SMEs Relationship Banking: Length, Loyalty, Trust. Do SMEs get something in Return?

Daniel Badulescu

Abstract—Under the difficult access to finance of SMEs, they expect that its relationship with the banks shall constitute a real help to access appropriate financing, at reasonable costs and requirements, given the possibility of mutually beneficial and long lasting relation. The literature, but also the research we have carried on, is centered on such determinants as concentration and the length of the relationship, but at the same time, there is little certainty that banks are responding positively to them. Furthermore, although the trust is considered as being a fundamental element of bank relationship – see the case house bank – SMEs find that the banks finance them looking rather on collaterals and covenants than to trust. Moreover, a positive behavior, such as prompt or advance repayments of loans, doesn't generate any positive feedback from the banks side. All these show a deep un-satisfaction of the SMEs concerning their relationship banking.

Keywords—banks' behavior, relationship banking, SMEs

I. INTRODUCTION

SMEs financing is, both from theoretical and practical view, a matter of first importance, but the analysis of the situation and looking for the best financing are still controversial topics, far from an unanimous decision, for scholars, bankers or other financial suppliers (public or private), or even for the beneficiaries of financing itself-SMEs' managers. The present paper is based on the identification of specific features of the SMEs in the contemporary economy, particularly how they come to financing, trying to answer to a first question as: to what extent available funds are the best for this sector?

Further we plan to get beyond the macroeconomic perspective and focus on more detailed elements, such as the analysis of relationship banking, especially (but not exclusively) in terms of financing. We want to find the answer to the question if SMEs benefit by authentic relationship banking, if the banks understand the real needs of customers both in terms of timeliness or the volume of funding provided, but also as cost, covenants, collaterals etc. Identifying and understanding the key elements defining the SMEs' relationship banking (concentration, length, mutual trust) will give us the possibility to confirm the literature data through our own research based on a survey we carried out on a significant number of SMEs from Bihor County, Romania.

Daniel Badulescu is with the Department of Economics, University of Oradea, 410087 Oradea, Romania (phone: 0040-259-408472; fax: 0040-259-408409; e-mail: dbadulescu@uoradea.ro).

Its general objective is to understand how the SMEs perceive the role of the banks and the banking relationship for the development of their business. Are the SMEs' loyalty and confidence in their banks mutually rewarded by the credit institutions?

Our intention is to find out if, as perceived by SMEs representatives, the loyalty of the SMEs (expressed by the small number - one or maximum two banks), the length of the relationship (reported, *inter alia*, to the "age" of the company) and the expectations regarding the reciprocity in the behavior lead to a mutual and adequate attention and feedback from banks' side and weather SMEs benefit from possible more favorable treatment. The results could be a starting point for a future deepening of this very interesting topic.

II. BRIEF OVERVIEW ON THE SMEs' FINANCING ISSUES IN LITERATURE

Most of the researches regarding the development and the financing of SMEs talk about a lack of funding as a structural feature, often unavoidable, which must be mitigated by measures going beyond the framework of the market, often through state intervention: government lending programs, grants, guarantees or other favorable fiscal measures [1], [2], [3]. The explanations of insufficient, unsuitable or belated funding are obviously based on the features of the demand, regardless of whether these features are interpreted as a "degradation" of desirable characteristics, typically found in large firms, whether they are specific problems that need addressed solutions, adapted to this sector.

According to Cressy and Olofsson [4], even if SMEs should not be interpreted as the scale-down version of large business, they often are analyzed and financed with methods and techniques provided by large companies financing. Based on Cosh and Hughes [5] works, the authors show that the lack of adequate financing for SMEs is caused by their less attractiveness for the funds providers, especially when compared with large firms, due to: a small proportion of fixed assets in total assets, large debt to commercial suppliers, a significant proportion of short-term loans financing fixed assets, heavily reliant on retained profits to fund investments, almost an exclusive bank financing (comparison with venture capital), relatively high debt-equity ratio, and a higher failure rate.

All these features create a risky financial profile, which turn back the banks from a real involvement in the SMEs sector. Moreover, some researchers assert the idea that firms tend to

choose those financing which minimizes the interference in the administration of business and ownership dilution – e.g. the Pecking Order Hypothesis (POH) cited by Cressy and Olofsson [4]. In this way, SMEs tend to add intense use of own funds (retained profit), commercial credit (trade debt) and only after the bank loans and, occasionally, other forms of funding.

According to Beck, Demirgüç-Kunt, and Soledad Martinez [6], the problems of inadequate funding of SMEs may come also from the supply side (*supply side constraints*), particularly related to the way financial institutions work. Financial institutions have a lower interest financing SMEs operating in the third sector, innovative technologies, etc., and the invoked arguments as: the impossibility of building a viable image on repayment capacity [7], the "moral hazard" – lack of bank control over loan utilization [8], [9], banking relationship without history, the precarious financial situation, opaque, non-professional prepared, or the absence of an appropriate collateral [10], [11], [12], [13], [14].

