Multiple banking relationships:

Do firms mistrust their bank?
The case of privately held French SMEs

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REFAIT ALEXANDRE Catherine, CRESE, University of Franche-Comté

SERVE Stéphanie, THEMA, University of Cergy-Pontoise

Introduction

- « **Small business uniqueness » (Ang, 1991) and the French case**
  - Privately held: owner=CEO and owners' characteristics matter in financial decisions (Ang, Rebel and Lawson 2010)
  - With a strong dependance to banks
  - In a context on financial crisis: credit rationing?

⇨ Focus on the banking relationships, and the use of multiple banking by SMEs

Introduction

- **Focus on the determinants of multiple banking**

  ⇨ Two analytical frameworks:

  - Traditional: the impact of firms' characteristics
  - More original: the impact of the quality of banking relationship, mainly assessed by distance and trust
    - Informal relationship matters (Ang, 1992)
    - New approach, from the point of view of the SME

  ⇨ Exploitation of a survey addressed to CEOs of French SMEs in December 2012

Literature review (1)

- **Framework 1: Multiple banking and firms' characteristics**
  - Single banking relationship incites the bank to collect information and monitor the firm (Fama, 1985; Haubrich, 1989, Greenbaum and Thakor, 1995; Thakor, 1996)

    → Opaque firms obtain more financing at better conditions

  - Single banking relationship gives an informational rent to the bank

    → Transparent firms will escape from the hold up problem by developing multiple banking relationships (Detragiache, Garella and Guiso, 2000; Berger, Klapper and Udell, 2001)

  - Consequences for firms 'characteristics:
    - High performing firms: single banking (better monitoring) or multiple banking (to escape from the monopoly power of the main bank)
    - High risky firms: single banking (to increase the probability to get new financing) or multiple banking (to get better support in case of financial distress)
    - Bigger and older firms: multiple banking

Literature review (2)

- **Framework 1: Mixed empirical evidence**
  - Inconvenients of multiple banking relationships:
    - Higher interest rates and higher credit constraint (Petersen and Rajan, 1995; Cole, 1998; Harhöff and Korting, 1998; De Bodt, Lobez and Statnik, 2005)
  - Performance and risk:
    - Positive relationship between performance and the number of banks (Detragiache, Garella and Guiso, 2000) vs. Negative relationship (Castelli, Dwyer and Hasan, 2010; Degryse and Ongena, 2011)
    - Higher default risk for multiple banking firms (Foglia, Laviola and Reedtz, 2004) vs. Better support of banks in case of financial distress (Brunner and Krahner, 2008)

⇨ Mixed results + A statement: multiple banking is widespread in continental Europe (90-95%)

⇨ Search for other determinants based on the quality of the banking relationship

Literature review (3)

- **Framework 2: Quality of the banking relationship and trust**
  - Banking marketing literature:
    - A "good" customer relationship is an important determinant of perception of service quality (Zeithalm, Berry and Parasuraman, 1988)
    - A "good" customer relationship is in the interest of banks (Ritter, 1993)
  - The role of trust: "one party has confidence in an exchange partner's reliability and integrity" (Morgan and Hunt, 1994)
  - Empirical evidence regarding on-line relationship banking: characterization of trust by Mukherjee and Nath (2003)
    - Antecedents: beliefs in common, communication, opportunistic behaviour in presence of asymmetry of information
    - Consequence: desire to maintain a valuable relationship

Literature review (4)

- **Framework 2: Few empirical evidence**

  - Harhoff and Körting (1998): concentrated borrowing and higher trust lead to better financing conditions for SMEs
  - Lehman and Neuberger (2001) and Moro and Fink (2013): from the point of view of loan officers, the quality of banking relationship has an impact on the decision to finance SMEs

⇨ Our study: the determinants of the choice of multiple banking from the point of view of the SME

Data and methodology (1)

