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Sustainable Architecture for Finance in Europe (<https://safe-frankfurt.de/>)

SAFE Finance Blog

Good Relationships Help to Get Loans

02/08/2017

Entrepreneurs receive more and longer lending if they know a banker from the same elite service club branch / Negative effects on credit allocation in Germany



Elite service and charity clubs aim to open up valuable contacts and networks to their members. However, club contacts between bankers and entrepreneurs and ensuing credit relations turn out to have negative economic effects. A new study by Rainer Haselmann (<https://safe-frankfurt.de/de/forschung/wissenschaftler/details/showauthor/313-haselmann.html>) (Goethe University Frankfurt and Research Center SAFE), David Schoenherr (Princeton University) and Vikrant Vig (London

Business School), which is forthcoming in the Journal of Political Economy, shows that firms receive more loans from a bank if the managers of both entities are members of the same elite service club. These in-group lending relationships tend to be significantly less profitable for the bank compared to out-group

lending relationships.

“We were quite surprised by the enormous magnitude of our findings,” states Rainer Haselmann in an interview for the latest edition of the SAFE Newsletter (<https://scnem.com/a.php?sid=ad3ad.2a4ors2,f=5,n=ad3ad.2a4ors2,p=1,artref=6392435>) (Q1 2017). “According to our data, a firm experiences a 37 percentage points (pp) higher increase in lending from an in-group bank, after their senior officials joined the same club branch, compared to lending from other banks.” At the same time, the in-group bank generates a 4.4 pp lower return on in-group loans compared to out-group loans in the same city. State-owned banks engage more actively in in-group lending than private banks.

According to Rainer Haselmann, the lower returns on in group-loans is due to the fact that in-group banks continue to lend to in-group firms when these firms’ business is turning bad and when out-group banks have already started to withdraw lending. “Apparently, bank managers feel obliged to their club mates and disregard business facts for too long,” explains Haselmann. The authors could not find any evidence for the assumption that in group-firms are offered special conditions, such as lower interest rates.

The study also revealed that, in general, firms do not use the extra financing to make new investments but rather to increase payments to the shareholders or, in small firms, to the CEO. “This implies that, in a broader context, in-group lending as a consequence of elite networks results in an inefficient allocation of resources. A developed economy like Germany would likely experience a higher overall economic growth rate if bank officials would not engage in elite networks,” concludes Haselmann.

The research paper is based on member data of 400 service club branches throughout Germany as well as contract-level financial data.


Haselmann, R., Schoenherr, D. and V. Vig (2016): "Rent-Seeking in Elite Networks", forthcoming in the Journal of Political Economy and available as SAFE Working Paper No. 132 (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2911062).

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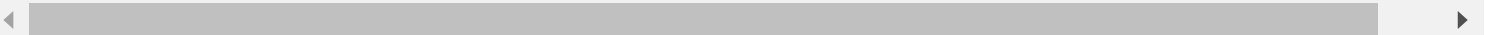
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