

Markups, Productivity and the Financial Capability of Firms

Carlo Altomonte, Università Bocconi

Abstract

In this paper we introduce financial frictions in a framework of monopolistically competitive firms with endogenous markups and heterogeneous productivity, as in Melitz and Ottaviano (2008). On top of fixed entry costs, firms also need to build start-up capital (tangible fixed assets) used as collateral in order to obtain a loan necessary to cover part of production costs. In addition to productivity, firms are also heterogeneous in their financial capability: some firms obtain start-up capital at better conditions, thus decreasing their cost of collateral. As a result, financial capability and collateral requirements enter together with productivity in the expression of the equilibrium firm-level markup. At the aggregate level, the model shows that tighter credit constraints in the form of higher collateral requirements mitigate the pro-competitive effect of trade. Theoretical results are tested employing a refined measure of productivity purged from the differential access of firms to start-up capital, and capitalizing on a representative sample of manufacturing firms covering a subset of European countries during the financial crisis. Our structural estimation strategy also allows to retrieve a firm-level measure of credit constraints from balance sheet data.