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Jean Bonnet,

Sylvie Cieply

University of Caen Basse-Normandie, CREM-CNRS, UMR 6211

Marcus Dejardin

FUNDP - University of Namur, CERPE, Belgium

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Does the regional dimension matter as regards finance and entrepreneurship?

Jean BONNET *, Sylvie CIEPLY * and Marcus DEJARDIN **

* University of Caen, CREM-CAEN, UMR CNRS 6211, Faculty of Economics and Business Administration, 19, rue Claude Bloch, 14032 Caen, Cédex, France.
jean.bonnet@unicaen.fr, sylvie.cieply@unicaen.fr

** FUNDP - University of Namur, CERPE, Faculty of Economics, Social Sciences and Business Administration, 8, Rempart de la Vierge, 5000 Namur, Belgium.
marcus.dejardin@fundp.ac.be

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Abstract: This article investigates the interrelationships between finance and entrepreneurship by exploring regional discrepancies in France. The focus is (1) on regional differences in financial relationships, (2) on the way these relations influence financial constraints on new firms and (3) on the complementary/substitutable effects between funds. No path of exclusion is identified. Rather, firms that are self-constraining or suffer from a weak credit rationing are the ones that later on develop intensive relationships with banks. Substitution exists in almost all the French regions. Results suggest the departure point of an original pecking order theory according to the entrepreneurial intensity of regions.

Keywords: financial constraints, credit rationing, financial relationships, new firms, regional development, regional disparities.

JEL-code: G20, M13, R10.

1.   INTRODUCTION

Financial constraints are among the impeding factors most cited for entrepreneurial dynamics to flourish (Evans and Jovanovic, 1989, Holtz-Eakin et al., 1994). New firms do not generate enough earnings to self-finance their growth. Raising equity on financial market without any track record is usually forbidden and anyway too costly. Most of new firms, whose growth rate is not exponential, cannot be the target of venture capital funds or business angels. Finally, in spite of financial innovations, their external financing remains based on access to bank loans. And it can be assumed that new firms are highly constrained on the credit market too.

Since a decade, this problem has received high attention. Many studies underline the high financial pressures supported by small firms as their informational system is insufficiently formalised (Gertler and Gilchrist, 1993, 1994, Carpenter et al., 1994, Gilchrist and Himmleberg, 1995). Their informational disadvantage drives to informational asymmetries between creditors and debtors and produce situations of rationing in the credit market (Binks, et al., 1992, Berger and Udell, 1998).

Despite the relative homogeneity of the banking supply in France, credit rationing appears to be not equally distributed among French regions (Bonnet et al., 2005). Some regional differences are indeed still at work when financial constraints of new firms are analysed. In particular, the probability for a start-up to be unconstrained is superior (or equal for a few regions) in all the French regions in comparison with the Île-de-France region. That is, if they are regional differences at work as regards credit constraints new firms can suffer from, financial relationships are one of the most often cited solution for firms to tackle the problem and, as a consequence, it appears interesting to study differences in financial relationships among regions as well.

We use the French INSEE-Sine dataset which gives us information, at the micro level, on the financing policy of young firms when they are created and during the first four years of their life. In the following section, we introduce financial relationships as a way to bridge new firms' capital gap. In the third section, the data and the method of treatment are introduced. The fourth section gives the main results.

In brief, we show that financial constraints exist and are, above all, induced by firms themselves. They do not anticipate their financial needs, or they are afraid of asking for bank

loans. Despite all the literature on financial constraints, we show that banks remain the main partner for providing finance to firms and that no dependency path can be identified when the access to bank loans is concerned. In addition, relations between banking constraints and banking relationships support the thesis of a substitution effect between banking finance and other external finance. This substitution effect exists in entrepreneurial regions that have developed proximity capital relationships and finance by other firms alongside a less developed banking finance. These results can be the departure point of a pecking order theory applied to new firms that integrate the entrepreneurial intensity of regions.

