Abstract

This dissertation consists of three essays about firm financing. The first essay detects the bank-firm relationship in a transition country while the second and third essays address the importance of country factors in a company's capital structure decisions.

The question of the extent in which the financial sector problems "spill over" to firms is an important issue to study and it is particularly under-explored in the context of transition economies, where the financial systems are fragile. In my first essay I study the effect of an Estonian bank's failure in 1998 on its corporate loan clients by comparing the performance of clients to that of a random sample of other firms. First, I analyze whether bank bankruptcy causes the bankruptcy of client firms. I find that client firms are less likely to survive until 2000 even after controlling for their pre-bank bankruptcy performance. Second, I analyze the behavior of firms' profitability, liquidity, and growth of fixed assets. I find liquidity to be the only variable that decreases for the client firms compared to the control firms after the bank bankruptcy.

In my second essay I evaluate the importance of firm-specific, country-institutional and macroeconomic factors in explaining the firm leverage variation simultaneously. I use a large European dataset covering almost 600,000 firms from 10 Western European countries over 1995-2002. The unique feature of this dataset is that it allows me to study the capital structure of small firms, which has not been studied to date due to lack of data. I show that the country institutions and macroeconomic factors are significant determinants of firm leverage and that their significance varies across firm types. These factors are primary determinants of small and unlisted company leverage. This finding supports the belief that small firms are financially constrained and are less independent in determining their own leverage. Therefore, the conclusions of previous studies based on large stock market-listed firms are not portable to the average firm.

In my third essay I am interested in capital structure determinants in the transition countries. Market based financial institutions emerged just recently in these economies, indicating that imperfections in the financial markets, which explain the leverage level of the firms, might be especially large. This study is based on a large sample of listed and unlisted companies from nine Eastern European countries. I find

country-specific factors to explain the largest share of leverage variation for small unlisted firms while firm-specific factors explain the most for listed and large unlisted companies. This finding is well in line with the results based on Western European firms. Hence, it seems that the development level of the local financial market does not make country-specific factors more prominent.