A few main obstacles restricting the supply of SME financing can be pointed out:

- Overlapping between the state institutions and banks (private or not) regarding the SMEs financing, distorting the market mechanisms and influencing competition;

- Excessive collateral requirements, conservative methods in the assets valuation and risk weighting. "With the lack of supplementary financing instruments such as factoring and leasing available to SME that would alleviate the need for collateral, banks' insistence on collateral requirements is a major impediment to financing" [15], [16];

- Insufficient ability of loan officers to understand and analyze the SMEs sector. For a long time, banks have seen the financing of large firms as the most suitable way for a rapid growing of market share and profitability, in terms of a controlled risk. "In contrast, SME loans are seen as less attractive because the banks would occur substantial amount of cost to process the loan, while the absolute dollar returns are much smaller compared to large corporate loan. Applying the same techniques of large corporate evaluation to SME obviously results in many SME not being able to meet bank lending criteria" [15];

- Complicated, expensive and sometimes unnecessary procedures. Like corporate financing, SMEs are requested for detailed business plans, documentation and risk scenarios, commitments in legal forms, together with long credit approval period. When often the repayment period is shorter, financial and time costs to obtain a credit can be substantial, relative to the size of the enterprise, and deter SMEs from banking financing;

- Structural problems – unclear definition of SME, insufficient financing alternatives to bank loans, lack of comprehensive and easy to use SME databases, fragmented banking systems. "Without sufficient resources and economies of scale, the private sector may be unable to introduce any significant and widespread lending programs to effectively meet the requirements of the SME sector" [15].

As conclusion, SMEs cannot meet the requirements of banks, without which banks are unable to lend, "which leads to the perception that SMEs are riskier than large enterprise, and this justifies the need for additional safeguards in the form of collateral, higher interest rates and so forth"[15].

In discrepancy with these "classical" assessments, another recent theory comes to show that, at least in recent times, SMEs financing market is increasingly competitive, far from being saturated, with profitable growth prospects, surpassing the business of niche banks. Thus, all types of banks (large or small, domestic or foreign) see SMEs as a strategic sector, on which they want to aggressively expand their operations [3].

Using their ability to exploit economies of scale and scope, the big and foreign universal banks are the leaders of this process. The network developed by international banks enables them replicating successful experiences in other parts of the world in relation to SMEs, by easily take advantage of the learning effects on increasing the effectiveness of financial intermediation.

However, it appears that these new accounts are valid, in particular, for developed economies - US or United Kingdom- while in continental Europe and especially in developing countries, SMEs remain dependent on financing based on relationship lending [3].

III. RELATIONSHIP BANKING IN SMEs FINANCING AND THE IMPORTANCE OF CONCENTRATION, LENGTH AND TRUST. SOME THEORY

Which is the place of relationship banking in the process of funding and what special features we can find in the case of SMEs financing? In order to answering these questions, we have to start accepting theories about the „ raison d'être" of the banks as mitigating information asymmetry, developed by Diamond [17] and later by Bhattacharya and Thakor [18] or Boot [19], and the key role of relationship banking. According to Boot, relationship banking can be defined as the provision of financial services by a financial intermediary which:"i. invests in obtaining customer-specific information, often proprietary in nature; and ii. evaluates the profitability of these investments through multiple interactions with the same customer over time and/or across products"[19].

Most of researchers have tried to accredit the idea that the banking relationship has a unique nature that individualizes it between other relations existing on the market. Thus, it has the role to solve the free rider problem and to facilitate the re-using of information over time [20], it is flexible, but at the same time it gives the opportunity to exercise some discretion, and allows including subsequent conditions to the principal, such as the collateral or covenants.

These contractual features facilitate implicit long-term contracts and can solve the principal agent and the asymmetric information problems theories. Inside a banking relationship, a borrower is determined to disclose more information than in a standard transactional type interaction (transaction-oriented interaction) and the lender may have sufficient motivations to produce financial information [19].

Other benefits are related to the flexibility and discretion (and thus facilitating the implicit long-term contracts), control of potential conflicts of interest (including in the contract various conditions and extensive commitments), acceptance of the periodical monitoring of the economic performance and the collateral of the borrower (leading to an essential link between lender and debtor), allows the bank's involvement in short-term loans that might not be profitable for the bank in a short perspective, but this relationship can become profitable if it takes quite a lot.

The uniqueness of banking relationship does not transform it in a perfect relationship, risk-free for both parties. Thus, the researchers have identified two essential costs of relationship banking: the soft budget constraint and hold-up problem [18]. The problem of soft budget constraints refers to inconsistent policy of the bank executing the credit contract provision or applying its own rules in the process of screening and financing the customers, starting from this closeness resulting by banking relationship, according to Bolton and Scharfstein [21] or Dewatripont and Maskin [22]. "That is, if renegotiation of a loan agreement is too easy, a borrower may exert insufficient effort in preventing a bad outcome from happening" [19]. Banks have tried to countervail this behavior requiring a higher rank of the claim (e.g. a mortgage attached to loan contract), hoping the threat of collateral execution will exercise a direct and efficient influence in the debtor performance.