2. THE REDUCING OF NEW FIRMS CAPITAL GAP BY FINANCIAL RELATIONSHIPS: A REVIEW OF THE LITERATURE

2.1. The new firms' capital gap hypothesis

From a theoretical point of view, the new firms credit gap hypothesis finds a strong support in the credit rationing theory (Stiglitz and Weiss,1981, Williamson, 1987). New firms cannot produce any track record, their informational system is rather opaque and their manager over-optimistic (Ang, 1991). In consequence, informational asymmetries should be high; selection adverse and moral hazard more frequent, and credit rationing the solution for banks to limit their risk exposure. Information imperfections finally result in a finance gap (Binks et al., 1992) that corresponds to the total refusal of the credit required by firms. In this case, new firms suffer from a strong credit rationing. Other constraints can be considered too. Firms can be financed for an amount inferior to the one they desire. This situation, described by Keeton (1979), corresponds to a weak credit rationing. Finally, some firms can internalise credit constraints as they anticipate refusal of credit by banks. In this case, they do not ask for credit at all and they suffer from a kind of self-constraint (Kon and Storey, 2003, Cieply and Dejardin, 2010).

This over-exposition of new firms to credit constraint is generally supposed to be higher when new firms are centred on innovative activities. Banks are indeed not suitable to finance specific investments (Williamson, 1988). Their risk exposure is too high whereas they are not

interested in the future profit of successful innovative firms. For these firms, the value of collaterals for banks relatively to the amount which should be financed is too low. Credit rationing can thus be supposed to be higher for these innovative firms.

2.2. The role of financial relationships for new firms

The role of banking relationships

The most common way for an "information-opaque" firm to reduce credit rationing is to build long-term relationships with banks (Petersen and Rajan, 1994, Berger and Udell, 1998).

Banking relationships make informational asymmetries, lack of credit availability and cost of credit decrease. They facilitate the exchange of information between bankers and firms. They facilitate the exchange of information between bankers and firms. The proximity which is bound with relationships gives bankers access to "soft" information[1] on which small firms' access to loan depends. With the development of banking relationships, firms themselves are incited not to develop opportunist behaviours. Contingent contracts constitute a credible threat on the future financing of firms. If commitments are not fulfilled by borrowers, banks can indeed refuse to supply new loans (Stiglitz and Weiss, 1983). In addition, the development of banking relationships allows firms to benefit from a reputation of reliability that enables them to get loans with better conditions (Diamond, 1989). This reputation effect increases incentives for firms to respect their financial commitments (Bolton and Sharfstein, 1996, Boot and Thakor, 1994). Firms are not encouraged to transgress commitments anymore insofar as while reputation building is slow its destruction is instantaneous. The advantage of bank loans is particularly important for innovative firms if they need confidentiality in the access to external finance (Osha, 1995, Bhattacharya and Chiesa, 1995).

Finally, the problem for new firms is to establish such relationships. This problem leads to the question of exclusion in the credit market for new firms. To cope with this problem, the link between banking constraints and banking relationships must be analysed. A positive link between financial constraints and banking relationships should show the absence of exclusion and the presence of a training process in the credit market.

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[1] Soft information is "in the air" and is integrated in a diffuse way by bankers. This information is opposed to "hard" information which concerns financial accounts and formalized information such as legal statute, formal agreements and all other reporting devices (Stein, 2002).

Despite all these benefits, we must mention that banking relationships can induce new costs for firms too. With banking relationships, firms have to cope with the risk of rent expropriation (Sharpe, 1990, Rajan, 1992). As banks internally own private information on firms, as this private information cannot be transferred, they benefit from a monopoly power on the credit market. The consequence for firms of this is a higher cost of loan relatively to the risk exposure of banks. Information sharing may indeed serve as a collusive device which can soften competition (Bouckaert and Degryse, 2004). To reduce the monopoly power of banks, the solution could be to develop relationships with several banks (Von Thadden, 2004). This solution is not perfect as it induces the "winner's curse" problem: the banking competitor will indeed only attract the riskiest firms (Rajan, 1992, Von Thadden, 2004). Another limit is the decrease in the investment of banks in the depth of the banking relationships (Petersen and Rajan, 1995, Boot, 2000). However, for new firms this solution is not realistic. Dietsch and Golitin-Boubakari (2002) collects evidence for 2000 that very small firms (turnover < 2 million EUR) work with only one bank, and small firms (2<turnover<7.5 million EUR), with only two banks. As relationships with several banks are limited for small firms, it should be more limited with new firms. Another solution should be to develop financial relationships with non banking partners in order to either diversify their portfolio of lenders or signal their quality to banks.

