

Financial Integration and Firm Performance: Evidence from Foreign Bank Entry in Emerging Markets

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Abstract

While the positive growth effects of financial integration are extensively documented, little is known of its impact on small and young firms. This paper aims to fill this void relying on a panel of 60,000 firm-year observations on listed and unlisted companies in Eastern European economies to assess the differential impact of foreign bank lending on firm growth and financing. Foreign lending stimulates growth in firm sales, assets, and use of financial debt even though the effect is dampened for small firms. More strikingly, young firms benefit most from foreign bank presence, while businesses connected to domestic banks or to the government suffer. Overall, our findings suggest that foreign banks can help to mitigate connected-lending problems and to improve capital allocation.

Keywords: Foreign bank lending, emerging markets, competition, lending relationships

JEL Classifications: G21, L11, L14

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