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PRESS RELEASE

Internal resources, bank credit and other funding sources: what are the alternatives for businesses in Belgium?

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Different sources of funding help to ensure activity and business development. A number of factors may influence access to and use of those sources; this article examines those factors.

Where possible, firms use the resources that they generate from their operating surplus to finance their own activity. Apart from the costs of external funding – which are higher, partly owing to information asymmetries – this preference is attributable to the business founders' desire to retain control, according to the pecking order theory. If firms need additional funds, e.g. because they have a liquidity shortage or they want to embark on major investments, they can resort to external sources of funding.

The instruments actually used depend not only on their respective costs, determined by market conditions, but also on the nature of the needs and the firms' own characteristics.

In particular, firms forming part of a group, be they parent companies or subsidiaries, have certain facilities at their disposal. In particular, they have access to liquidity reserves common to their group, which can help them to meet their need for working capital. If appropriate, capital injections can also be arranged via cross shareholdings, to enable them to finance their activities in the long term.

However, most Belgian firms are not part of a group and therefore do not have such financing facilities. Consequently, they normally resort to bank credit if their internal resources are no longer sufficient to meet their working capital needs, or in order to undertake fixed capital investments. Bank credit also plays a predominant role in the funding of small and medium-sized enterprises. It thus emerges as an essential factor in the development of production capacity, and hence in the expansion of the economy's growth potential. However, its role in the financing of intangible fixed investments remains minor.

Bank financing is also strongly supported by the savings structure of Belgian households. In recent years, a large proportion of those savings have been placed in sight deposits and savings accounts, i.e. on the liabilities side of the balance sheet of monetary financial institutions. As a result, it is mainly those institutions that channel the funding resources generated by Belgians' savings into productive investments. That may favour the allocation of resources to projects which are relatively safe but perhaps not very innovative, as the banks take account of the risk factor in their lending policy.

For their part, innovative firms might display some interest in non-bank credit, such as subordinated loans granted by individuals or specialist financial companies. However, the financing of these firms, which are often young and not connected with a group, does carry a risk. That is probably the reason why many entrepreneurs depend on funds lent by their family and friends, or – in some cases – by financial intermediaries such as private equity companies.