

# SMEs view on German banks credit process

## EMPIRICAL EVIDENCE ON THE OUTSIDE PERCEPTION OF THE CREDIT PROCESS

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### Introduction

Customer advisors spend only half of their working day in direct contact with the customer. This was one finding of our 2004 empirical survey with the German Top 500 banks on credit process excellence. Significant potential for optimization of the credit process was revealed: Only 60% of banks' SME clients were profitable after operating, risk, and capital cost. As a response banks have to increase their earnings by means of risk-adjusted credit pricing and cross-selling.

Against this background we conducted an empirical survey with 2,102 German SMEs on credit processes. We wanted to compare the 2004 results with the outside perception of the credit process. By evaluating the SMEs view on advice given by banks, the rating process, service, and credit availability, further optimization potential can be identified. We address the "Hausbank" (house bank)-relationship between SME and bank as well as the acceptance of likely future scenarios of the credit process.

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### Data Sample

The survey "Kreditprozesse aus Sicht des Mittelstands" (SMEs view on credit processes) was carried out in August of 2005 in cooperation with the Frankfurt am Main chamber of commerce and industry. A total of 187 SMEs from Rhein-Main area as well as the State of Rhineland-Palatinate and the State of Saarland provided information about their perception of German banks credit process.

### Findings

*Hausbank-relationship* – SMEs on average have 2.8 bank relationships but can always identify one Hausbank as their prime lender. On average, 50% of total credit volume is held at the Hausbank. A closer Hausbank-relationship correlates with a higher credit volume being held at the Hausbank.

The majority (62%) of SMEs is owner-operated. 40% of owners are also customers of their enterprises Hausbank in private financial matters. This underlines the close Hausbank-SME relationship.

*Value added* – Do SMEs trust their customer advisors? We found that the majority of SMEs (70.5%) have a trust based relationship with their key account manager. 45.6% of SMEs see the value-added of their Hausbank-relationship in advice received, particularly advise about the rating process.

Another value added of a Hausbank-relationship is the support of the enterprise in case of temporary financial problems. 81.4% of SMEs acknowledge an information lead of their Hausbank compared to other banks as well as to the market. Regression analysis confirms a relationship between this information lead and expected liquidity insurance.

*Credit conditions* – 35.5% of the respondents have better credit conditions at their Hausbank. In contrast accept 29.5% of

SMEs a premium on credit conditions at their Hausbank vis-à-vis other banks. Figure 1 illustrates that an average premium of 0.34% (median: 0.25%) on the credit conditions is accepted.

Declaration of value added within the Hausbank-relationship correlates with the perception of better credit conditions at the Hausbank. One can draw the conclusion that the value added within a Hausbank-relationship is included in the overall perception of credit conditions.

*Rating process* – Did knowledge of the rating process improve significantly in the past years? The rating is the determining factor for credit decisions as well as credit conditions. Figure 2 points out that only every second SME (50.9%) is familiar with the rating at their Hausbank. Even less (42%) know how

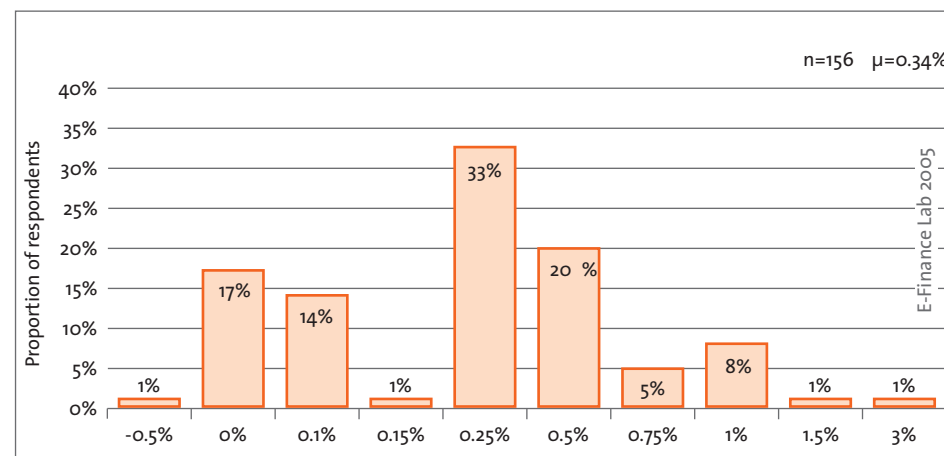


Figure 1: Average accepted additional charge on credit conditions at the Hausbank.

