



# ESRI Research Bulletin

## *Bank-lending Constraints, Trade Credit and Alternative External Finance since the Financial Crisis: Evidence from European SMEs*

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Council)

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# Bank-lending Constraints, Trade Credit and Alternative External Finance since the Financial Crisis: Evidence from European SMEs<sup>1</sup>

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Policy makers and researchers have been concerned about the availability of traditional bank credit since the recent financial crisis began. In particular, Small-and-Medium sized Enterprises (SMEs) have been subject to constraints in relation to accessing both working capital and investment financing. Considerable research has focused on the determinants of access to credit for SMEs. However, less work has been completed on the types of alternative finance that firms turn to when access to traditional lending channels is strained. Depending on the types of alternatives actually used, policy implications may vary.

Firstly, we use SME firm-level data from the ECB for the post-crisis period to test whether firms that are rejected bank credit are more likely to either apply for or use alternative financing. These alternatives include trade credit, informal lending, loans from other companies, market financing (issued debt or equity) and state grants. Our identification of constraints captures both credit-rationed firms (rejected applicants) and firms that self-ration (firms that reject loans on price grounds). Secondly, we look at whether or not constrained firms are more likely to apply for or use any of the aforementioned alternative forms of financing.

Our findings suggest that credit-rationed firms are more likely to apply for and use trade credit. This increases with firm size and age. We also find that constrained firms are more likely to use informal lending or loans from other companies, but we find no evidence that bank-constrained SMEs apply for, or use, market finance. Smaller, self-rationing borrowers are seen to be more likely to apply for grant finance. Finally, we find that firms denied credit for working capital tend to turn to trade credit, while informal and inter-company lending tends to act as a substitute for bank investment loans.

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<sup>1</sup> Casey, E. and O'Toole, C. (2014). Bank-lending constraints, trade credit and alternative financing during the financial crisis: Evidence from European SMEs, *Journal of Corporate Finance*, published online: <http://dx.doi.org/10.1016/j.jcorpfin.2014.05.001>

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These results have a number of implications for policy. As trade credit appears to be a primary substitute for firms rejected for bank lending, this may highlight a lack of other viable alternatives. This is also evidenced by the findings that firms tend not to turn to formal market debt or equity funding in such circumstances. Broadening the mix of financing available by European SMEs should therefore be an important policy objective at both EU and member state levels. Similarly, as we find little evidence of any uptake among constrained firms of state financing supports, this suggests that such policy measures concerning access to finance may be poorly targeted. Alternative interventions may need to be explored in order to better assist constrained firms that present viable investment opportunities.