Financing Investment: The Role of Heterogeneity

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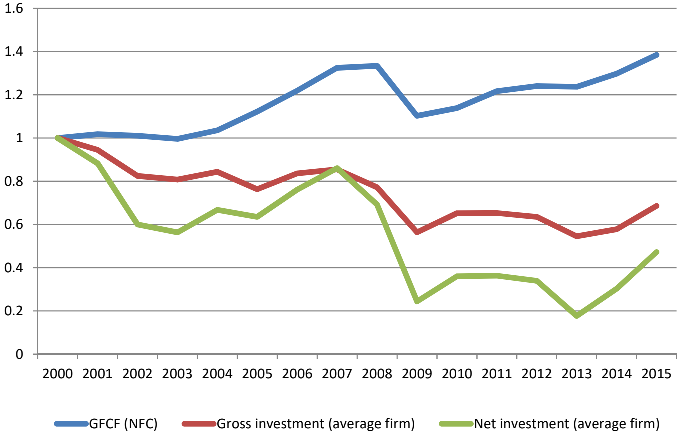
Chapter 7: joint work with Annalisa Ferrando and Carsten Preuss

Slow Recovery in Europe: Sluggish Corporate Investment

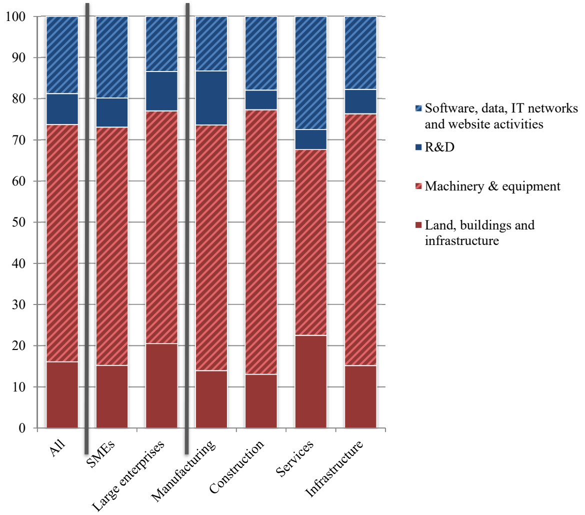


Type of Investment Finance and Sluggish Recovery

- Too much debt on firms' balance sheet: **debt overhang** problem $\Rightarrow$ Low Investment
- Too much short term debt: rollover risk $\Rightarrow$ Low Investment
- Too little equity financing: $\Rightarrow$ reduces risk sharing and increases uncertainty $\Rightarrow$ Low Investment
- Too much debt and low interest rates with financial frictions $\Rightarrow$ misallocation of K $\Rightarrow$ Low TFP

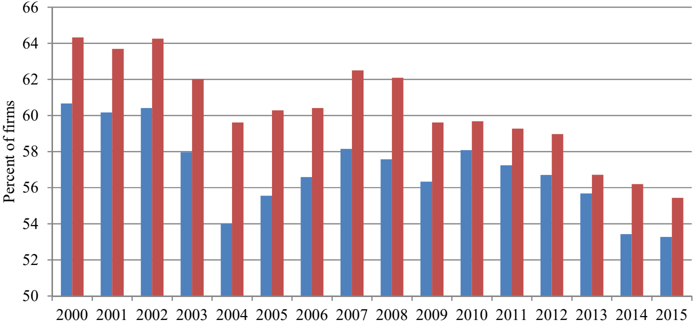
Can we Dig Deeper? Investment Types: EIBIS Data

70 % of Investment is in Fixed Tangible Assets



External Finance Over Time: ORBIS Data

Firms with more than 50 % of their financing being external constitute largest fraction of firms. But this varies over time.



External and Internal Finance seem to have equal roles in financing of different type of investment.

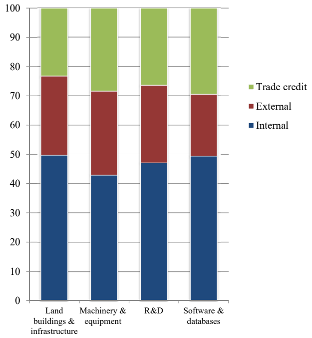


Figure: SMEs

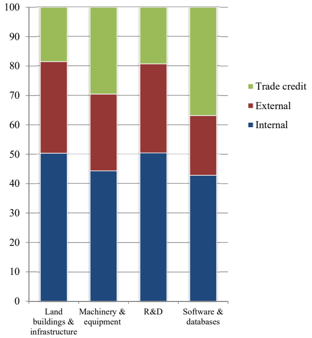


Figure: Large Firms

Internal Finance seems to have a bigger role especially for intangible investment.

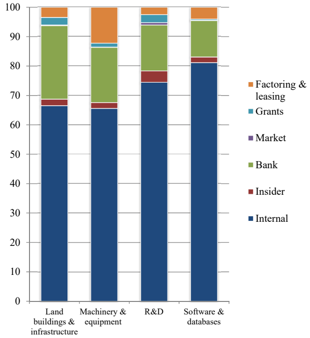


Figure: SMEs

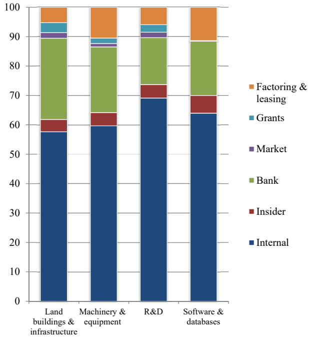


Figure: Large Firms

Explaining the Discrepancy

- ORBIS is based on balance sheet accounting so we only use liabilities for financing, whereas EIBIS use both assets and liabilities as sources of finance
- EIBIS does not ask about trade credit and includes cash in internal finance, whereas ORBIS has cash under short term assets.

Key Takeaways from Regression Analysis

- Firms finance tangible assets mostly with external finance—**ST and LT bank debt**
- Firms who have more than 50 percent of their total financing from external sources increase investment more in the aftermath of the crisis—Importance of **access to external finance**
- SMEs use internal finance to finance **intangible investment**
- **Trade credit** was an important source of finance both for SMEs and large firms during the crisis
- **Policy lesson 1:** SMEs need to move from internal to external finance for their intangible investment, especially R&D.
- **Policy lesson 2:** Need less national rules/regulations to enhance more cross-border asset/equity ownership.