Hold-up problem refers to the use of the monopoly of information held by the bank, resulted from the credit relationship, allowing the finance of this client, in the future, in non-competitive terms, as stated by Sharpe [23], Rajan [24] or Boot [19]. Once this treat is understood, the company either will avoid the bank financing, either will decide for more bank relationships, hoping to reduce the information monopoly of a single bank and "transfer" the problem of optimal loan costs by encouraging competition between creditors. There is also a non-financial cost of this "freedom", the relationships with many banks can help to reduce the hold-up problem, but worse credit availability. One explanation is that multiple relationships can reduce the value of information acquisition to any one individual bank – see Thakor [25], or cause too much competition *ex post*, which may discourage lending to "young" firms [19].

For most authors, the SMEs financing is subject to the banks choice between relational lending and transactional lending, an alternative which reveals how banks understand to use internal advantage or specific features of the market [9], [6], [26]. According to Berger and Udell [9], "Transactions lending technologies are primarily based on "hard" quantitative data that may be observed and verified at about the time of the credit origination". This kind of information comes, ex limited, from the financial indicators calculated on the basis of financial statements; information provided by credit bureaus, the national database of payments incidents – as cheques, promissory notes, the Central Credit Registers, collateral registration, valuation reports etc.

The main feature of this type of information resides in the fact that it is relatively easy to obtain and verify and it can serve as a basis for future decisions. Standardized and disseminated through internal channels of communication inside the financial institution, they are used for conceptualizing and standardization of the credit policies, in line with corporate strategies, and being a reliable element in the network management of the large international banks.

On the other hand, the relationship lending "is based significantly on "soft" qualitative information gathered through contact over time with the SME and often with its owner and members of the local community… may include the character and reliability of the SME's owner based on direct contact over time by the institution's loan officer"[9]. To these are added the information stored in the records of the credit institution (frequency of transactions, payment behavior, the number of additional operations carried out by the shareholder or manager in own name – deposits, credit cards) or from variables, intuitive interactions with employees, clients or the suppliers, or with other entities.

Unlike transactional lending, authors insist on the fact that, more often, the credit officer is the holder of such information, proprietary in nature, and these information can be hardly standardized and sent through official channels within financial institution, difficult to be verified by other experts, located in head offices, separate by the customer interaction.

In accordance with the theories mentioned above regarding the demand/supply constraints, the SMEs sector will be neglected by large banks or foreign banks, centered on transactional lending. Instead, small niche banks, mostly domestic/local, valorize the relationship lending, where they have a natural competitive advantage, making it more suitable for the SMEs financing, but their low power hardly support the SMEs sector expanding.

Returning to the specificity of banking relationship in the area of SMEs financing, we find that the literature focuses around two fundamental coordinates. On one hand, we analyze the main determinants of actual banking relationships – and here we call the duration of a bank-borrower relationship (length) and the number of bank relationships (concentration). On the other hand, we approach the concept of housebank as a suggestive example of relationship lending, or the firm's main lender,"with the capacity to generate more and better information than other financial intermediaries" [27].

IV. Reported Research Results on the Actual Dimensions of Relationship Banking in SMEs Financing

According to Hernandez-Canovas and Martınez-Solano [27], the SMEs with longer bank relationships "have enhanced access to loans, but at the same time they incur higher costs for their debt". Lower costs for loans are obtained by the firms working with two banks, but if this limit is exceeded (e.g. three or more banks) this advantage would be reduced. For the above quoted authors, "longer or more concentrated bank relationships are not always beneficial for SMEs operating within a continental European bank-based system" [27].

In market terms, the bank conducting relations with a company is interested to use and to increase the information asymmetry between his client and other banks (competitors) on the market, anticipating that banks interested in this customer will spend much more for getting information about itself, about its exposure, type of relationship or other contractual provisions, rather than spending the bank which granted and monitors the loan [26].

Furthermore, the relationship between the lending bank and the client contributes to mitigating the consequences of adverse selection and information asymmetries; the bank expects an increase of the SMEs costs if it would like to re-financing its projects to another bank, reducing the possibility that the company easy close the relationship.

For some scholars [27], the situation gives the bank a considerable power in relation with the customer, the bank may force uncompetitive conditions, a kind of monopoly. This idea is not accepted by all researchers, considering those costs rather being a consequence of the need to cover the expenditure made by the bank during the search, screening and analysis *ex ante*, and less an abusive attempt to increase revenue per a customer almost "trapped" [28].

In a market dominated by new customers, small businesses, with unconvincing financial data - as SMEs market, banks will often count considerable initial expense, whose recovery on the existing portfolio is a problem with few solutions.

An exclusive relationship with a bank generates three major effects: the cost of the loan, the availability of bank for new loans and, finally, the financing conditions. Establishing a close link between the exclusivity of the relationship lending and the cost of the loan is not unanimous, but rather contradictory. For example, some studies have found that in many European countries, small companies working with one or maximum two banks, should pay higher costs for their loans; in contrast, in the U.S., the relationship based on length and concentration was rewarded with the lower loan costs [27].

