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Corporate debt and investment: A firm-level analysis for stressed euro area countries

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Abstract

This paper investigates the link between corporate debt and investment for a group of five peripheral euro area countries. Using firm-level data from 2005-2014, we postulate a non-linear corporate leverage-investment relationship and derive thresholds beyond which leverage has a negative and significant impact on investment. The investment sensitivity of debt increased after 2008 when financial distress intensified and firms had a lower capacity to finance investment from internal sources of funds. Our results also suggest that even moderate levels of debt can exert a negative influence on investment for smaller firms or when profitability is low.

Keywords: Corporate debt, leverage, debt overhang, investment, threshold model

JEL Classification: E22, F34, G31, G32

1. Introduction

Corporate debt increased rapidly in many peripheral euro area countries in the years preceding the financial crisis (Figure 1). The build-up of debt was largely driven by easy access to credit and coincided with strong increases in investment (Figure 2), but did little to create conditions for sustainable growth.

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