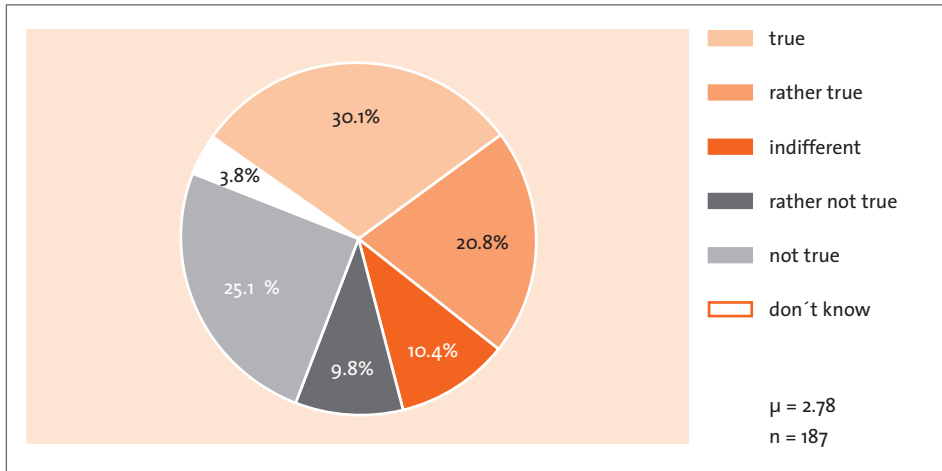


Figure 2: "Our enterprise is familiar with the internal rating of our Hausbank".

their rating is calculated. This corresponds to current results of other German SME questionnaires. This result is quite striking considering that the topic has been present for several years now.

A necessity for advice about the rating process can be inferred. Within the sample only 35.2% of SMEs received advice concerning the rating process, and up to now 19.1% took steps to improve the rating in cooperation with the Hausbank. Receiving rating advisory correlates with a positive overall view of the rating process.

**Credit process** – The credit process from application to cash disbursement on average takes 28 days. This is in sharp contrast to our 2004 survey when the banks declared to process a credit within 10.8 days. One

possible reason for this deviation could be lack of communication about the requirements of a credit application: 46.9% of SME did not get a list of all necessary documents when applying for credit. Another reason revealed in our 2004 survey is related to time consuming media conversions: Every second bank stated that data must be manually reentered into the systems during the credit process.

**Access to credit** – For more than a quarter of SMEs within the sample (27.3%) credit is hardly available. Credit availability is significantly worse for SME with a Hausbank-relationship to a Sparkasse institution, and significantly better for SME with a private bank.

The results presented in figure 3 "credit availability" support our 2004 survey. As an

instrument for risk management, 68% of banks indicated a refusal of credit to certain customer groups, whereas 29.7% of banks stated to focus on the acquisition of specific customer groups.

**Credit process: Future scenarios**

A likely future scenario of the credit process is the increased use of external rating agencies by banks. 36.8% of SMEs within the sample are willing to obtain an external rating, whereas only 5.4% were actually in contact with an external rating agency.

Another scenario is an automated link that allows the Hausbank access to certain financial data of the SME (Value Chain Crossing, VCC). 31.7% of SMEs would agree to such a cooperation, and 21.8% assess VCC as beneficial.

**Conclusion**

Evaluation of the outside perception of the credit process validates the potential for optimization shown in our 2004 survey of German Top 500 banks. One key to further process optimization lies with the customer advisor, who typically spends only half of his day in direct contact with the customer. Customer satisfaction as well as the perception of a value added within the Hausbank-relationship are mainly driven by the customer advisor. Through the automation of the rating process we expect the duration as well as the cost of the credit process to decline considerably. Integrating the credit process in a centralised IT platform furthermore reduces unnecessary media conversions.

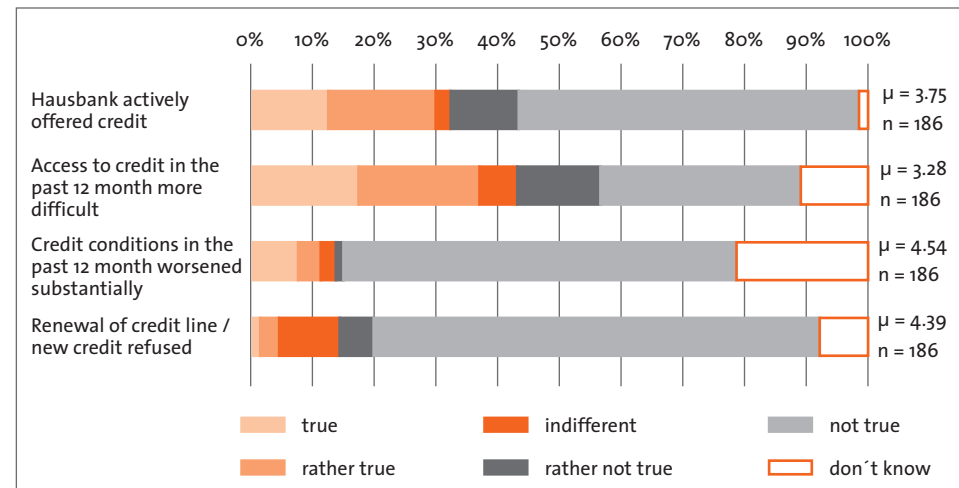


Figure 3: Credit availability