Researchers have shown an increase in the availability of the bank to support the firm in new projects, to provide a higher percentage of co-financing [27], but instead firms involved in an exclusive relationship lending must reward the bank by accepting more severe requirements on the control of the activity and offering the best collaterals [29], [30], etc. Finally, the financing conditions and, in particular, the collateral requirements show that the firms with loans to one or maximum two banks and the firms choosing to renew the credit lines to the same bank obtain somewhat better lending conditions; the bank doesn't ask additional guarantees, or certain guarantees could be released under pledge [31], [27] etc.

As a conclusion, we can say that in most European countries, a small number of bank relationships and a long term company-bank relation could provide to SMEs certain advantages, but at the same time, banks can exercise certain power, in particular by charging higher interest payments.

In the same time, reducing the intensity of the relationship by searching for other options of financing may lead to loans at more advantageous prices, but narrows the chances of other alternatives.

According to Elsas and Krahnen [32] quoted by Hernandez-Canovas and Martinez-Solano [27], the existence of an authentic lending relationship is not dependent on the length or the number of bank relationships, "but rather on the bank's participation in the firm's financing, on its capacity to generate information, and on its commitment to aid the firm when it experiences financial difficulties. Financial intermediaries complying with these requisites are known as housebanks and are regarded as the firm's main lender, with the capacity to generate more and better information than the other financial intermediaries" [27], for borrowers, the role of housebank being just to replace the funds withdrawn by other financial or non-financial creditors.

A second partial conclusion derived from the works of Hernandez-Canovas and Martinez-Solano shows that housebanking – based on the existence of trust between the company and the bank – improves access to finance and reduce the cost of the loan, without, however, ignoring the probability of supplementary and valuable collateral. Thus, "a relationship based on trust is a better strategy to improve SME access to finance than establishing longer or more concentrated relationships" [27].

This option does not ignore of the traditional indicators (length and concentration) but rather it is an alternative where information asymmetry is counteracted by other elements in order to improve access to finance and, at the same time, reduce the cost of the loan.

V. OUR RESEARCH: METHODOLOGY, DATA AND COMPARABILITY AT THE NATIONAL LEVEL

The research we carried out is part of a wider project investigating some relevant issues on the relationship between SMEs and banks, such as: the role of the main determinants of the banking relationship, the use of credit products, the type of bank (domestic, foreign, large, small, local etc.) serving the SMEs' interests in the best way, etc. Data collection was focused on gathering information mainly from SMEs in Bihor county, Romania. The survey was carried out during March-May 2011 and the following rules and objectives were observed:

-prior to the data collection itself, the potential portfolio was selected and verified on the web page of the Ministry of Public Finance [33], in order to:

a. remove, *ex ante*, the firms with no activity, or without reported financial statements, suspended, etc.;

b. check the potential firms in terms of including in SMEs category (turnover less than 50 million Euros and up to 250 employees);

c. remove the companies working in financial intermediation (mutual funds and other financial entities, financial leasing, other lending activities, insurance and

reinsurance of pension funds, insurance agents and brokers, credit, pawn houses etc), and, as far as possible, the firms belonging to groups that, if consolidated, may exceed SMEs threshold concerning number of employees/turnover, etc.

- the web page of the Public Finance Ministry [33] also served to obtain data such as age of the company, last turnover (2010), the profit (2010), the average number of employees;

-the questionnaires were addressed to the executive manager of the company.

As a result of the survey, the primary dataset covered 611 companies. After removing the questionnaires containing errors, the resulted valid sample consists 595 firms (a statistical error of 2.62% and a confidence level of 95%).

Although almost all data were collected from Bihor county (95%) and to a small extent from the neighboring counties of Arad and Satu Mare (all from Western and North-Western Romania), there are no special features, different economic laws or regulations for this area, or special behaviors of banks, government agencies relating to SMEs, compared to other regions of Romania, or anything else that could influence the results.

Moreover, based on data issued by the National Bank of Romania [34] and main commercial banks [35], we found a regular and normal position of the region (compared to the national average) for a series of bank indicators, such as: number of bank units, number of inhabitants per bank branch, volume of loans (in national currency – RON – and foreign currency) granted to companies, the volume of deposits, current accounts and so on.

Thus, in terms of number of branches, the data of the National Bank of Romania and commercial banks for year 2010 indicates an approx. number of 5,700 bank units, i.e. a banking density of 25.5 units per 100,000 inhabitants [36]. As to the Bihor County, at the end of 2010, there are 143 bank units (2.49% of total banking establishments in Romania), a banking density of 22.52 units per 100,000 inhabitants [35], a position close to the national average.

For the main bank indicators (loans, deposits) we can also notice a position close to the national average (excluding the capital Bucharest), the only exception being the loans granted in foreign currency, where the figures for Bihor county are over 2.5 times higher than the national average (also, excluding Bucharest).

