEs (small and medium-sized enterprises) and mid-caps (larger-scale SMEs), which usually have little direct access to capital markets and depend on effective bank financing in addition to equity finance and other non-bank sources of funding. The strong dependency of SMEs and mid-caps on bank financing has left them more exposed to the post-crisis weaknesses and deleveraging needs of the EU banking sector. This box focuses on the financing of NFCs (non-financial corporations) in general, comparing SMEs and mid-caps with large enterprises in the crisis period from 2009 to 2014, based on the results of the European Central Bank and European Commission survey on the access to finance of enterprises (SAFE)¹. In particular, the box illustrates that during the crisis period, “credit-constrained firms” – those firms which, in the SAFE, reported that they had limited access to bank loans – tended to switch to non-bank financing (trade credit, leasing) more often than firms without credit constraints. It appears, though, that firms in the countries most affected by the crisis faced more difficulties in making this switch in financing.

On the basis of the SAFE it is possible to calculate the percentage of euro area NFCs of different sizes which have recourse to various financing instruments (see the table below). Firms that are surveyed in the SAFE are asked whether or not they used a set of financing instruments in the preceding six-month period.² These instruments range from internal sources (retained earnings), grants/subsidised bank loans, bank financing (credit lines, overdrafts, credit cards and loans) to various sources of non-bank external finance such as trade credit, other loans (informal or from a related company), leasing, issued debt, mezzanine financing and equity.

Table Use of financing instruments by non-financial corporations

(percentage averages out of total sample over 2009-2014)

	Micro	Small	Medium	Large
Retained earnings	24	30	38	46
Grants/subsidised loans	12	16	20	22
Bank overdrafts	38	43	40	42
Bank loans	28	39	43	48
Trade credit	26	30	35	38
Other loans	9	12	19	28
Leasing	19	40	50	56
Debt securities	1	1	1	4
Mezzanine	1	2	4	6
Equity	4	6	8	9

Sources: ECB and European Commission Survey on the access to finance of enterprises.

Notes: Firm size is defined in terms of number of employees, with micro firms having one to nine employees, small firms ten to 49 employees, medium firms 50 to 249 employees and large firms 250 employees or more. “Other loans” are loans (excluding trade credit) from related companies or shareholders, family and friends. “Grants/subsidised loans” involve support from public sources in the form of guarantees, reduced interest rate loans, etc. “Bank overdrafts” include credit lines or credit card overdrafts. “Mezzanine” refers to subordinated loans, participation loans or similar financing instruments.

1 The SAFE is available here: <http://www.ecb.europa.eu/stats/money/surveys/sme/html/index.en.html>.

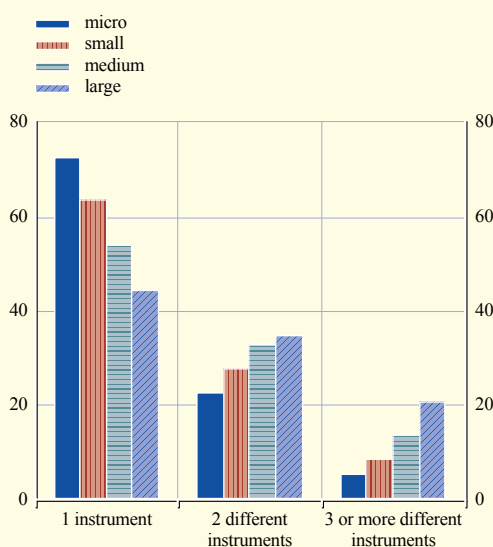
2 For previous analysis using information derived from the SAFE, see the presentation by O’Toole, C., “SME lifecycle and non-bank financing in Europe: what determines usage?” at the ECB workshop: SMEs’ access to finance: the role of financial and non-financial intermediaries and capital markets, 11 December 2014.

Bank-based instruments such as grants/subsidized loans, bank overdrafts and bank loans are used more than market-based instruments such as debt securities, mezzanine financing and equity. Retained earnings are also used, especially by large firms (see the table). While leasing appears to be the most used instrument, at least for medium-sized and large firms, it is not necessarily the most important in terms of volume or in terms of financing new investment. For most of the instruments, there is a clear pattern; the percentage of use increases with the size of the firm. This confirms that large firms typically have better and more diversified access to the various sources of finance. It is also interesting to note that, out of all the external financing instruments used, micro and small firms favour short-term bank instruments like credit lines, bank overdrafts and credit cards, followed by bank loans, trade credit and leasing, while medium-sized and large firms have more frequent recourse to leasing, followed by bank loans (long-term and short-term) and trade credit.

