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Informational Asymmetry and the Bank/Company Relationship: A Deep Hiatus

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Abstract

In a bank / company report, the level of information and understanding of what is happening in the company is inevitably incomparable between a banker and a company executive. This difference largely explains the difference of opinion between the two parties. After a long hiatus, research has massively focused on explaining the different aspects of the relationship between the bank and the company. Indeed, the theory of financial intermediation has evolved considerably in recent years following the integration of information asymmetry problems. Banks have particular expertise in valuing businesses, making them more suitable than other creditors to select and control borrowers. Such superiority of banks is attributed to the Bank-Enterprise relationship, which is now a crucial element in the elimination of asymmetric information problems and the reduction of the scale of risk. This study is motivated by the lack of consensus on the role of the Bank - Enterprise relationship in disclosing information. More specifically, the major concern of this paper is to bring out, through the literature, the impact of the bank / enterprise relationship on information asymmetry.

Keywords: Client relationship management, Bank/enterprise relationship, Informational asymmetry.

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Introduction

Strategic marketing is the essential tool to accomplish the assigned objectives, especially in the banking sector. It remains the best answer to the mutations drained by multiple crises, changes in consumption habits, and changes in the socio-economic environment. Indeed, it proposes solutions, and supports the decision-makers to avoid any hasty decision making, which may incur significant medium or long-term risks for the bank.

In addition, it aims to build customer loyalty by progressive satisfaction, including establishing a customer relationship, win-win impregnated by confidence.

Faced to increased competition among banking operators, especially in the Moroccan monopolistic context, banks are concerned about their performance and obviously their sustainability, pay particular attention to the relationship bank/enterprise.

The 7th edition of the Deloitte Bank and Client Relations Study in 2017 emphasizes on the importance of the relationship aspect [1].

Indeed, the report shows that 66% of corporate customers trust their bank through the relationship established with their bankers. In this context, the banks seem to control, through the management of the customer relationship CRM, the risk of attrition. This is not the only obstacle that the relationship helps to overcome. So it is, modern banking theory considers it as an endogenous response to the imperfections and incompleteness of the financial markets. A good customer relationship allows the bank, in addition to loyalty, to mitigate information asymmetry. This gives the creditor, by allowing him to develop specific procedures for the acquisition of information on the borrowers, appreciable comparative information on the potential competitors, since he puts at his disposal a "capital knowledge" which comes to flesh out his intangible asset.

In this paper, we try to provide, through the literature, an explanation of the link between the customer relationship in the banking industry and information asymmetry. We will first discuss the informational asymmetry as supported by the bank and the client company, and we will look in the second place at the preponderant role of a good customer relationship.

Information Asymmetry: A Dreadful Firewall Dismantled

In the Maghreb, the SME is the core of the economic network. This entrepreneurial category represents a powerful growth and employment engine [2,3]. These companies are insufficiently equipped with their own funds, and are therefore faced with an urgent increase in working capital requirements. The best solver of this strain is the banking network, the head of company inevitably goes there for a line of cash at the height of its cycle of activity, or in the long term, to solicit a financing of its projects investment. This explains the heavy reliance of SMEs on banks; a dependency that increases more and more with informational opacity. This retention of information can sometimes be a result of the fragility of the information system of SMEs, especially at an early stage of their entrepreneurship life. Indeed, the information advantage of the banks is practically nil at the time of the opening of a credit file, and all the more so since the customer's past as a borrower is recent. It is then virtually impossible to draw reliable information on the ability and willingness of the client to pay interest and repay capital from the analysis of the history of his previous debt. The superiority of banking knowledge is therefore almost exclusively based on the information acquired once the credit relationship is engaged.

Many times, retention may be related to the leader's information disclosure behavior. This being said, the client can sometimes also be victim of information asymmetry. We will give more details in the second part of this paragraph.

The entrepreneurial client, actor of information asymmetry

In a bank/business relationship, the quantity and quality of information obtained depends on the nature of the relationship between the bank and the customer [4]. Considering the previous researches, there is a profound influence of managerial behavior on management methods and accounting practices, especially in SMEs [5-7]. Therefore, the banker is supposed to bear in mind the importance that the manager gives to accounting information, when evaluating a request for financing. Thus, based on the principle that attitudes can explain behavior, in accordance with the theory of planned behavior [8], we state that the degree of utility of accounting information in making decisions announced by the manager may have an impact on the bank credit agreement process. This idea was confirmed by the study of Nkhili and Derbel [9]. In fact, the probability of obtaining credits is higher when the managers transmit all the necessary accounting documents, namely the balance sheet, the income statement and the statement of cash flows.

However, the bank has a superior knowledge, particularly because of its ability to produce private information of both objective and subjective nature specific to each borrower. This faculty is made possible by the decentralization of loan decisions, up to a customer relations officer, when the amount of the commitments is not considered very important. To base a decision to grant credit, the banker is supposed to collect all information relating to the client, and the characteristic and perspective of his project to finance. Revealing this type of information is done through the confidentiality and integrity services that banks guarantee to their customers. That being said, once disclosed, this information, which will facilitate the granting of credit, may fall back into a competitor's information system, thus posing a threat to the client company, and consequently to an informational comparative advantage and sometimes strategic.