The role of other non financial partners

Banks are not the only financial supports of new firms. Other partners can be identified. First, bearing in mind the role of established firms as regards new firms, and above all the traditional central role of large firms in the French industrial landscape, the role of other firms is considered (Hancké and Cieply, 1996). Commercial partners supply trade credit to their customers. According to Petersen and Rajan (1995), this mean of financing is often the only one firms can obtain when they suffer from credit rationing. In this case, trade credit appears as a substitute for bank loans. Another effect of trade credit on bank loans can be identified: trade credit and other long-term financial relations between established firms and new firms can signal the quality of new firms to bankers. In this sense, established firms, and, especially so in the French context, large manufacturing firms, can act as a "go-between" between banks and small firms, all the more so since they are new. Because of their position vis-à-vis new firms, established firms own a vast amount of operational inside knowledge which can be

transferred to banks either as hard evaluations. This information then becomes part of the evaluation package that banks can use in their SME's assessment.

Second, new firms can be financed by financial partners which supply them with equity. This is particularly the case of venture capital funds the activity of which has sharply increased in France. Venture capital institutions are known for their high expertise in screening and monitoring projects, particularly highly innovative ones (Berger and Udell, 1998). As a consequence, when they provide equity to new firms, they not only finance them, they signal the quality of firms to outsiders as well.

Third, new firms can be financed by other investors who benefit from private information on the quality of the firm (Leland and Pyle, 1977). This is the case of the manager himself. Friends and family own "soft" information too. They all correspond to the "proximity finance". Ang (1991) call them the "3F" (Family, Friend and "Fools"). Their financial support to new firms can signal their quality to outsiders in addition.

Finally, two alternative views may be proposed to analyse the role of non banking investors: either they substitute for banks and bridge the bank loan gap; or they supplement bank loans and sometimes incite banks to increase their supply of credit to new firms by producing a signal effect on the quality of new firms.

3.   SETTING UP THE EMPIRICS

The INSEE-Sine dataset is exploited to empirically test the influence of local finance on the probability to be less or more financially constrained. These data give information on the financing policy of young firms when they are created and when they eventually face financial problems two years later. We construct classes that are representative of credit constraints and variables that are representative of an *a priori* index of highly intensive relationships with the different potential financial partners.

3.1. Data

The survey (Sine 94-1) was conducted by the French National Institute of Statistical and Economic Studies[2] in 1994 and takes into account 30 778 firms which had been set-up or taken over during the first half of 1994 and which had survived for at least one month. The sample[3] is representative of the total population of entrepreneurs which was of 96 407 new firms. In this survey, new firms are identified on the basis of their registration in the "Système d'Informations et de Répertoire des Entreprises et des Etablissements" (SIRENE repertory[4]). The units under review belong to the private productive sector in the fields of industry, building, trade and services. This survey identifies qualitative data surrounding entrepreneurship and, more precisely, it contains variables related to the entrepreneur, to the context and to the environment of entrepreneurship.

A second survey carried out in 1997 (Sine 94-2) gives us information about the status of the same firms (closed down or still running). In 1997, 16 039 firms were still running and replied to the second survey. For the firms that are still running, this survey also explores the financial behaviour of the firm during the last two years and the financial problems they faced. On the basis of this second survey, we construct classes of credit rationing. For a more appropriate homogeneity of our dataset we consider only new firms without legal change (firms which are transformed from sole proprietorship into limited partnership), set up by a man or a woman (without subsidiaries) in the metropolitan area (*overseas department* excluded). At this stage remain 12 681 firms.