The share of NFCs making use of more than one non-bank external source of finance increases with the size of the firm. Out of all firms using non-bank external sources of finance, 57% made use of just one financing source and the rest used at least two sources. Micro (72%), small (64%) and medium-sized (54%) firms mainly used one non-bank instrument of finance (see Chart A). However, over half of large firms (56%) made use of at least two sources of non-bank finance. The differentiation increases with size: for instance, 13% of medium-sized firms

Chart A Share of NFCs making use of different non-bank external instruments

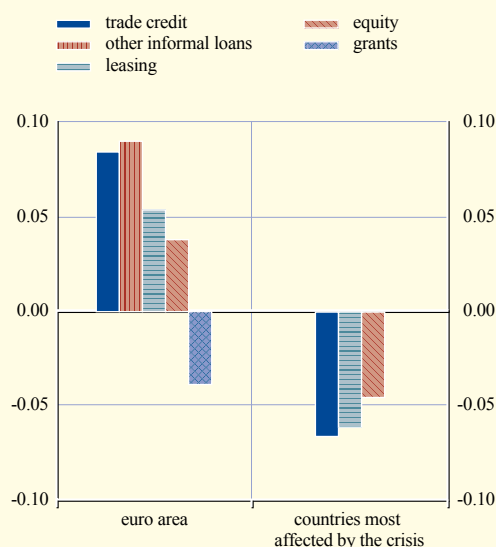
(percentages of replies out of total sample over 2009-2014)



Source: ECB and European Commission Survey on the access to finance of enterprises.
 Notes: Firm size is defined in terms of employees, with micro firms having one to nine employees, small firms ten to 49 employees, medium firms 50 to 249 employees and large firms 250 employees or more. Non-bank financing instruments are: trade credit, other loans, leasing, debt securities, mezzanine financing and equity.

Chart B Likelihood of credit-constrained NFCs using non-bank external instruments

(estimates based on least squares regressions)¹⁾



Notes: The dependent variable is a binary one that takes value 1 if the firm has used a specific source of finance in the preceding six months; it is zero otherwise. The estimation period is 2009-2014 for 11 euro area countries. Only statistically significant coefficients are reported.

1) The estimations are based on weighted least squares regressions (see the report on the results of the SAFE at <http://www.ecb.europa.eu/stats/money/surveys/sme/html/index.en.html> for an explanation of the weights used in the survey). The regressions include country-industry fixed effects and time fixed effects and errors are robust. The number of observations ranges from 39,949 for leasing to 18,242 for equity.

and 21% of large firms reported that they were using three or more external non-bank financing sources contemporaneously, while this percentage drops to 9% for small firms and 5% for micro firms.

Econometric analysis provides more information on the use of non-bank external sources of finance during the crisis. To investigate the determinants of the usage of non-bank financing, a dummy variable, which takes value 1 if the firm has used a specific external source of non-bank finance in the preceding six months or zero otherwise, is regressed on a set of factors. These are firm-specific factors related to the company's demographics and financial situation and factors related to bank financing, such as bank lending costs and credit standards, and an indicator of bank credit constraints.³ These variables are particularly useful for detecting possible substitution relationships between bank and non-bank sources. Furthermore, country-level variables related to real activity (GDP growth and the unemployment rate) are taken into account and a distinction is made between countries that were less affected by the crisis (Belgium, Germany, France, Netherlands, Austria and Finland) and those that were more severely affected (Ireland, Greece, Spain, Italy and Portugal).

Generally, financially constrained firms have been more likely to turn to non-bank financing such as trade credit and leasing. Chart B reports the estimated coefficients of the econometric analysis. Focusing on those firms that reported to have been constrained in their access to bank loans, the results show that they were more likely to rely on non-bank financing (trade credit and leasing) than firms that did not report constraints (positive coefficients in the left-hand panel). The coefficient on the use of equity is also statistically significant and there is evidence that credit-constrained firms made less use of grants, indicating that firms that had already been denied bank loans found it difficult to benefit from public schemes aimed at obtaining guaranteed bank loans. Furthermore, credit-constrained firms in countries more severely affected by the crisis found it more difficult to switch from bank loans to other sources of finance than firms with the same kind of constraints in other countries (negative coefficients in the right-hand panel).

Overall, the findings in this analysis confirm that non-financial corporations, and especially SMEs, use market-based sources of funding less than bank financing. Although capital markets represent an important alternative source of financing for non-financial corporations, they are accessible mainly to larger firms with high credit ratings and which are generally located in larger countries with more developed financial markets. Unless non-financial corporations – and especially SMEs – have access to alternative sources of finance, any decline in bank lending is likely to have an adverse impact on their ability to finance investment. By harmonising financial market policies and supporting a shift towards market-based financing, the European Commission's initiative for a capital markets union will make SMEs in Europe more resilient to bank credit supply shocks and will help to reduce obstacles to their access to finance.

3 The dependent variable is a categorical one that takes value 1 if the firm has used a specific source of finance in the preceding six months; it is zero otherwise. The independent variables control for size, age, turnover classes, whether firms are independent or family owned and their financial situation in terms of sales and profitability, own capital and credit history. All variables are derived from the survey.