VI. THE QUESTIONNAIRE: CONTENT AND HYPOTHESIS / ASSUMPTIONS

The objectives of the research, as stated in the content of the questionnaire, were partly inspired by Hernandez-Canovas and Martınez-Solano's paper [27] referring to some basic elements that define the banking relationship and its effects in SMEs perception (use of banking relationship, determinants, concentration, confidence, trust, reciprocity), collateral issues. Our questionnaire also contained some additional research items, concerning the lenders' specificity and ownership: local banks vs. foreign banks, small banks vs. large banks etc.,

obviously in terms of relationship banking and financing availability of SMEs.

According to the objective of this paper, we present and discuss here a first set of four questions focused on the way SMEs perceive the banks behavior concerning the main determinants of relationship banking (as discussed in Section IV): concentration (number of bank relationship), length (loyalty) of relationship banking, reciprocity (the bank's response to a co-operative behavior of SMEs).

The questionnaire focused on the following questions/issues that were analyzed both individually and correlated:

1. "Indicate the number of banks you work with" (excluding accounts with non-significant balance and/or no operations in the last 3/6 months);
2. "on a scale from 1 (strongly disagree) to 5 (strongly agree), evaluate the following statement: "When granted a credit to a SME, confidence/trust in the company's shareholders/managers is the most important argument for the bank" (more important than the collateral, scoring, the length of relationship, etc.)";
3. "indicate how many times" (the frequency) loan repayments in time or in advance determined more favorable treatments from the bank side" (e.g. lower cost for next loans, improved business conditions, lower collateral requirements, etc.);
4. "specify since how many years you have got the longest active relationship with a bank".

In order to test the correlations we applied chi square method (χ^2) for the following correlations:

- the relationship between the number of SMEs-bank relationships and the trust of the bank in the company's representatives (shareholders/managers) (a)

- the relationship between the longest relationship of a company with a bank and the more favorable treatment from the bank side in case of in-time or in advance re-payments of a loan (b).

The results obtained were as follows:

For (a), we found $\chi^2_{calc} = 340.51 > \chi^2_{t(0.95;4)} = 9.48$

that is: there is a strong correlation between the number of SMEs – bank relationships and the confidence that the bank has in the shareholders/managers of the company, both in the sample, and in the total population.

For (b), we found $\chi^2_{calc} = 755.65 > \chi^2_{t(0.95;12)} = 21.02$,

So we can state that between the variables "the longest relationship of a company with a bank" and "the more favorable treatment from the bank side in case of in-time or in advance re-payments of loan" there is a strong correlation, both in the sample and in the total population.

VII. DISCUSSION AND RESULTS

Concerning the number of banks companies work with, the recorded answers were as follows (Fig. 1): approximately 42% of the total (i.e. 247) respondents declared they are working with a single bank, 36% (i.e. 216 respondents) work with two

banks, 15% (92 respondents) work with three banks. The SMEs working with 4, 5 or more banks cumulated only 7% of the total responses. We notice, therefore, a high percentage of customers preferring to work with one, or maximum two banks, which shows both a significant concentration of relationship banking, a SMEs representatives fidelity to the selected bank, both, in terms of our analysis, an element that facilitate the analyze for the next steps, as a dominant segment in our sample. This assessment is highlighted by the weighted average of responses, indicating a number of 1.41 banking relationships per firm.
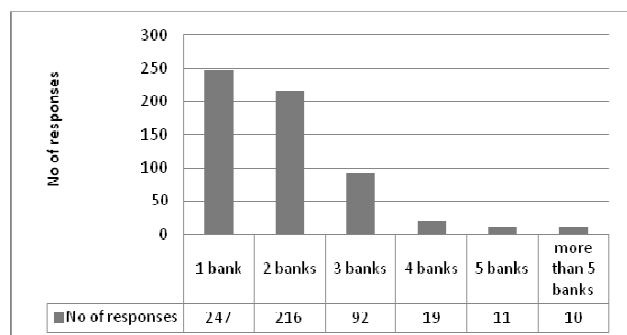
Fig. 1 Number of banking relationships (number of companies working with one bank, two banks, three banks, etc., respectively)
Source: own calculations, based on the dataset

The next question, e.g. "When granting a loan to an SME, the confidence in the company's shareholders/managers is the most important argument for the bank (more important than the collaterals, scoring, length of relationship, etc.)", we notice that almost one-third of the respondents (i.e. 181 respondents) declared a strongly disagree, followed by a percentage of 29% of respondents who are more likely to disagree (i.e. 172 respondents) (see Fig. 2). Neutral answers are about a quarter of the total (i.e. 145 respondents), less than 10% (i.e. 60 respondents) are more likely to agree with this claim, and only 6% strongly agree. The average score of responses is 2.32, indicating, on the scale going from 1 (strongly disagree) to 5 (strongly agree), a general disagreement with the statement.