3.2. Indicators of credit rationing and financial relationships

The classes that are representative of credit rationing are constructed with the combination of questions from both the first survey of 1994 and the complementary survey of 1997. The first questions, extracted from Sine 94-1, give information about the asking for bank loans by

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[2] INSEE (Institut National des Statistiques et des Etudes Economiques).

[3] The sample was built by randomly drawing out samples from the 416 (2x8x26) elementary strata. These strata are classified according to the origin (start-up or takeover: 2 modalities), the branch (8 modalities) and the localization (22 French regions plus 4 overseas *départements*). The databases must then be used with the correction of a weight variable (the reverse of the draw rate per branch, per region and per origin).

[4] Yet economic "activations" and "reactivations" are excluded from the surveyed sample. Economic "activations" correspond to units which do not have any activity and which decide to exercise one. Economic "reactivations" correspond to units which had stopped their activity and which start up again. They only deal with individual entrepreneurs –craftsmen or shopkeepers-. Financial and agricultural activities and the French units established abroad are set aside as well.

firms before their setting-up and the decision of banks (either to lend or not to lend). The other questions are extracted from the second survey of 1997 and take into account financial problems the firm faced over the last two years. Using the survey of 1997, we only consider the situation of firms which were established in 1994 and which were still alive in 1997. This methodological choice allows us not to consider as rationed firms the ones that were "lame ducks" and that were identified as bad firms by bankers. A good discrimination process, which consists in not lending to bad firms (firms that will quickly die), should not be considered as a rationing process. Additionally, we only consider firms that have actually invested over the last two years.

Following Cieply and Dejardin (2010), four modalities of the variable "financial constraint" can be distinguished:

1. The "*No rationing*" modality is made up of two kinds of firms. The first ones asked for bank loans and were granted them. The second ones did not ask for bank loans and did not face any financial problems during 1996-1997.

2. The "*Self constraint*" modality concerns firms that did not ask for bank loans but should have asked for some as they faced financial constraints during 1996-1997.

3. The "*Weak constraint*" modality groups together firms that did ask for bank loans and were granted them but they faced financial problems during 1996-1997.

4. The "*Strong rationing*" modality gathers firms that did ask for bank loans and were refused them in 1994.

The variables that are representative for financial relationships are constructed with the combination of several questions of the 1997 survey regarding the financial management policy of cash requirement, the financial management policy of investment, and the inter-firm financial cooperation links in 1994. Four variables are constructed.

1. The first one is the "*highly intensive relationships*" with banks. Firms in this class manage cash requirement by overdrafts or bank loans and/or finance investments by bank loans.

2. The second one is the "*highly intensive relationships*" with "3F": Family, Friend and "Fools" (Ang, 1991), or proximity finance. Firms in this class

manage their cash requirement and finance their investments by private resources (from managers, relatives and/or existing associates).

3. The third variable is the "*highly intensive relationships*" with external finance providers. Firms manage their requirement and/or finance their investments by raising new equities.

4. The last variable is about financial *links between enterprises* (high intensive relationships with other firms). Strong financial links of cooperation with other firms are identified in 1994 and firms manage financial difficulties during 1996-1997 by increasing terms of payments.

3.3. Discovering regional discrepancies in financial relationships

Referring to the French economy, the existence of constraints regarding entrepreneurship is often pointed out as explaining the low propensity of entrepreneurship (Abdesselam et al., 2004a).

Creating firm results from a complex combination of motivations (taste for entrepreneurship, desire to be independent etc.), of situational variables (to be unemployed) and of constraints (access to financial, technical and informational resources etc.): all these variables describing a more or less favorable environment for entrepreneurship (Shapero, 1982, Lacasse et Lambert, 1989).

