

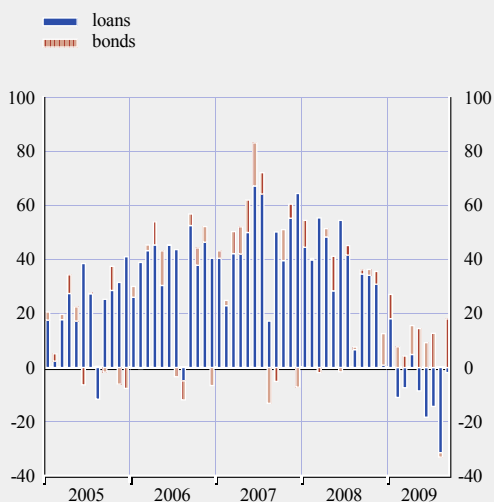
ACCESS TO FINANCE FOR NON-FINANCIAL CORPORATIONS IN THE EURO AREA

Since profitability and thus the ability of firms to generate internal funding have remained very low, or even deteriorated, non-financial corporations may become heavily dependent on external financing. In this context, constraints in firms' access to external finance could increase firms' solvency and liquidity risks, triggering an increase in corporate defaults and putting additional pressure on the profitability of the banking system. Against this background, this box examines how the availability of financing resources for non-financial corporations has developed since the previous issue of the FSR. It finds that, for larger companies, access to external finance has improved slightly, but that, for both large and small firms, conditions remain tight.

Bank loans are traditionally the most important source of external finance for European companies. According to the results of the latest bank lending survey, in the third quarter of 2009, banks tightened the lending standards applied to loans and credit lines to enterprises for the fifth quarter in a row, but there are also clear indications that the process of tightening lending standards is coming to an end.

Chart A Net flows of loans and bond issuance by euro area non-financial corporations

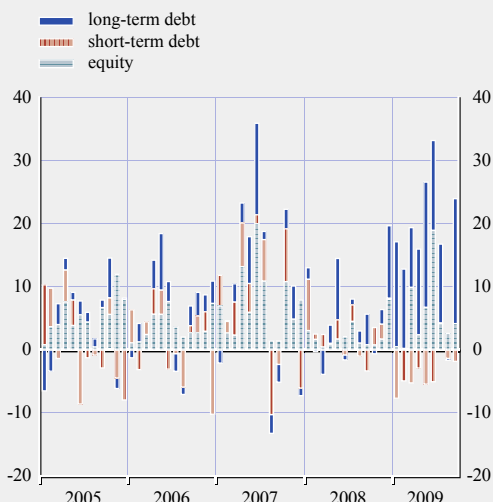
(Jan. 2005 – Sep. 2009; EUR billions)



Source: ECB.

Chart B Issuance of debt and equity by euro area non-financial corporations

(Jan. 2005 – Sep. 2009; EUR billions)



Source: ECB.
Note: Issuance of debt refers to net issuance.

While the continued reports of tightening credit standards may raise concerns, it should be remembered that banks often apply very lax credit standards in booms, meaning that a certain level of tightening may be justified to achieve lending standards fully reflecting borrowers' riskiness.¹ Moreover, the decrease in bank lending to firms, which can be observed at the aggregate level, seems to be primarily a result of firms' lower demand for credit: the brisk deterioration in real economic activity and capital expenditure by non-financial corporations since the beginning of this year has been the main contributor to the sharp slowdown in overall lending business.

At the same time, the tightening of lending standards was also the consequence of increasing vulnerabilities in the banking system. However, largely as a result of the standard and non-standard monetary policy decisions, supply-side factors, such as capital costs of banks, banks' access to funding and banks' liquidity positions, have become less important over the last six months. Overall, the cumulated tightening of credit standards may have weighed somewhat on loan dynamics in 2009. Surveys among enterprises and recent empirical studies indicate that supply-side restrictions have indeed been relevant in the current crisis.²

Tighter financing conditions by banks have been partly offset by improvements in the availability of market-based financing, reflected in higher net bond issuance (see Chart A). As indicated by net issuance volumes, the maturity of debt has been predominantly long-term, reducing firms' dependence on financing from banks and financial markets in the coming years (see Chart B). Furthermore, the issuance of equity by non-financial corporations has also increased substantially. The rebound of capital markets and the significant decline in the costs

1 For pro-cyclical lending standards, see ECB, "Determinants of bank lending standards and the impact of the financial turmoil", *Financial Stability Review*, June 2009.

2 For the importance of demand-side and supply-side effects, see ECB, "Euro area bank lending survey – October 2009"; and ECB, "Monetary policy and loan supply in the euro area", *Monthly Bulletin*, October 2009, and the literature there cited.

of equity and debt made market-based finance more attractive. Both instruments play a role primarily for large companies.

In addition to market-based finance, inter-company loans and cross-holdings of unquoted shares among non-financial corporations also compensated, to some extent, for the tightening of bank credit standards (according to data from integrated euro area accounts). These instruments may be relevant, in particular, for companies belonging to a conglomerate, and therefore also predominantly for larger companies.

Considered together, the findings indicate that firms' access to external finance may have improved somewhat, at least for large companies. Small and medium-sized companies are more likely to be facing constraints in their financing needs, which is also suggested by the findings from the first euro area survey of SMEs conducted by the ECB and the European Commission.