International Financial Integration and Entrepreneurship

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The Questions

Finance crowds local entrepreneurs out
(or relaxes borrowing constraints?)

Finance increases the likelihood of crises
(or fosters risk sharing?)

Old Question, New Data

The Data

98 countries, 24 million firms (listed and unlisted), classified into SIC industries

"Entrepreneurship":

Firm Entry (% firms younger than 2 years)

Firm Size (# employees)

Skewness in Firm Size distribution

Finance:

- AREAER IMF indices
- K inflow / GDP, K inflow+outflow / GDP, FDI inflow / GDP

Foreign Liabilities (Stock) / GDP

The Method

1. Cross-Section:

    $$E_{ic} = \alpha K_c + \beta X_c + \delta_i + \varepsilon_{ic}$$

    Isolates country component of firm data. Other determinants of firm size, age, distribution? E.g. regulations (labor, product market?) Omitted Variables is usual cheap shot, but unfortunately crucial

2. Rajan – Zingales:

    $$E_{ic} = d_i + d_j + \gamma Lib_c . EUS_i + \varepsilon_{ic}$$

    Control set now as general as it gets. But firm age/size/entry in US plausible benchmark? WalMart in India?

The Method

3. Diff in Diff:

    $$DE_{ic} = \gamma Lib + \beta DX_c + d_i + v_{ic}$$

    Controls crucial again – to isolate treatment effect of liberalization. Financial liberalizations do not occur in a vacuum: is DX_c controlling for all there is?

The Usual Suspects

- Omitted Variables

- Treatment

- Endogeneity:
  Countries with many young, small firms tend to attract foreign capital. Problem in cross-sectional and diff in diff estimates. Stress Rajan-Zingales approach: differential effects probably not caused by aggregate firm characteristics.

- Sampling:
  US 7m observations, France 4m, Japan, Germany, Italy, Netherlands, Czech Rep *all* 1m. Doesn't appear to correlate with financial development, but focus on sub-sample where proportion of firm universe is known (and constant)?

The Usual Suspects

- Measurement: Entrepreneurship or Firm Size / Age?

  "Entry" is about proportion of young firms

  "Skewness" is about size distribution...
  Industry with many large and old firms will be skewed
  Industry with high exit rate may be skewed

  Sufficient statistics for "entrepreneurship"?

More likely, paper about effect of finance on firm characteristics.

The Point

- Key point: In spite of nitpicking discussant's checklist, results are eminently convincing and robust.

- But is that surprising?

- Results here are quite similar to things we already know about the effects of finance on (small, young) firms.

- Given literature, difficult to see how could have found otherwise.

The Literature

- Beck, Demirguc-Kunt, Laeven, Maksimovic (2004, 2005):

Financial Development (Private Credit) boosts growth of small firms.

(using a Rajan-Zingales methodology)

- Beck, Levine (2002):

Financial Development boosts creation of new firms

(though Banks vs. Markets does not)

- Henry (2000, 2003):

Liberalizations of Stock Market / Capital Account boost Investment.

- Bertrand, Schoar, Thesmar (2004):

French Banking Deregulation boosted firm creation (and exit) in bank dependent industries. And altered market structure.

- Black, Strahan (2005):

US branching deregulation boosted incorporations.

The Contribution

- What is new here?

- Exceptional data and international coverage (with sampling issues). Differences with Beck's recent data?

    => Effects of Finance Universal?

- Finance is measured by Foreign Capital or Capital Account Liberalization Indices rather than Private Credit.

    => Origin of Capital Matters? Foreign vs. Domestic?

    => Are measures here capturing something Private Credit did not?

The Contribution

- What Capital? Paper begins analyzing an "FDI channel".

$$E_{ic} = \alpha \, ShareForeign_{ic} + \beta X_c + \delta_i + \varepsilon_{ic}$$

- Foreign-owned firms increase the share of young firms. But silent as to whether displace local ones.

- Why not simply use data to decompose E_{ic} into local vs. foreign firms?

    => Would answer first question paper set out to examine.

- But endogeneity issue. Sectors with lots of young, dynamic firms tend to attract FDI.

The End

- Rich data – should enable an answer to question whether foreign capital has crowding out effects.

- Not clear whether can answer the crisis-growth question.

- Can and should do more than just replicating existing results.