

# TRADE, FINANCE AND ENDOGENOUS FIRM HETEROGENEITY

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**Alessandra Bonfiglioli**

Queen Mary University of London

**Rosario Crinò**

Università Cattolica del Sacro Cuore,  
Dept. of Economics and Finance

**Gino Gancia**

Queen Mary University

## Abstract

We study how financial frictions affect firm-level heterogeneity and trade. We build a model in which productivity differences across monopolistically competitive firms are endogenous and depend on investment decisions at the entry stage. By increasing entry costs, financial frictions lower the exit cutoff and hence the value of investing in bigger projects with more dispersed outcomes. As a result, financial frictions make firms smaller and more homogeneous, and hinder the volume of exports. Export opportunities, instead, shift expected profits to the tail and increase the value of technological heterogeneity. We test these predictions using comparable measures of sales dispersion within 365 manufacturing industries in 119 countries, built from highly disaggregated US import data. Consistent with the model, financial development increases sales dispersion, especially in more financially vulnerable industries; sales dispersion is also increasing in measures of comparative advantage. These results help explaining the effect of financial development and factor endowments on export sales. (JEL: F12, F14)

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*The editor in charge of this paper was Claudio Michelacci.*

Acknowledgments: We thank the Editor (Claudio Michelacci), four anonymous Referees, Johannes Boehm, Harald Fadinger, Gene Grossman, Elhanan Helpman, Matthias Kehrig, Ferdinando Monte, Fabrizio Zilibotti and seminar participants at the International Monetary Fund, University of Porto, University of Nottingham, Università della Svizzera Italiana, Queen Mary University of London, Universitat Autònoma de Barcelona, CREI, 2017 CEPR European Research Workshop in International Trade, 2016 “Winter Symposium in Economics and Finance” (Milan), 2016 CEPR Macroeconomics and Growth Workshop (London), MadMac workshop on Growth and Development (Madrid) and the 2016 SED Annual Meeting (Toulouse) for comments. We acknowledge financial support from the Barcelona GSE, the Spanish Ministry of Economy and Competitiveness (ECO2014-55555-P and ECO2014-59805-P), and the Catalan AGAUR (2014-SGR-546). Bonfiglioli, Crinò and Gancia are Research Fellows at CEPR. Crinò is Research Affiliate at CESifo

E-mail: a.bonfiglioli@qmul.ac.uk (Bonfiglioli); rosario.cрино@unicatt.it. (Crinò); g.gancia@qmul.ac.uk (Gancia)