The analysis of the third question – the longest relationship with a bank (expressed in years) shows a wide distribution of the perceptions (Fig. 3). An important part of respondents are involved in 3, 4, or 5 years banking relations (cumulated 41%, i.e. 243 respondents), and around one third of the total respondents have 8 or more years relations with a bank. As resulted from the answers, the banking relationship has an average duration around 5.4 years. This figure indicate that the lenght of the banking relationship of SMEs in Romania is acceptable, taking into account the economic context and the relatively history of the market economy. More specific, the legal and organizational framework of the private initiative in the Romanian economy is around 22 years old, and the methodological definition of SMEs is even more recent (not to ignore the fact that the average life of a SME in Romania is about 6 years old).
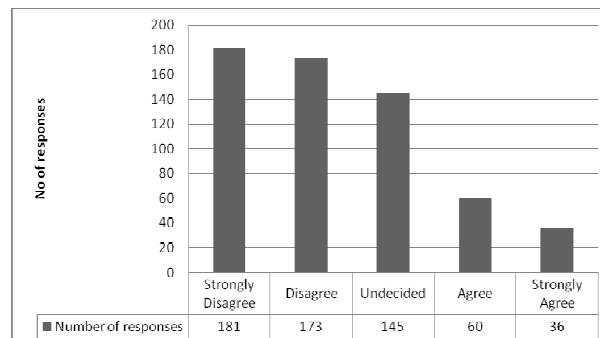

Fig. 2 Agreement/disagreement with the statement: "Bank has full confidence in SMEs' owner/managers when granting a loan"
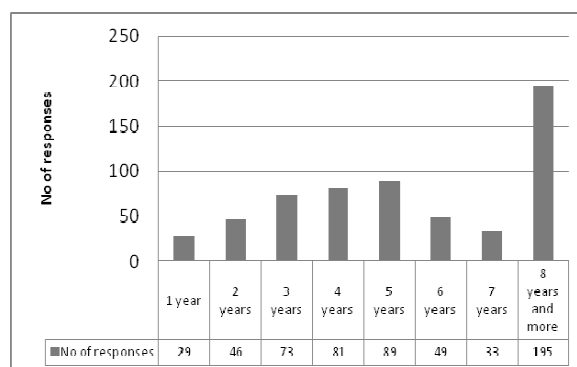Source: own calculations, based on the dataset

Fig. 3 The longest bank relationship (the maximum duration of a company's relationship with a bank)
Source: own calculations, based on the dataset

Finally, the fourth question reffered to the fact that in-time or in advance loan re-payments have led to more favorable treatments from the bank (Fig. 4). The results indicate that: 41% of respondents (i.e. 243 respondents) consider that only occasionally the bank responds with a favorable treatment; 35% of the respondents (i.e. 210 respondents) believe that they have never received a more favorable treatment from the bank; a much lower percentage – 18% of the respondents (i.e. 107 respondents) consider that they often receive a favorable treatment, and about 6% indicate that, when duties are paid in-time or in advance, they always receive a favorable treatment from the bank. In the scale going from 1 (almost always) to 4 (never), the average of 3.055 reveals a clear negative perception: there is a lower feedback of reciprocity from the bank side in case of in-time or in advance payment in lending duties.
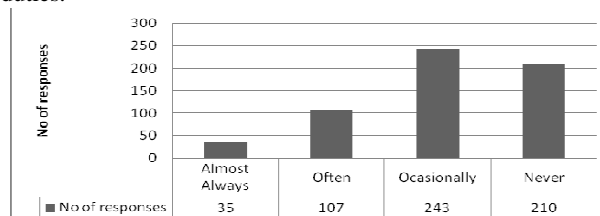

Fig. 4 Frequency (how often) in-time or in advance payments led to favorable treatments from banks
Source: own calculations, based on the dataset

Going deeper in the analysis, we focused on the segment of SMEs working with one or maximum two banks and its position towards the questions related to: the confidence banks has in the company's shareholders/managers when granting a credit, the length of the longest relationship with the bank, and the more favorable treatment possibly received from the bank in case of in-time or in advance loan re-payments.

In this respect, for the whole sample, the perception of the disagreement for bank's confidence in SME representative cumulated 59%; in the case of SMEs involved in relations with (working with) one or two banks, the perception of the disagreement raises to 63%!

About the correlation with the longest relationship with a bank, results didn't show significant differences in the timeframes analyzed, which can induce the idea that the concentration of banking relationship is not positively correlated with the duration of the relationship.

Finally, expectations of a favorable response of the Bank to SMEs positive behaviors in the context of lending relations are relatively similar. However, that indicates that SMEs that are aware of their loyalty to the bank, haven't seen any acts of recognition or reward. Our expectations that the fidelity of the SMEs expressed by the concentration in the number of the banking relationship (e.g. SMEs working with an exclusive bank or with maximum two banks), and the positive behaviors in the credit relationship will generate both satisfaction for SMEs, and recognition from their banks are not confirmed.

VIII. CONCLUSION

Lenders involvement to meet the financial needs of the SMEs is not always at the expected level, and there are various reasons (both objective and subjective), features (both structural and internal), and both demand and supply side constraints. SMEs cannot meet the requirements of the banks and the general perception is that SMEs are riskier than large firms, so to obtain the necessary funds the SMEs have to agree to the banks conditions and safeguards in the form of collateral, higher interest rates, shorter repayment periods, and circumspection for SMEs' future plans and so forth.

