Research Project on Restarting European Long Term Investment Finance (RELTIF)

Summary of the CEPR – Assonime

Workshop on Corporate Financing and European Investment Financing

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Said Business School, University of Oxford

1. *The Workshop on Corporate Financing and European Investment Financing was introduced by Colin Mayer, who illustrated the RELTIF programme and workshop goals and structure.*

The Workshop is an important part of the major research programme that the Centre for Economic Policy Research (CEPR) and Assonime have launched on corporate financing in Europe. The general project ambition is to arrive to authoritative and robust policy recommendations able to guide and influence the future evolution, and attendant policy actions, in the structure of financial markets in the years to come, so as to restore appropriate incentives for long term investment in the EU (and worldwide).

The research programme is divided into two stages. The first stage included the release of a Green Paper that identified the main policy issues at the forefront of current debates. The Green Paper argues that the underlying causes of low levels of investment in Europe have not yet been identified. In particular, it is far from clear that the source of the investment deficit is the financial system. E.g.: it could equally well be low demand for capital rather than insufficient supply of finance. And, even if it is supply rather than demand for finance, there is a question of whether the problem is a transitory or a structural one.

The Green Paper presents also a set of stylized facts on key policy questions to be addressed in greater depth in the second stage of the research programme that shoot for commissioning research on the issues identified in the first stage and to produce a final policy report (a "White Paper") based on the accumulated evidence.

The main stylized facts arising from the Green Paper are that: 1) there exist large (cross- country and cross-firm) differences between corporates in facing financing; 2) there is overall a little shortage of long-term finance, with differences between large and small firms; 3) Bank loans contracted sharply in the crises.

The Workshop is meant to embody the link between the Green Paper and the next stages of the research programme. Following the Workshop and in light to the issues it will arise, the CEPR and Assonime are planning to launch a call for Research Proposals on "Restarting European Long Term Investment Finance".

2. *The Workshop was organized along the following key themes, in line with the issues raised by the Green Paper.*

Session 1 on "Monetary policy, market freezes and access to finance", chaired by Colin Mayer. The following papers have been presented and discussed:

- **Sovereign Stress, Non-conventional Monetary Policy, and SME Access to Finance**.

  Authors: Annalisa Fernando (ECB), *Alex Popov (ECB) and Gregory Udell (Indiana University).

  Discussant: José Luis Peydrò (Universitat Pompeu Fabra and CEPR).

  The paper investigates the effect of sovereign stress and of non-conventional monetary policy on small firms' financing patterns during the Euro area debt crisis. Authors find that firms in stressed countries were more likely to be credit rationed, both in the quantity and in the price dimension. There is no evidence that less creditworthy firms were more likely to be constrained. They also find weak evidence that the announcement of the ECB's Outright Monetary Transactions Program was followed by a short-lived decline in the share of credit rationed firms and of firms discouraged from applying. However, beyond the first 6 months after the announcement, a rising share of firms discouraged from applying for bank credit and a higher use of trade credit by firms in stressed countries points to a further tightening of credit constraints in the economy.

- **Global Financial Crisis and Foreign Currency Borrowing**.

  Authors: *Philippe Bacchetta (Université de Lausanne and CEPR) and Ouarda Merrouche (University of Lausanne and CEPR)

  Discussant: Clemens Otto (HEC, Paris)

  The paper documents a dramatic increase in foreign currency borrowing among leveraged Eurozone corporates since the financial crisis. Authors trace this increase to two main symptoms of the global financial crisis: (1) a domestic credit crunch causing leveraged corporates to switch to foreign banks; and (2) a higher funding cost in the borrower home currency causing foreign banks to increasingly transfer currency risk to the borrower. They also show that disruptions in swap markets led exporters to increasingly shift from currency swaps to foreign currency bank credit. While large high-credit quality corporates could tap the bond market during the credit crunch, lower-credit quality borrowers turned to foreign banks. Although global bank lending is often reported to amplify the international credit cycle, the paper shows that foreign banking acted as a shock absorber that weathered the real consequences of the credit crunch for Eurozone corporates that suffered most from the credit crunch.

Session 2 on "Collateral, Relationships and Access to Finance", chaired by Andrea Polo. The following papers were presented and discussed:

- **Housing Collateral and Entrepreneurship**

  Authors: Martin C. Schmalz (University of Michigan), David A. Sraer (UC Berkeley and CEPR) and *David Thesmar (HEC Paris and CEPR)

  Discussant: Thomas Hellmann (Saïd Business School, Oxford University)

  The paper shows that collateral constraints restrict firm entry and post-entry growth, even in the long-run. The empirical strategy uses French administrative data and exploits cross-sectional variation in local house-price appreciation as shocks to the value of collateral available to homeowners. They find that an increase in collateral value leads to a higher probability of becoming an entrepreneur. Conditional on entry, entrepreneurs with access to more valuable collateral start larger firms, use more debt, and create more value added, for at least six years after creation.

