Perceived Competence and Credit Access of SMEs: Can Trust Change the Rules of the Game?

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What Affects Credit Access

- Age of the firm;
- Length of the relationship;
- Quality of information provided;
- Concentration of borrowing from few banks;
- ….

All factors of the relationship that reduce information asymmetry.

What about competence and trust?

Competence and Trust

Competence

a set of knowledge, experience, skills and attitudes attached to a person

- Can help credit access because of perceived capability of running business

Trust

the willingness of a party to be vulnerable to another party based on the fact that the other party will perform a particular action, irrespective of the ability to monitor

- Can increase credit access because of increased perceived reliability of the customer

Hypothesis

- **Competence**

  High perceived competence in entrepreneur is positively related to credit gained and negatively related to interest rate charged

  – Competence measured using to 4 items

- **Trust**

  Low trusted firms perceived competence is positively related to overall credit access and negatively related to interest rate charged

  – Trust measured using 7 items

Panel Characteristics

- **Banks**
  - 9 small local community banks (Cooperative Banks)+ 2 national banks in North East Italy;
- **Firms**
  - 535 SMEs in North East Italy (max turnover €46,900,000)

Original database: 535 SMEs – Bank Manager relationships

Results

- **Total Debt**
  - Competence increases the credit gained
  - In low trusted firms competence increases the credit gained / in high trusted firms competence is not significant
- **Interest rate:**
  - Competence reduces the interest rate charged
  - In low trusted firms competence reduces the interest rate / in high trusted firms competence is not significant

Comments

- **Perceived competence**
  - Is relevant irrespective of the quality of the firm:
    - personal competence matters
    - it can be helpful in harsh times when firm's performance worsens
    - banks should develop tools to evaluate personal competence
  - SMEs can be better off accessing more credit and at better condition:
    - Firm's performance can be less adversely affected in harsh times

Comments (cont'd)

- **Trust**
  - Compensates for low perceived competence
    - Trusting relationship matters;
    - Entrepreneurs should develop trusting relationship
  - Entrepreneurs should develop trusting relationship by:
    - Being clearer and responding rapidly to bank requests;
    - Avoiding hiding information
    - Considering the bank more as a partner than an enemy

Comments (cont'd)

- **Bank Financing Structure**
  - Small banks do not constrain credit to current customers in harsh times:
    - Small banks rely on OTH;
    - Small banks are less adversely affected by financial crises;
    - Small banks transfer such a benefit to current customers;
  - OTH can support banks in relationship lending

Conclusion

- **Lending activity**
  - Not just based on facts and figures
  - Competence and Trust smooth the pro-cyclic effect of credit scoring/credit rating methods
- **Bank Financing Strategy**
  - Competence and Trust seems to be easier for banks that rely on OTH than OTD.
  - OTH seems to be more supportive for SMEs (but additional research is needed)

Any question?

Thank you

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