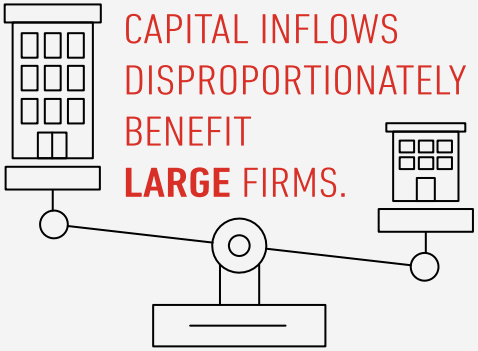
EVIDENCE-INSIGHTS-POLICY

DO FIRMS BENEFIT FROM CAPITAL INFLOWS?



CONTEXT

In 2014, foreign investors invested more than one trillion U.S. dollars in emerging countries. Of those inflows, 90 billion U.S. dollars came in the form of equity financing. On aggregate, capital inflows have helped many developing countries invest and grow despite their associated volatility. But we still do not know how those inflows are transmitted in an economy once they arrive. Calomiris et al. (2018) used firm-level data to study how equity capital inflows that enter emerging market economies affect equity issuance and corporate investment. This study is an investigation of whether publicly traded firms in emerging countries issue more equity when their countries experience increases in foreign equity purchases. In particular, authors ask whether the firms that raise new equity use those funds to finance corporate investment.

DATA

This is the **first study that examines the links between capital inflows and investment using issuance-level data.** To do so, authors assembled a large granular data set containing information on 20,306 seasoned equity issuances and financial statements for 12,723 firms in 25 emerging market countries as well as capital inflows during the 26-year period from 1991 to 2016.

FINDINGS

Capital inflows disproportionately benefit large firms. Equity inflows have a large and statistically significant effect on the issuances of large firms. Moreover, the relation between equity capital inflows and equity issuance is monotonically increasing in firm size. This result is consistent with the well-known fact that international investors are particularly interested in investing in the shares of large, well-established emerging market firms. To identify supply-side shocks, capital inflows into each country are instrumented with exogenous changes in other countries' attractiveness to foreign investors. The results show that shifts in the supply of foreign capital are important drivers of increased equity inflows.

Equity capital inflows lead large firms to increase corporate investment. Using a back-of-the-envelope calculation, the analysis indicates that every million U.S. dollars of foreign equity capital results in seasoned equity offerings that fund an increase of about 110,000 U.S. dollars of corporate investment. The 110,000-dollar estimate is the result of 160,000 U.S. dollars of additional secondary equity issuance (in response to every million U.S. dollars of inflows) and 700,000 U.S. dollars of average additional spending on investment (for every million U.S. dollars of capital raised). Capital inflows appear to reduce the cost of equity finance, allowing emerging market firms to finance new investments. In all, equity issuance seems to be an important channel through which capital inflows affect real economic activity.

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