Regarding financial resources, the intensity of credit rationing may be related with the geographical localization of the firm newly set up or taken over. Previous results on financial constraints (Bonnet et al., 2005) have shown that the probability to be unconstrained is superior (or equal for a few regions) in all the French regions in comparison to the referent region (Île-de-France). The capital-region then appears as a region where strong financial constraints are at work especially for takeovers.

Yet the existence of decentralized financial institutions, venture capital institutions, and/or business angels, even the financial links that young firms may build up with other firms, may also differentiate in a broader perspective the access to financial resources and have an influence both on the propensity to set up a firm and on the duration of new firms (Guiso et al., 2004). The entrepreneurs embedded in entrepreneurial networks generally benefit from the financial support of relatives and then create enterprises with a larger initial size (Volery and Servais, 2001). Is it this embedding characteristic of territories marked by an

entrepreneurial culture that favors the access to proximity financial resources? In which amount could it explain the possibility to depart from banking financial relationships (substitutability) or on the contrary is it constitutive of a signal that allows banks to develop more banking relationships (complementarities)?

It could be noticed here that Île-de-France, Rhône-Alpes and the southern regions of France (Languedoc-Roussillon, Provence-Alpes-Côte d'Azur, Aquitaine, Midi-Pyrénées) display a strong entrepreneurship propensity among their population. It is globally accounted for by a high number of start-ups by inhabitant and by a high weight of start-ups versus takeovers in the total population of new firms. This is especially the case of Île-de-France where very strong entrepreneurship intensity with regard to the single population of start-ups may be observed (Abdesselam et al., 2004b). Let us note additionally that regions of the North and the East of France of ancient industrialization (Franche-Comté, Champagne-Ardenne, Picardie, Lorraine, Nord-Pas-de-Calais) and the Limousin and the Centre regions are regions with a relatively low entrepreneurial propensity. Consequently, some results will be presented in distinguishing entrepreneurial regions from the others.

4. LOOKING FOR REGIONAL DISCREPANCIES IN FINANCIAL RELATIONSHIPS

To study regional discrepancies in financial relationships, logistic regression according to regions are run on financial relationships (Table 1). We find that non-entrepreneurial regions[5] experienced more financial relationships with banks and less financial relationships with 3F and other firms. In the less entrepreneurial regions banks are the main providers of finance to new firms; banks substitute the lack of local direct finance. If we consider the model with all the regions, most of the French regions are found to have more highly intensive relationships with banks than the region Île-de-France, even the two entrepreneurial regions Aquitaine and Midi-Pyrénées.

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[5] PROVINCE is a dummy variable that gathers all the non-entrepreneurial regions of the country. The entrepreneurial regions are defined with the rate of entrepreneurial activity measured by an entrepreneurship rate (start-ups+takeovers / 10000 inhabitants). Île-de-France, Rhône-Alpes and the southern regions of France (Languedoc-Roussillon, Provence-Alpes-Côte d'Azur, Aquitaine, Midi-Pyrénées) display a very strong propensity to entrepreneurship and constitute our entrepreneurial regions.

