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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