Could relationship banking improve these findings? Analyzing the literature we have focused on several key determinants of relationship banking, particularly the length (duration), concentration (the number of banks they work with) and confidence.

From the bank's point of view, both length and concentration work against informational asymmetry and hold-up problem, and allow the bank to invest resources in analysis and financing of a customer; in the same time, here are perverse effects such as moral hazard, excessive closeness to customer etc.

From the customer's point of view, influenced by the possible informational capturing and extraction of monopoly surplus, the outcomes of stability and loyalty to the bank are divalent: while the cost of financing does not seem to improve, there may be some advantages, such as the availability of the bank for future projects or loans with more acceptable conditions. We can say that a small number of bank relationships and a long term relation with them could provide to SMEs certain advantages, but at the same time, banks could exercise certain power, particularly by charging higher interest payments. Alternatively, reducing the intensity of the relationship by looking for others alternative of financing may lead to more advantageous loan prices, but narrows the chances of other options.

In the second part of the paper we have tested these elements (length, concentration, trust) in a survey, carried out on a significant number of SMEs from Western part of Romania. We found that most companies are working with one or two banks, and the maximum duration of relationship banking is relatively high. However, the response of banks is considered by SMEs representatives as being inappropriate. Thus, more than half of SMEs representatives consider the bank doesn't show a confidence in SMEs representatives (shareholders, managers) when granting a loan, giving more valuations to the formal aspects of the contract, to the collaterals etc.

Furthermore, the loyalty, honesty, and performing (even in advance) of their obligations under the loan contract do not generate an equivalent feedback from bank: about three quarters of the respondents never or rarely noticed this feedback. Deepening the analysis by interpreting the responses of those who are working only with one or maximum two banks, we found that expectations regarding the bank confidence in SMEs are lower, and the most loyal customers are, at the same time, the most disappointed by the bank behavior. As all-in-all conclusion we found that, as SMEs are aware of their loyalty to the bank, they haven't seen any positive feedback from banks' side; the concentration, the length and positive behaviors in the (credit) relationship banking will not generate a significant recognition from their bank and, consequently, there is a lower satisfaction of SMEs in their banking relationship.

REFERENCES

[1] M. Schiffer, B. Weder, *Firm size and the business environment: Worldwide survey results.* International Finance Corporation Discussion Paper 43, 2001.
[2] T. Beck, A. Demirgüç-Kunt and V. Maksimovic, V., "Financial and legal constraints to firm growth: Does firm size matter?", in *Journal of Finance* vol. 60, pp. 137–177, 2005.
[3] A. de la Torre, M.S. Martínez Pería, and S.L. Schmukler, "Bank involvement with SMEs: Beyond relationship lending", *Journal of Banking and Finance*, vol. 34, pp. 2280–2293, 2010.
[4] R. Cressy and C. Olofsson, "European SME Financing: An Overview", in *Small Business Economics* 9, pp. 87-96, 1997.

[5] A. Cosh and A. Hughes, "Size, Financial Structure and Profitability", in: A. Hughes and D. Storey (eds.), *Financing Small Firms*, London: Routledge, 1994, pp. 64–111.

[6] Th. Beck, A. Demirgüç-Kunt and Maria Soledad Martinez Peria, *Foreign banks and small and medium enterprises: Are they really estranged?*, 2010, http://www.voxeu.org/index.php?q=node/4828.

[7] A.N. Berger et al., *Bank Concentration and Competition: An Evolution in the Making*, 2003, http://siteresources.worldbank.org/DEC/Resources/84797-1114437274304/jmcb_intro_final.pdf.

[8] A. Berger and G. Udell, "The economics of small business finance: The roles of private equity and debt markets in the financial growth cycle", in *Journal of Banking and Finance* vol. 22, pp. 613–673, 1998.

[9] A. Berger and G. Udell, "A More Complete Conceptual Framework for SME Finance", *World Bank Conference on Small and Medium Enterprises: Overcoming Growth Constraints*, pp. 1-37, 2004, http://siteresources.worldbank.org/INTFR/Resources/475459-1107891190953/661910-1108584820141/Financing_Framework_berger_udell.pdf.

[10] OECD: *Financing newly emerging private enterprise in transition economies*, OECD Publication Services, 2000.

[11] OECD: *Promoting entrepreneurship and innovative SMEs in a global economy: Towards a more responsible and inclusive globalization*, 2004.

[12] O. Toivanen and R. Cressy, "Lazy Entrepreneurs or Dominant Banks? An Empirical Analysis of the Market for SME Loans in the UK", 2000, EFA 2002 Berlin Meetings Presented Paper; Warwick Business School SME Centre Working Paper; Cass Business School Research Paper, http://ssrn.com/abstract=300060 or doi:10.2139/ssrn.300060.

[13] D. Badulescu and Alina Badulescu, "Financial Constraints Facing SMEs: Some Theory and Evidence", in *Metalurgia International* vol. XV, Special Issue no. 8, 2010.

