Summary

Since the middle of the 1990s, the preconditions for firms to fund themselves have undergone considerable change. A major tax reform in 1990/91 and the transition to low inflation made borrowing less favorable. Bank and financial crises, and new financial regulations to prevent such crises, have also affected the funding of firms. Despite the fact that difficulties to get funding is an important restriction for the development of above all small and new firms, there has been no clear picture of how the capital structure of Swedish firms has developed, and how these and other factors have affected the development.

Using a unique and detailed data base, this report shows that there have been major changes in the capital structure of firms since the end of the 1990s. During 1998–2010, the leverage ratio as well as the share of firms that had a bank loan fell. These changes took place in all types of firms, but the decline was greater among new and smaller firms. The decline has been gradual for new firms, but it was more pronounced from 2005. Starting with the financial crisis in 2007–2009, it also became increasingly difficult for new firms to qualify for bank loans through a good performance. In contrast, large companies increased the amount borrowed from banks during the first years of the financial crisis. After 2008, however, lending has also decreased for these firms. In two more recent surveys, it is, among other things, shown that funding is still a major restriction in firms' possibilities to invest and expand.

The report also discusses possible explanations behind the development. Several factors have affected the supply of capital negatively. Since 2008, banks have strengthened their financial position by, among other things, restricting lending to firms. The financial crisis, which increased the requirements placed on banks by their financiers, as well as the new financial regulations, the so called Basel rules, are important factors behind this development.

The supply was also affected by the lowering of banks' preference order in case of bankruptcy and non-payments undertaken in 2004. After an assessment had pointed out the negative consequences for above all new and small firms, the law was changed in 2009.

Demand factors could also have played a role. In addition to the tax reform and reduced inflation rates, which made high leverage less advantageous, the lowering of income and property taxes in combination with higher real wages have meant that more people have had the opportunity to build up savings that can be used to fund enterprises. Since personal savings, along with retained earnings, are preferred as a means of funding by most business owners, this can have contributed to a lower demand for bank loans. At the same time, the distribution of wealth is more skewed in Sweden than in most other countries. Only a third of the adult population has enough wealth to start a limited liability company of average size, which, according to the analysis, requires 150 000 – 200 000 SEK in equity capital. In most other rich countries, that share is considerably higher, and in Australia as high as 70 percent.

The increased difficulties to borrow from banks have therefore not only meant a restriction for enterprise as a whole, it could also have contributed to making the opportunities to start a business less evenly distributed among the population. This, in turn, could have made it more difficult to create your own employment, not least for the young and for people living in areas with high unemployment. The possibility that more jobs are created can also have been affected negatively since there is a connection between the number of new firms on the one hand and the number of rapidly growing firms on the other hand.

A further reason to expect that funding difficulties can impair job creation has to do with the extent to which people belonging to different parts of the wealth distribution are financially constrained. At the top of the distribution, new research has found that people often start a business to reach private goals, such as more freedom and control. To some extent, this means that they contribute less to the welfare of society as a whole compared to what had otherwise been possible. Further down the wealth distribution, people are more often financially constrained. They are therefore frequently either unable to start a business, or unable to run their business at an efficient scale. In both cases, this comes to the detriment of social welfare. Since it is the latter group that is primarily affected by greater difficulties to borrow from banks, it is

more likely that the economic effects will be negative for society as a whole.

In the report, it is also shown that firms that expanded in terms of employees more often had bank loans during the first year of business than firms that did not increase employment. The reduction in the share with bank loans has, however, been just as large in this group, which indicates that the development towards a smaller share with bank loans cannot be explained by banks making better credit ratings. During the financial crisis, they instead redirected lending to inherent customers, which is likely to have impaired the effectiveness of capital allocation.

The analysis also shows that there is a relatively large number of firms that make comparatively high profits and have a strong financial position but still do not grow. The ones that grow in terms of employees are, in general, less profitable, and are therefore also more dependent on external financing. Firms with the ambition to grow are therefore more affected by the difficulties to find external finance than other firms. In addition to negative effects on employment and enterprise growth, this means that surveys of the financial situation of firms can become misleading. This is important to bear in mind when such surveys are interpreted.

The falling share of firms that have access to bank loans could be an important explanation for the relatively poor development of the share of the population that runs a limited liability company. During the period 2005–2010, this share did not increase despite improvements in the business climate. Attempts at making this enterprise form more accessible were also undertaken, in part by lowering the mandatory amount of equity capital. Instead, the types of enterprise that required less capital became more common. Among people in the age 16–34, which generally have lower savings and find it more difficult to get bank loans, the share running a limited liability company dropped. This occurred although the increase in other types of enterprise was greater among the young than in other groups of the population, and despite the fact that young people were more interested in starting a business than other groups. Among people in the age 65–74, the share running a limited liability company increased fairly rapidly. Apart from strengthened incentives to continue working, the fact that people in this group in general have greater wealth and meet less financial

restrictions than the young could be an important explanation for this.

To reduce the financial restrictions against starting and expanding a business, reforms that improve the opportunities for more people to increase their savings are important. More detailed and timely data on the financing of firms would also be helpful since it would make it possible to detect financial difficulties at an earlier stage. It is, for one thing, important to be able to evaluate how the new financial regulations affect the possibilities for, in particular, new and small firms to borrow from banks. An improved corporate bond market, which is mainly directed towards larger companies, could also be helpful since it could increase the opportunities for other firms to borrow from banks. Better conditions for incentive programs for employees are also worth considering since they would lower the need for capital for, in particular, new, innovative, and therefore risky companies.