

Bank relationships matter

May 18 2010

In the current economic climate, many small businesses face difficulties when applying for loans. However, the process may vary depending on the business' previous relationships with financial institutions. In a recent study, Tansel Yilmazer, assistant professor in the MU Department of Personal Financial Planning, found that relationships between small businesses and financial institutions affect both the borrower's decision to apply for a loan when in need, and whether the institution approves the loan. The impact of relationships on loan rates, however, varies with the economic climate.

"The findings suggest that when in a recession, such as now, when loan rates are already low, good relationships between the business and the financial institution do not really matter," said Yilmazer. "However, when in an economic expansion, positive relationships allow loan officers to lower the loan rate."

Researchers also found that small businesses are more likely to apply for loans, and [financial institutions](#) are more likely to grant [loans](#) if there is an existing relationship between the two. These results are unaffected by the [economic climate](#) –and exist during both recession and expansion years. Recently, "communication" was added to a list of criteria that lenders use to determine whether or not to grant a loan. According to Yilmazer, this further demonstrates the importance of relationships.

"Relationships are important for both businesses in need of a loan and financial institutions that are trying to attract less risky businesses," Yilmazer said. "Relationships between people capture more information

than computer models."

Previous research had shown conflicting results regarding whether or not relationships affect the loan rate set by lenders. The study was conducted using data collected from the 1993, 1998 and 2003 Survey of Small Business Finances, which is funded by the Federal Reserve Board. Of these years, 1993 and 2003 were both [recession](#) years, and 1998 was an expansion year.

More information: The study, "A Multistage Model of Loans and Role Relationships," was co-authored with Sugato Chakravarty from Purdue University and was published in Financial Management last December.

Provided by University of Missouri-Columbia

Citation: Bank relationships matter (2010, May 18) retrieved 25 April 2024 from <https://phys.org/news/2010-05-bank-relationships.html>

<p>This document is subject to copyright. Apart from any fair dealing for the purpose of private study or research, no part may be reproduced without the written permission. The content is provided for information purposes only.</p>
--