Table 1: Logistic regressions

	Highly intensive relationships with banks	Highly intensive relationships with 3F	Highly intensive relationships with external finance providers	Highly intensive relationships with other firms
PROVINCE	0.2137***	-0.1463***	-0.0861	-0.3913***
CHAMPAGNE-ARDENNE	0.4277***	-0.4946***	0.0482	-0.9663
PICARDIE	0.3751***	-1.0304***	0.8906***	-1.1962
HAUTE-NORMANDIE	0.00925	-0.0272	-0.3173	-1.9032*
CENTRE	0.2973***	-0.2209**	-0.7838*	-0.8402*
BASSE-NORMANDIE	0.6313***	-0.5787***	0.5308	-1.9353*
BOURGOGNE	0.1196	-0.1430	0.1275	-1.3313*
NORD-PAS-DE-CALAIS	0.1113*	-0.0982	0.0899	-0.8283**
LORRAINE	0.2202***	-0.0855	-0.3885	-0.5067
ALSACE	-0.0034	-0.1045	-0.1466	ns
FRANCHE-COMTE	0.4515***	-0.4160***	-0.9199	0.2786
PAYS DE LA LOIRE	0.3619***	0.0148	-0.0939	-0.3448
BRETAGNE	0.390***	-0.3606***	-0.6694	-1.2111**
POITOU-CHARENTES	0.3607***	-0.329***	-0.9694	-0.2382
AQUITAINE	0.3107***	-0.4404***	0.3171	-0.7384**
MIDI-PYRENEES	0.4980***	-0.3993***	-0.3258	-1.3488***
LIMOUSIN	0.8163***	-0.9554***	0.7956*	ns
RHÔNE-ALPES	-0.0354	-0.0614	-0.1777	-0.5568**
AUVERGNE	-0.0967	-0.0195	0.8653***	-0.0857
LANGUEDOC-ROUSSILLON	-0.0177	-0.1692*	0.2315	-1.1815***
Provence-Alpes-Côte d'Azur	-0.0801	0.0537	0.3589*	-0.4134
CORSE	0.6901***	-0.3016	-1.1619	0.0691

ÎLE-DE-FRANCE is the reference class for the second model.

The Spearman correlations (Table 2) show that highly intensive relationships with banks and highly intensive relationships with 3F are negatively correlated, which tends to confirm, at a regional level, the substitution effect.

Table 2: Spearman correlations between Financial Relationships

Spearman	Banks	3f	External	Other
Banks	1			
3F	-0,757	1		
External	-0,308	-0,094	1	
Other	-0,221	0,328	-0,192	1

To have a precise idea of the substitution/complementary effect, we made the cross table between these two variables at the individual (firm) level and calculated the Chi2 square by regions (Table 3).

Table 3: Cross Table Highly intensive relationships with banks / with 3F

	3F relations among firms with banking relations (%)	3F relations among firms without banking relations (%)	Chi 2
ÎLE-DE-FRANCE	9,68	25,47	259.54*** (<.0001)
CHAMPAGNE-ARDENNE	4,39	19,65	28,02*** (<.0001)
PICARDIE	5,38	8,10	1.89 (0,16) ns
HAUTE-NORMANDIE	5,97	26,25	49,59*** (<.0001)
CENTRE	7,71	21,07	35,72*** (<.0001)
BASSE-NORMANDIE	7,64	13,95	5,90** (0,0151)
BOURGOGNE	4,88	24,75	54,72*** (<.0001)
NORD-PAS-DE-CALAIS	8,25	21,29	43,43*** (<.0001)
LORRAINE	8,73	22,57	32,1*** (<.0001)
ALSACE	8,93	19,68	18,43*** (<.0001)
FRANCHE-COMTE	8,36	15,38	5,05** (<.0246)
PAYS DE LA LOIRE	8,74	25,89	67,36*** (<.0001)
BRETAGNE	4,33	24,09	104,21*** (<.0001)
POITOU-CHARENTES	6,48	20,52	31,20*** (<.0001)
AQUITAINE	6,71	16,14	34,16*** (<.0001)
MIDI-PYRENEES	7	18,13	41,98*** (<.0001)
LIMOUSIN	4,98	11,24	3,94** (<.0473)
RHÔNE-ALPES	10,46	19,49	42,56*** (<.0001)
AUVERGNE	6,38	21,43	26,23*** (<.0001)
LANGUEDOC-ROUSSILLON	5,29	21,85	74,07*** (<.0001)
PROVENCE-ALPES-CÔTE D'AZUR	8,30	25,66	117,29*** (<.0001)
CORSE	3,40	30,99	33,57*** (<.0001)

Clearly it appears that the substitution between banks and 3F effect exists in all the French regions except one region where there is no significant effect, Picardie.

By characterizing the different financial relationships with the control variables of the logistic regressions[6], we notice that takeovers have developed higher intensive relationships with banks; the same applies for firms which high amounts of money invested in the project, as well as when the example of the entourage was the main motivation to set up the firm. On the contrary, being unemployed, or responding to a new idea for the motivation to set-up the firm, mean significantly less intensive relationships with banks.

