Extended Abstract submitted for CEA UK/Europe 2012 Annual Conference

Financial Underdevelopment, Distorted Lending, and Export Market Survival: Evidence from Chinese Manufacturing Firms

Ziliang Deng [a] **Lei Hou** [b c]

[a] (**corresponding author**) School of Business, Renmin University of China; ziliang.deng@ruc.edu.cn; dengziliang@rbs.org.cn
[b] Department of Economics, University of Munich, Germany
[c] School of Economics, Jilin University of China

Compared to enterprises engaging in domestic businesses only, exporters are more dependent on a stable and strong financial support for working capital and risk insurance (Amiti and Weinstein, 2009). In the downturn of international trade during the recent global financial crisis, exporters have been forced to contract exports or even exit from foreign market due to rising cost and limited availability of external credit, apart from the shrinking market demand (Auboin, 2009; Chor and Manova, 2012). As the incumbent exporters play a dominant role in country-level export performances (Bernard and Jensen, 2004; Eaton et al., 2008; Manova and Zhang, 2009), how to support their survival and operations in foreign market is a topic of vital importance.

An emerging stream of literature focuses on the role of finance in fueling trade performance. While it is well recognized that finance is a key determinant of firms' export participation and trade volumes (Beck, 2002; Beck, 2003; Muuls, 2008; Berman and Hericourt, 2010; Manova, 2011; Demir and Dahi, 2011), the impact of finance on exporter's survival is largely neglected. In reality, exporters' failures in foreign markets can be affected by the development of domestic financial system due to the following intrinsic disadvantages of exporters in financing. Exporting requires more external finance to cover additional fixed cost and variable cost, however due to longer shipment time and higher risks involved in international businesses, exporters generally find it more difficult to obtain sufficient funding. Therefore, they are more financially constrained and more sensitive to financial environment. (Chor and Manova, 2012; Feenstra et al., 2011; Manova et al., 2011). Moreover, compared to pure domestic businesses, cross-border activities have to endure additional negative shocks such as demand downturn in overseas markets or unexpected exchange rate fluctuations, all of which could induce a liquidity problem in the short run for exporters. Therefore, timely liquidity provision as a result of financial development is more favorable for exporters (Beck, 2002; Raddatz, 2006). Since exporters, in contrast to multinational firms, are more reliant on domestic finance, the development of domestic financial system is a crucial determinant of exporters' survival. With the development of domestic financial system, exporters can have better access to external finance, especially long-term finance, consequently, they are less likely to encounter a financial problem and exit foreign market.

This paper aims to fill the research gap of linking domestic financial development and export market survival. We use the data for Chinese manufacturing exporters during 1998-2008 to examine the impact of financial development on exporter survival in foreign market. We measure financial development using the size, lending efficiency, term structure of bank loans and the degree of state intervention in financial resource allocation respectively. We find that larger scale, higher efficiency of bank lending and less state intervention facilitate while the relative abundance of long term credit deteriorates exporter survival. These effects are more pronounced for private exporters. However, financial development has almost no effect on state-owned exporters. For foreign-invested exporters, the level of state intervention matter the most. We attribute this disproportional impact to the government's direct participation in funding investment and the distortional lending of banks, which vary across regions and industries with different levels of presence of state-owned enterprises.

JEL Classification: G21; G28; F10; D21
Keywords: Financial development; Financial distortion; Export; Firm survival

References

Amiti, M., Weinstein, D.E., 2009. Exports and financial shocks. NBER Working paper 15556.

Auboin, M., 2009. Boosting the availability of trade finance in the current crisis: Background analysis for a substantial G20 package. CEPR Policy insight No. 35.

Chor, D., Manova, K., 2012. Off the cliff and back? Credit conditions and international trade during the global financial crisis. Journal of International Economics, forthcoming.

Bernard, A.B., Jensen, J.B., 2004. Entry, expansion, and intensity in the US export boom, 1987–1992. Review of International Economics 12, 662-675.

Eaton, J., Eslava, M., Kugler, M., Tybout, J., 2008. Export dynamics in Colombia: firm-level evidence. In: Helpman, E., Marin, D., Verdier, T. (Eds.), The Organization of Firms in a Global Economy, Harvard University Press, Cambridge, Massachusetts, London.

Manova, K., Zhang, Z., 2009. China's exporters and importers: Firms, products and trade partners. NBER working paper 15249.

Beck, T., 2002. Financial development and international trade. Is there a link? Journal of International Economics 57, 107-131.

Beck, T., 2003. Financial dependence and international trade. Review of International Economics 11, 296-316.

Muuls, M., 2008. Exporters and credit constraints: A firm-level approach. National Bank of Belgium working paper No.139.

Berman, N., Hericourt, J., 2010. Financial factors and the margins of trade: Evidence from cross-country firm-level data. Journal of Development Economics. 93, 206-217

Manova, K., 2011. Credit constraints, heterogeneous firms and international trade, NBER Working paper 14531.

Demir, F., Dahi, O. S.,2011. Asymmetric effects of financial development on South-South and South-North trade: Panel data evidence from emerging markets. Journal of Development Economics 94, 139-149.

Feenstra, R.C., Li, Z., Yu, M., 2011. Exports and credit constraints under incomplete information: Theory and evidence from China. NBER working paper 16940.

Manova, K., Wei, S., Zhang, Z., 2011 Firm exports and multinational activity under credit constraints, NBER Working paper 16905.

Raddatz, C.E., 2006. Liquidity needs and vulnerability to financial underdevelopment. Journal of Financial Economics 80, 677-722.