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Firms in the great global recession: The role of foreign ownership and financial dependence

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ABSTRACT

This paper investigates the channels through which the global crisis of 2008–2009 spread to economic activity of an emerging, fast growing economy with sound macroeconomic fundamentals. On the basis of Polish firm-level data we find that a number of individual firm characteristics account for a heterogeneous response. In particular, foreign ownership appears to have provided a higher degree of resilience to the crisis. Our results indicate that this effect might be due to intra-group lending mechanisms supporting affiliates facing external credit constraints.

1. Introduction

While the 2007 subprime crisis originated in few developed countries, the ensuing global recession of 2008 quickly spread to most countries around the globe, revealing an extraordinary degree of interdependence and synchronisation in the world economy. Activity and trade fell abruptly and worldwide following the intensification of the financial turmoil in autumn 2008. World industrial production collapsed by 13% between its zenith recorded in April 2008 and its nadir of March 2009. The worldtrade

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contraction from peak-to-trough was even faster-paced and deeper: it lasted eight months and amounted to 25% (see Baldwin and Taglioni, 2009). These patterns were observed in nearly every country, even in countries with relatively solid economic fundamentals and whose financial markets had remained relatively unaffected by the financial crisis. In short, the recent downturn has been unparallelled since at least the Great Depression in terms of its suddenness, severity and cross-country synchronisation (Eichengreen and O'Rourke, 2009).

Considerable research efforts are being devoted by economists worldwide to fully understand the causes and mechanics of the crisis. Over a thousand new working papers have been posted on the SSRN website since 2008 containing the terms “2008 crisis” or “global crisis” in their title, abstract or keywords. This rich literature in the making is slowly reaching a consensus on the key features and stylised facts characterising the harsh response of economic activity and trade to the recent crisis. First, the deterioration in global demand appears to have been sharper and more profound than during any other recession recorded after the Second World War. Second, the downturn has been accompanied by a general climate of extremely high uncertainty and exceptionally low business confidence. Third, the pace of financial markets tightening and asset prices collapse was faster than ever in post-war times. Finally, the rapid growth of internationally fragmented vertical production chains observed in recent decades is unanimously considered to be the main culprit for the synchronisation of the crisis' impact across countries.

Our paper contributes to the strand of this research which investigates how the financial troubles in few industrialised countries led to an economic and trade crisis that affected firms worldwide and, especially, in countries whose financial markets were not directly affected by the “Subprime Crisis”. It does so by exploring the channels and extent of contagion to Polish firms. The interest in this dataset stems from the features of the Polish economy. It is an emerging, small open economy, highly dependent on global and regional production chains, whose growth was robust and based on strong economic fundamentals before the crisis. While Poland experienced a significant slowdown in economic activity as of the second half of 2008, it was the only country in the EU that managed to record positive GDP in 2009. Also, Polish banks did not overinvest in toxic assets and the domestic housing market did not collapse. Hence, there are reasons to treat the recent global financial crisis as a large but exogenous shock to the Polish economy and so its experience represents a model case for an empirical investigation of a global contagion.

Our analysis first assesses how key balance sheet indicators, including sales, profits, indebtedness, investment, foreign trade, evolved during the time of the global crisis. Secondly, it examines if foreign ownership, and the associated involvement in global value chains, was a factor influencing firms' performance and, if so, through which channels. Finally, the identified channels are shown to be also important to explain differences across firms in the trade response to the crisis. To the best of our knowledge, this is the first article addressing systematically the implications of the recent crisis for firms' balance sheets and drawing from it insights about their resilience to global shocks.

We find that ownership status (foreign vs. domestic), size and sector of activity are important to understand the firm-level impact of the global crisis: while firms producing all manner of postponable goods and services have been disproportionately hit by the crisis, foreign owned and larger firms were better able to cope with the contraction of foreign demand and increased credit constraints. Our central result is that firms belonging to multinational groups were much more resilient to the crisis than their domestically owned counterparts. In this respect, access to external and intra-group financing emerges as a key factor supporting their sales, investment and trade activity.

This finding is consistent with papers looking at earlier crisis episodes. For instance, Bernard et al. (2009) analyze US exports during the Asian crisis and find that the decline in US arm's length trade towards Asia was more than eight times greater than the drop of US–Asia trade undertaken within supply chains. By contrast, no difference between the two categories of exports was found vis-à-vis the rest of the world.[1] Further evidence that foreign owned companies might respond better than other firms to a financial crisis comes from Desai et al. (2004), who investigate the response of US multinational affiliates and local firms to currency crises in emerging economies. During these episodes, sharp exchange rate depreciations tend to be followed by a credit crunch, hitting particularly those firms that borrow in foreign currency. The key finding of the paper is that, unlike local firms, foreign-owned companies can rely on internal capital

[1] See Altomonte and Ottaviano (2009) for preliminary evidence confirming the results of Bernard et al. (2009) on the basis of data on exports from Western to Central and Eastern Europe during the recent crisis.