By considering the relationships with 3F, we observe that takeovers develop less intensive ones. By contrast, being unemployed or belonging to a non-European country is characteristic of more intensive relationships with 3F. If we consider jobs created by these new enterprises, five French regions show a very favorable evolution, both for start-ups and takeovers: Midi-Pyrénées, Rhône-Alpes, Poitou-Charentes, Bourgogne and Champagne-

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[6] Complete tables, including results for control variables, are available upon request from the authors.

Ardenne. Conversely, regions that present the worst performances in terms of jobs are Provence-Alpes-Côte-d'Azur, Languedoc-Roussillon and Île-de-France. At this level of aggregation, it seems however difficult to link these results with the intensity of financial relationships firms may have developed in these regions. If takeovers devoid of any constraint at the beginning (especially financial constraints) are more prone to create new jobs, it is nevertheless not possible, using data analysis methods, to associate this model to some specific French regions (Abdesselam et al., 2004a). That being, a public policy for creating new jobs would *a priori* yield better positive results in the short term by alleviating constraints on takeover firms, whereas discovering new products, new markets conditioning the creation of future new jobs, would be rather more important in the case of new ventures or ex-nihilo start–ups.

5. CONCLUSIONS

To conclude, new firms significantly suffer from a lack of access to finance. The constraint may be above all due to the apprehension of the manager-owner to ask for credit. Strong rationing which corresponds to credit refusal by banks only matters for a very small part of financial constraint. Moreover, the existence of a banking constraint at the beginning of firms' life does not induce the absence of banking relationships in the future. Banking relationships cannot be strictly associated with the absence of credit rationing at birth. This observation supports the thesis the fact that no path of exclusion can be identified on the credit market. In addition; any kind of signals from informed partners to banks cannot be put into light. On the contrary, banks and others investors are more substitutable than complementary when financing new firms is concerned. So, the financial story of new firms created in late 20th century in France is clear: they suffered from financial constraints as they did not obtained the total credit required but were partly financed so that banking relationships could be developed and future investments and working capital could be financed by banks. In the period between setting up and becoming bankable, other financing means are substitutes for bank loans and do not product any signal effect at the moment they are supplied to new firms. Entrepreneurial regions which are characterized by a higher percentage of strong rationing and self-constraint at the beginning tend to develop less highly

intensive relationships with banks but more highly intensive relationships with the proximity capital and highly intensive relationships with other firms.

These results could be at least partially explained by the economic structures and the different characteristics of the regional development, especially in terms of the association between the previous occupation of the entrepreneur and the motivation to set up the firm. Additionally these results could be explained by financial characteristics. They can indeed be the departure point of a "pecking order theory"[7] applied to new firms that integrate the entrepreneurial intensity of regions. In the most entrepreneurial regions, the investment policy of firms is more uncertain, projects are more volatile and finally the risk exposure of banks is higher than in less entrepreneurial regions. Banks can thus be reluctant to finance all the external demand of financing, which is high relative to other regions. In these regions, the entrepreneurial atmosphere provides solutions to new firms as proximity finance and interfirms relationships are more intensively developed. In highly entrepreneurial regions, the external financing of firms is based first on proximity finance and interfirms relationships and only secondly on banks. In the less entrepreneurial regions, projects are less volatile and investments less based on specific assets. Banking finance is easier and can substitute for the lack of both proximity finance and interfirms relationships. Finally in these low entrepreneurial regions, the external financing of new firms is based first on banking finance and secondly on proximity finance and interfirms financial relationships.

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[7] According to the classic pecking order theory (Myers, 1984, Myers and Majluf, 1984), firms prefer first internal finance, second debt (unrisky then risky) and third raising new equity. This hierarchy is modified for innovative firms, whose assets are highly specific (Williamson, 1988). In this case, raising new equities is preferred to loans.

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