[14] D. Badulescu, "SMEs Financing: the Extent of Need and the Responses of Different Credit Structures", in Theoretical and Applied Economy, vol. XVII No. 7(548), pp. 22-35, 2010, http://ideas.repec.org/a/agr/journl/v7(548)y2010i7(548)p25-36.html.

[15] RAM Consultancy Services Sdn Bhd, *SMEe Access to Financing: Addressing the Supply Side of SME Financing*, REPSF Project No. 04/003, pp. 1-28, July 2005, http://www.aseansec.org/aadcp/repsf/docs/04-003-FinalMainReport.pdf.

[16] D. Badulescu and Alina Badulescu, "SMEs Financing Needs and the Relationship Lending Perspective. Theoretical Considerations and Empirical Evidence", in *Metalurgia International* vol. III, 2012.

[17] D. Diamond, "Financial intermediation and delegated monitoring", *Review of Economic Studies* vol. 51, pp. 393–414, 1984.

[18] S. Bhattacharaya and A.V.Thakor, "Contemporary banking theory", in *Journal of Financial Intermediation*, vol. 3, pp. 2–50, 1993.

[19] A.W.A. Boot, "Relationship Banking: What Do We Know?", in *Journal of Financial Intermediation* vol. 9, pp. 7–25, 2000, doi:10.1006/jfin.2000.0282, available online at http://www.idealibrary.com.

[20] S. Grossman and O. Hart, "Takeover bids, the free-rider problem, and the theory of the corporation", *The Bell Journal of Economics*, vol. 11, pp. 42–64, 1980.

[21] P. Bolton and D.S. Scharfstein, "Optimal debt structure and the number of creditors", in *The Journal of Political Economy*, Volume 104, Issue 1, pp. 1-25, Feb. 1996.

[22] M. Dewatripont and E. Maskin, "Credit and efficiency in centralized and decentralized economies", in *Review of Economic Studies*, vol. 62, pp. 541-555, 1995.

[23] S. Sharpe, "Asymmetric information, bank lending and implicit contracts: A stylized model of customer relationships", in *Journal of Finance* vol. 45, pp. 1069–1087, 1990.

[24] R. Rajan, "Insiders and outsiders: The choice between relationship and arms length debt", in *Journal of Finance* vol. 47, pp. 1367–1400, 1992.

[25] A. Thakor, "Capital requirements, monetary policy and aggregate bank lending: Theory and empirical evidence", in *Journal of Finance* vol. 51, pp. 279–324, 1996.

[26] A.N. Berger and G.F. Udell, "Universal Banking and the Future of Small Business Lending", in: Anthony Saunders and Ingo Walter (eds), *Financial System Design: The Case for Universal Banking*, Homewood: Irwin Publishing, 1996.

[27] G. Hernandez-Canovas and P. Martınez-Solano, "Relationship lending and SME financing in the continental European bank-based system", in *Small Business Economics*, vol. 34, pp. 465–482, 2010.

[28] M. Petersen and R. Rajan, "The effect of credit market competition on lending relationships", in *Quarterly Journal of Economics*, vol. 110, pp. 406–443, 1995.

[29] G. Jiménez and J. Saurina, J., *Collateral, Type of Lender and Relationship Banking as Determinants of Credit Risk*, Banco de Espana, Madrid, 2004.

[30] A. Argentiero, *Some New Evidence on the Role of Collateral: Lazy Banks or Diligent Banks?*, Institute for Studies and Economic Analyses, Rome, 2009, http://fileserver.carloalberto.org/id2009/argentiero.pdf.

[31] D. Harhoff and T. Körting, "Lending relationships in Germany: empirical evidence from survey data", in *Journal of Banking and Finance* vol. 22, 1998.

[32] R. Elsas and J. Krahnen, "Is relationship lending special? Evidence from credit-file data in Germany", in *Journal of Banking and Finance* vol. 22 (10-11), pp. 1283–1316, 1998.

[33] Ministerul Finanţelor Publice, *Agenţi economici şi instituţii publice - date de identificare, informaţii fiscale, bilanţuri (date la 31.12.2010)/ The Ministry of Public Finance, Economic Agents and Public Institutions-identification data, fiscal information, balance sheets, tax (at 31.12.2010)*, http://www.mfinante.ro/pjuridice.html?pagina=domenii

[34] National Bank of Romania, *Financial stability report*, 2010, http://www.bnr.ro/DocumentInformation.aspx?idDocument=9477&idInfoClass=6877

[35] Websites of the main commercial banks in Romania: www.bcr.ro, www.brd.ro, www.raiffeisen.ro, http://www.bancatransilvania.ro/, etc.

[36] National Bank of Romania, *Annual Report 2010*, http://www.bnr.ro/DocumentInformation.aspx?idDocument=11513&idInfoClass=6874

Daniel Badulescu was born in Craiova, Romania, in 1967. He graduated the Academy of Economic Studies in Bucharest (1992) and earned his PhD at University of Oradea (2007). He is now Associate Professor of Banking and Business Economics and Finance at the University of Oradea, Romania.

He has written numerous journal articles and books. His research interests include Banking, Business Finance, etc.