MULTIPLE BANKING RELATIONSHIPS AND CREDIT MARKET COMPETITION: WHAT BENEFITS THE FIRM?

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Non technical abstract

Strong theoretical explanations provide ground for the existence and value of single lending relationship or multiple bank relationships with two banks, but less clear are the rationales for multiple banking involving more banks and its measurable benefits. Nevertheless, this is in contrast with the large diffusion of multiple banking relations both in Italy and in many other European countries.

According to the theory, if there is information asymmetry between banks and borrowers (i.e., banks have less information than the borrowers about their actual risk profile), a single bank most efficiently performs the monitoring, screening and renegotiation activities, which result in cheaper financing, greater credit availability for the firm and – more generally - in inter-temporal smoothing of credit conditions. But, a single bank will also have monopoly access to private information about the borrowing firms, resulting in potential hold-up costs (higher rates on new loans and threatening the firm not to extend further credit). A firm can avoid or reduce such costs by establishing a relationship with another bank. In this context, even two lending relationships can restore competition among banks.

However, multiple banking may be costly for the borrowing firm, because it implies significant transaction costs, higher risk of coordination failure in case of distress, and can affect both the cost of capital and the quality of the investment projects.

This paper empirically addresses the question of which are the benefits - in terms of credit availability - for a firm to borrow from multiple banks, and which are the determinants of the choice of number of lending relations. As multiple relationships can be seen as an induced form of banking competition at the firm level that may complement or substitute for banking competition at the market level, the analysis as well assesses the effects of bank market structure both on credit availability and on the multiple banking choice.

More specifically, the econometric tests examine (1) firm-specific characteristics and banking market features affecting the number of lending relationships, (2) whether having more lending relationships translates into a higher or lower probability of being credit tightened, (3) whether the market structure does directly affect the probability of tightening, and (4) whether multiple lending and local credit market competition are alternative or complementary forms of competition influencing credit availability.

The analyses are performed on a unique panel data set resulting from the merger of a time series-cross section of more than 11,000 corporate clients of Banca Intesa for which accounting data is available over the years 1997-2004,

with data on total exposure to the banking system from the Central Credit Register for the entire time period.

The findings suggest that:

- the probability of quantity credit constraint does reflect the firm risk profile (and its changes), and other firm-specific characteristics: highly leveraged, less profitable, more opaque firms are more likely to be credit tightened;
- all else equal, the likelihood of quantity credit tightening is lower for firms having more lending relationships and higher in more concentrated credit markets;
- banking concentration at firm level and at market level seem, therefore, to be detrimental to the firm: both forms of concentration increase the likelihood of quantity credit tightening, but the marginal effect of market concentration is higher. However, firms that engage in multiple relationships benefit from competition among lending banks in terms of a lower probability of credit constraints, though such competition does not fully outweigh the marginal effect of local banking market power;
- larger, growing, riskier, less profitable, more indebted and more opaque firms tend to chose a higher number of banking relationships. The opaqueness of firms' assets has the highest (positive) effect among the firm-specific characteristics: firms with a high share of intangible assets are more difficult to value and monitor, and perceived to be riskier (all else equal) by banks. Furthermore, intangible assets are less liquid and more specific (or less-redeployable). Opaque firms are, therefore, more likely to suffer from credit constraints and, as a consequence, tend to choose multiple lenders to reduce the risk of being rationed.

The results may be interpreted as evidence that firms use multiple banking to reduce the consequences of hold-up and the risk of credit tightening, though they would benefit more from banking market competition.

It is worth highlighting that, as multiple banking is not necessary an inverse measure of lending relationship, the empirical findings cannot be interpreted in contrast with the hypothesis that a single-bank lending relationship may benefit the firms. Furthermore, the analysis does not shed light on how an asymmetric distribution of credit among lending banks affects the firm's borrowing conditions and credit availability, or on the coexistence of a relationship lender with many other transaction lenders.

A literature is developing on the effects of creditor concentration, and further work on the issue should help explain the persistence of multiple banking in Italy and other European markets that are experiencing a new wave of banking market concentration.