- **How Collateral Laws Shape Lending and Sectoral Activity**

Authors: Charles W. Calomiris (Columbia University), *Mauricio Larrain (Columbia Business School), José Liberti (DePaul University) and Jason Sturgess (DePaul University)

Discussant: Paolo Volpin (Cass Business School and CEPR)

The paper investigates the effect of cross-country differences in collateral laws for movable assets on lending and the sectorial allocation of resources. Findings show that weak collateralization laws that discourage the use of movables assets tilt lending toward the use of immovable assets. Loan-to-value of loans collateralized with movable assets are lower in countries with weak collateral laws, relative to immovable assets. Weak movable collateral laws create distortions in the allocation of resources that favor immovable-based production.

- **When Arm's Length is Too Far Relationship Banking over the Credit Cycle**

  Authors: *Thorsten Beck (Tilburg University, Cass Business School and CEPR), Hans Degryse (Catholic University of Leuven, European Banking Center and CEPR), Ralph de Haas (EBRD) and Neeltje van Horen (De Nederlandsche bank)

  Discussant: Nicolas Serrano Velarde (Università Bocconi)

  Authors study how banks' lending techniques affect credit constraints of small and medium-sized enterprises across emerging Europe. They show that relationship lending alleviates credit constraints during a cyclical downturn but not during a boom period. The positive impact of relationship lending in a downturn is strongest for smaller and more opaque firms and in regions where the downturn is more severe. Additional evidence suggests that the reduction in credit constraints due to relationship lending helps to mitigate the adverse impact of an economic downturn on local firm growth.

Session 3 on "Real Effects of the Sovereign Debt Crisis", chaired by Marco Pagano. The following papers were presented and discussed:

- **Debt Overhang in Europe: Evidence from Firm-Bank-Sovereign Linkages**

  Authors: Sebnem Kalemli-Özcan (University of Maryland and CEPR) *Luc Laeven (ECB and CEPR) and David Moreno (University of Maryland)

  Discussant: Enrique Schroth (Cass Business School)

  Authors find a significant debt overhang effect that leads to sluggish investment in Europe. Firms with higher debt overhang invest less prior to the European crisis and this effect intensified during the crisis. Firms whose main bank is relatively weak do not necessarily show more debt overhang or more sluggish investment. Firms with weak balance sheets invest less both during regular times and crisis but this effect is smaller than that of debt overhang. Using a pan-European firm-bank matched data set including small firms, the paper documents that the worsening of debt overhang during the crisis can be linked to an increase in sovereign risk in Southern Europe.

- **Real Effects of the Sovereign Debt Crisis in Europe: Evidence from Syndicated Loans**

  Authors: Viral V. Acharya, *Tim Eisert (Erasmus University Rotterdam), Christian Eufinger (IESE Business School) and Christian Hirsch (Goethe University Frankfurt)

  Discussant: Vasso Ioannidou (Lancaster University and CEPR)

  This paper explores the impact of the loan supply disruptions in the Eurozone on the corporate policies of firms. It presents firm-level evidence showing that the loan supply contraction of GIIPS banks depresses investment, job creation, and sales growth of European borrowers that have a significant business relationship with these banks. These borrowers increase their precautionary motive to save cash out of free cash flows and rely more on cash holdings than bank lines of credit for their liquidity management. Findings show that the prevalence of large losses on the sovereign bondholdings of GIIPS banks and the resulting risk-shifting incentives of undercapitalized GIIPS banks are the main drivers of the contraction in loan supply and the adverse real effects suffered by firms throughout Europe.

- **When Credit Dries Up: Job Losses in the Great Recession**

  Authors: *Samuel Bentolila (CEMFI and CEPR), Marcel Jansen (Universidad Autónoma de Madrid), Gabriel Jiménez (Banco de España, Madrid) and Sonia Ruano (Banco de España, Madrid)

  Discussant: José Liberti (DePaul University)

  This paper studies whether the solvency problems of Spain's weakest banks during the Great Recession caused a reduction in credit supply and employment. Data from the official credit register of the Bank of Spain show that the banks that were bailed out during the crisis strongly curtailed lending well in advance of their intervention. Authors assess the impact of this credit supply shock by comparing the change in employment between 2006 and 2010 at the client firms of these weak banks to the corresponding changes in employment at comparable firms with pre-crisis loans from the rest of the banks. The results show that the poor health of the weak banks caused significant employment losses at firms of all sizes.

3. *Conclusions. Many questions emerged during the paper presentation and discussion. In particular, the following issues have been identified as worthy of investigation in the second stage of the research programme*:

- Corporate finance: the financing of SMEs (trade credit, venture capital and new sources of funding); bank versus bond finance; equity versus debt finance;
- Short versus long-term finance, including infrastructure finance;
- Demand versus supply of finance explanations of low levels of investment;
- Information problems in European financial markets;
- Regulatory issues, e.g. unintended effects on resource allocation process deriving from bank and insurance company regulation;
- Corporate governance issues.