- **The sample**
  - 901 SMEs opened the e mail ⇨ 95 answered the questionnaire
  - Financial data extracted from ALTARES (Dun and Bradstreet group)
  - Excluding firms with missing financial data (13)
  - Excluding firms that not fully completed the banking relationship part of the questionnaire (25)

⇨ Common sample of 58 SMEs

88% of the SMEs in the sample report multiple banking relationship (dummy variable MULTIBQ=1)

“Small” SMEs: median workforce=31 ; median net sales=4,2M€; median total assets=2,6M€, but rather old (31 years)

Data and methodology (2)

- **A family business issue?**
  - 54 SMEs in the sample (out of 58) are family owned: the CEO is the founder of the business, or this is the second/third generation
  - “Basic” definition for a privately held firm: a business owner
  - Banking relationships implications: Daurizio, Olivierio and Roman (2015):
    - Family has a positive effect on the relationship between borrowers and lenders, when compared with non family firms….
    - ….due to the use of increased “soft information”

Data and methodology (3)

- **Firms' characteristics**:
  - Age and size
  - Profitability (return on equity)
  - Leverage = Debt ratio (debt / total assets)
  - Bankrupcty=1 if the firm is involved in an bankruptcy process
  - Loan_demand=1 if the firm applied for a long term loan since the crisis (since 2007)

Data and methodology (4)

- **Quality of the banking relationship**:
  - Distance between the manager and the loan officer
  - Antecedents of trust
    - Asymmetry of information (<0)
      - **TRANSP_BK1**=1 if the manager thinks that his main bank is transparent in explaining the loan granting process
      - **TRANSP_BK2**=1 if the manager thinks he has been informed about the pricing process set by his main bank
    - Communication (<0)
      - **APPROACHABILITY=**1 if the manager takes the initiative of the meeting with his loan officer; 0 if the loan officer takes the initiative
  - Consequence of trust: the desire to build a valuable relationship
    - "Do you systematically search for the lower interest rate when applying for a credit?": **RATE**=1 if the response is "no" (<0)

Preliminary results (1)

- **Framework 1: Impact of firms' characteristics**

  - Smaller (total assets) and younger firms (age) are more likely to engage in single banking relationship: life cycle of banking relationships

  - The most performing firms (ROE) are more likely to engage in multiple banking relationships

    ⇨ During the crisis, French SMEs tried to protect themselves against the hold up problem

  - The presence of financial distress has a negative impact on the decision to engage in multiple banking relationships

  - Contrasting results for proxies of financing needs: loan demand (<0)/leverage (>0) ⇨ maturity matters

Preliminary results (2)

- **Framework 2: Impact of the quality of banking relationships**
  - The distance between the manager and his loan officer has an impact on multiple banking
    - ⇨ When the loan officer is located in a business center, firms are more likely to engage in multiple banking relationships
  - Transparency of the bank has a positive impact on the decision to engage in multiple banking relationships
    - ⇨ Double edge weapon for banks: tool to boost competition rather than trust component?
  - Firms that want to build a valuable relationship are more likely to engage in single banking relationship
    - ⇨ Proxy RATE (<0): The manager does not consider only the interest rate when applying for a credit

Going further (1)

- The quality of banking relationship appears to have an impact on the choice of SMEs to engage in multiple banking

- Econometrics:
  - Treatment of missing data ⇨ imputation of incomplete multivariate data (Rubin 1987)
  - Treatment of reverse causality : reverse causality: past performance and default risk may impact multiple banking

- Extension: refine the analysis of multiple banking with the number of banks and the composition of the pool (see the strong role of the public French bank BPI)

Going further (2)

- The use of multiple banking from both the point of view of the CEOs and the banks

  - 10 interviews with loan officers from 7 French banks (target: 15)

  - 9 interviews with owner-managers of French SMEs (target: 15)

  - To be done: interviews of alternative financing structures: public bank BPI, Institut du mentorat entrepreneurial, réseau Entreprendre and France Active

⇨ First results