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How diversified are Spain's

sources of business financing?

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Historically, Spanish and European companies in general have tended to look to banks for their financing more than other advanced economies such as the US.¹ However, this new expansionary cycle has seen a significant change in both the sources of financing used and the providers of such financing.

The main source of financing for SMEs is bank credit. Given that Spanish business is dominated by SMEs, it comes as no surprise that this is the main source of financing in the country. Small businesses cannot afford the costs of accessing capital markets. Among others, these include the costs of producing and reporting the necessary information. It is therefore essential for SMEs to maintain a close and stable relationship with their bank. In this way, bank managers are better able to gauge each company's credit risk. Larger companies, on the other hand, tend to provide more frequent and detailed financial information, usually audited, or even have an independent rating. This means they can complement bank credit with alternative sources of financing such as corporate bonds, issued directly on the financial markets.

One of the fundamental issues is the optimal mix of financing for companies, both for banks and entrepreneurs and, more generally, from a macroeconomic point of view. For large firms, a greater variety of sources of finance gives them access to a

larger number of investors and usually more favourable financial conditions. This is often accompanied by access to international finance markets, allowing more bank resources to be allocated to small businesses, which benefit more from banking activity. On the downside, capital market assets are highly volatile as liquidity is often drained in episodes of financial instability. Bank financing, on the other hand, tends to be less volatile.

Moving from theory to practice, there has been a decline in the relative weight of bank loans in Spain over the past five years while commercial credit and corporate bonds (the latter boosted by the ECB's corporate bond purchase programme) have become more prominent. This has reduced the concentration of financing sources, in line with the trend for the euro area as a whole although still at somewhat higher levels.

A similar pattern can be observed in the diversification of external financing providers. Looking at the counterparties of corporate loans and bonds (i.e. corporate debt holders), we can see a decline in monetary financial institutions, partly offset by a rise in the rest of the world; i.e. increased access to international finance. This demonstrates the confidence of international investors in Spanish companies and reveals an opportunity for the latter to diversify their sources of financing.

1. See the Focus «Capital market union: a first step» in MR04/2015.

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