The rise of bond financing in Europe

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The rise of bond financing in Europe - Overview

- Investigate the rise of bond financing in Europe (EA):
  - Descriptive analysis of corporate bond market 2002-2018
  - At firm level: leverage and debt composition
  - At market level: financial stability concerns
  - Studying Pre-Covid period for impact of downgrades
  - Capital IQ (S&P). NFC, public and private firms, plus balance sheet data from Compustat global.

The rise of bond financing in Europe – Overview, cont‘d

- Findings
  - Panel data set 2004-2018 with debt structure and balance sheet
  - Bond market volume in public market rises twice the rate of bank loans (3% versus 1.5%)
  - Composition: entry of smaller and less profitable (riskier) issuers
  - No direct substitution with bank loans: leverage rises
  - New issues are large and longer term (40-60% of old debt)
  - Pre-Covid: rating downgrades reduce access to bond market & increase access to bank lending. In contrast to US (role of subprime bond market).

Discussion 1

- Data set in search of a (main) question: Will access to bond markets…
  - …replace bank debt ? (1)
  - …increase leverage, default risk, financial instability ? (2)

- (1) is based on own model, along the lines of Holmström/Tirole 1997.
  - Tradeoff between bonds and loans depends on cost differential: funding costs versus costs of distress.
  - *However*, model is not really guiding the empirical analysis. Here, costs differ by assumption rather than being based on data. In this case, the pledgeability/ irreversibility of assets would have to play a role.

Discussion 2

- What does bond market growth imply for banks, the dominant source of external corporate funding?
  - Bond market volume rises twice the rate of bank loans (3% versus 1.5%)
  - *However*, what is role of banks in bond market access?
  - E.g.: Germany. House-banks pave the way to market access, i.e. they *are the market access*.
- Then optimization may have to be done from the point of view of the bank, rather than the firm, trading off its own earnings and risks against the price of loading off risk in the market.
  - E.g., bank lending contracts are endogenous - responding to bond issuance, e.g. by reducing maturity, seniority increases; or: by increasing asset encumbrance based on bond financed new assets.
  - Therefore, details of bank lending need to be controlled for.

Discussion 3

- The pre-Covid event study: Rating downgrades as additional risk factor for firms?
  - Causal effect not identified (admitted, but still…). DG likely to be endogenous.
  - Event study: not clear what it shows. Results consistent with alternative hypothesis – a stronger role for bank, taking back control (?)
- More generally: Unclear, why ratings may contain information that banks do not have.
  - Note: Downgrades are preceded by watchlist periods – in which agencies may become active monitors, seeking to protect the value of outstanding bond claims. See (Boot/Milbourn/Schmeits: Credit ratings as coordination mechanism. RFS 2006, 81–118)
  - What about watchlist episodes and outcomes?

Discussion 4

- Downgrade reduces market access for European firms? Even if true, it is not clear whether this affects access to debt financing, as relationship banks may come to help.
  - Thus, what is counterfactual: is there more stability without bond financing? What matters: Loss of market access, or loss of funding access?
  - Two-stage framework required: What opens bond market access (stage 1), what is additional effect downgrade (stage 2).

Discussion 5

- Policy/Financial stability
  - „Higher reliance on bonds…makes firms more exposed to shocks from outside the banking system“
  - „Thus protecting smaller issues from such turmoil (rising spreads, issuance problems) relying on lender of last resort policies“
- Bold conclusion…, because:
  - „Turmoils“ are fundamental events
  - Do we want to restrict defaults and debt restructuring to happen ?
  - Banks may be well equipped to handle debt restructurings outside the courts,
  - See on Germany: Brunner/Krahnen, Multiple lenders and corporate distress, (REStud 2008)
  - Jorda et.al.‘s zombie warnings may be premature, and rherefore: targeted CB bond market interventions need further thinking.

Thank you for your attention