How likely is a credit-less recovery in the euro area? The role of a capital markets union

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By Eleni Louri-Dendrinou

It is often discussed how bank-dependent for financing investment euro area firms are. It is estimated that 80% of their investment needs are financed from banks and only 20% from capital markets, while in the US the reverse is true. One of the reasons for this may be the large number of small and medium sized firms (SMEs) in Europe that are relatively small to be analysed and rated by rating companies. Hence, they remain dependent on the assessment of their local bank branch. Another reason may be the fragmentation of national capital markets where asymmetry of information, differences in regulation and savings availability issues are important.

Taking into account the reduction in the growth rate of bank credit in the euro area (reaching negative territory in many member countries since the onset of the financial crisis), how much are firm growth rates really affected? And are all euro area firms (for instance, large vs SMEs) affected in the same way? Have any of them managed to find substitutes for bank credit? And what role do the structural characteristics of the domestic banking sectors and even the domestic economies have (if any) in influencing firm growth? These are all interesting questions taking into account that firm growth is assumed to be the engine of economic recovery in the relevant literature.

Within this research framework, together with Dimelis and Giotopoulos (2013; 2015), we performed a panel data econometric analysis of more than 2000 euro area quoted firms in 2005-2011 (collected from Datastream) [1]. We found that the growth rate (growth of sales) of SMEs (with less than €10 million annual turnover) which were 95% of our (representative) sample was significantly dependent on bank credit. Especially, before the 2008 crisis, a positive relationship has been estimated and applied not only 'on average', but also across the distribution of firm performances (using quantile regressions). Post-2008, only those SMEs in the upper quantiles (often named 'gazelles' for exhibiting fast growth) were not dependent on bank credit. The rest were still significantly dependent. On the contrary, larger firms (5% of our sample) were not significantly affected neither before, nor after 2008 in any growth quantile. Apparently, large firms could resort to other sources of funding, the capital market being certainly one of them. So credit-less growth is relevant only for those firms large enough to receive investment funding from non-bank sources or for the 'gazelles' (among the SMEs). For the majority of the smaller, less dynamic firms of our sample such a probability is quite remote.

With average annual bank credit growth in our sample of +8% before 2008 and -1.6% after 2008 no wonder that average firm growth (+7% before the crisis and -1.3% post crisis) is found to be significantly affected. This is even more so in countries with a lower degree of financial development and a smaller foreign banking presence. The degree of concentration of the banking sector is also found to be negatively related to firm growth, which is expected to create further problems if we consider the aggressive consolidation that has taken place in the euro area banking sectors post-crisis. For instance, in Greece four banks control more than 90% of total banking assets since 2012. Financial stability issues during the crisis pressed for further consolidation. But competition issues may soon arise if such concentration is not properly regulated and supervised.

Taking into account these findings, one can only agree with the recent discussion started by the European Commission and the European Central Bank, and supported by many researchers, on the beneficial effect of a Capital Markets Union on firm growth and hence on economic recovery in Europe. It could reduce information asymmetries, harmonize regulation and unlock capital that is currently frozen. A Capital Markets Union could thus provide much needed access to investment funds and improve European SMEs' growth prospects. It could really extend the frontiers of Europe's single market as Commissioner Hill recently said.Credit-less recovery or 'phoenix miracles' arguments can then become more credible.

[1] An initial report of this research is published in Dimelis, S., Giotopoulos, I. and Louri, H. (2013), 'The credit crunch and firm growth in the euro area: 2005-2011, A quantile panel analysis', Bank of Greece WP No 165, (Nov. 2013).

A more recent version can be found in Dimelis, S., Giotopoulos, I. and Louri H. (2015), 'Can firms grow without credit? Evidence from the euro area 2005-2011', LSE GreeSE Working Paper series (forthcoming 2015).

Professor Eleni Louri-Dendrinou *is a Visiting Professor at the Hellenic Observatory. She is Professor at the Department of Economics, Athens University of Economics and Business. She completed a B.Sc. in Economics at the Athens University of Economics and Business, an MSc. in Economics at the London School of Economics and Political Science and a PhD in Economics at the University of Oxford. From June 2008 to June 2014 she served as Deputy Governor, Bank of Greece and President of the Hellenic Deposit and Investment Guarantee Fund.Her current research project is: "Is a credit-less recovery possible? Firm and Credit Growth in Euro area: 2005-2012 Implications for monetary and industrial policies".*