In addition, the second problem raised by the disclosure of private information lies in the risk for the client to see the financier undertake the project himself. Casson [10] summarizes this risk as follows: "The client needs the lender, but once the lender has the information, he no longer needs the client". Here again, the bank establishes a reputation of integrity by committing itself not to exploit on its own account the information received from its customers. Lending transactions on new clients that the bank can attract by honoring its financial commitments have a greater long-term value than the gains that can be realized in the short term by not respecting them.

However, the customer could sometimes find himself, victim of retention of information from his bank.

The other side of the medal: the client as victim of informational asymmetry

Usually, in the banking sphere, providing services suggests a meeting between a client with only a summary knowledge of the services offered, and an expert agent in banking. From this divergence of expertise, flows a source of information asymmetry.

The asymmetry experienced by the client in the behavior of his bank is rarely analyzed in the economic literature. Many times, the customer cannot predict with certainty whether his bank will renew his credit and under what conditions. For its part, the bank, thus in a position of power, finds it more thoughtful not to disclose its intentions, in order to guard against any opportunistic behavior on the part of its debtor. Faced with this risk of rationing and rates, a customer may be encouraged to engage in a long-term relationship with a bank.

Indeed, in a series of articles, Hoshi et al. [11], find, for a sample of Japanese clients, that those with close and long-term ties to a major bank have more flexible liquidity constraints than other. In addition, clients in the first group invest more in times of financial difficulty than those in the second group, suggesting again that long-term relationships with banks allow clients to overcome, at least in part, the difficulties associated with access to loanable funds.

The customer relationship: the strategic miraculous tool

Customer relationship: antidote of asymmetry: Confronted with the informational fire-wall, the bank must develop more rigorous control capacities, and equip itself with advanced technological tools, in order to rationally decide in terms of financing viable firms, but whose accounting documents and management are obscure (Watanabe, 2004). However, the information conundrum dissolves as confidence is built up, which in financial terms stipulates long-term credit relationships, which provide greater visibility into the behavior, business prospects, their financial positions, and especially their solvency. And this is precisely why the bank / borrower report plays a convincing role in the SME credit agreement [12]. A long-term credit relationship allows a better understanding of the customer, benefits both parties: it facilitates the acquisition of information for the banker, and therefore gives the customer greater availability with a lower interest rate.

This leads us to highlight the importance of relationship between the banker and the entrepreneur. According to Boot [13], it is a mutual commitment based on trust and respect. As for Bink and Ennew [14], they define it as a partnership relationship, identified on the one hand by the nature of the contract established between the two parties and the willingness of the manager to share the management information, and on the other hand, by the understanding, advice and support provided by the banker. In this context the agency theory of Jensen and Meckling [15], finds legitimately all its meaning.

According to the report that Marseillaise society of credit - MSC - has published in 2004 [16], entrepreneurial clients have, in addition to the file rating, a customer score, calculated monthly on the basis of:

Deposits and credits

1. Nature of the client: age, CSP, segmentation, etc.
2. Risks noted: unpaid, ATD, etc.

The rating is prior to the granting of credit, the comments of managers and decision-makers will have to give all necessary explanations when the decision will not be in line with the note. According to the MSC, one of the decisive elements of the behavioral variable included in the notation is “seniority-relationship”.

Duration is an important dimension of a relationship. From the moment a bank builds a credit report, it will be all the more incentive to classify the customer in the category of “good” borrowers when the number of credits that he has repaid without problem will be high. Indeed, a bank is able to build a statistical test for honest borrowers, based on past relationships with clients. To gain such a reputation is to develop a benefit for the customer, because over time, banks are more likely to finance borrowers than projects. Moreover, the time factor allows the bank to know customers more subjectively. Weaving lasting personalized relationships allows the banker to get an idea of the quality of his client, and therefore to better assess the credit risk, since the success of an investment does not only depend on the quality of the project, but also of the one who implements it.

As mentioned above, the banks develop, by the CRM, information specific to each borrower. It is nevertheless important to question the influence of the superiority of banking knowledge in terms of establishing customer [17,18] confirm this, and emphasize the dynamic aspect of customer relations. According to them, a bank that lends to a customer learns more about its quality as a borrower than any other bank. From this perspective, this type of relationship is perceived as an endogenous process. Internalized information, generated by the multiplicity of interactions over time and between different products, is indeed at the heart of customer-bank relationships.

Typology of customer relationship in the bank: In the banking sector, providing services, confronts often a client and an expert. This exchange is fundamentally dissymmetrical. However, the increased search for profitability hampers co-piloting when customers have profiles that banks are not looking for. This then translates into types of relationships that harm the interests of one party or the other (more often the client) when it is not both. It is precisely these difficulties that fuel the process of bank exclusion.

Except the proximity relations where the effects of asymmetry manage to be controlled, three types of relations can emerge and hinder the establishment of a Guerin quality co-piloting Guerin (2000) .

A dominant banker: it is a relationship where the banker monopolizes the expertise and understanding of the commercial logic, and therefore holds control. The client thus dominated by the banker submits to his authority both because he cannot dispute it, but also out of deference to a dreaded institution. Lack of trust in this type of relationship can lead to inappropriate behaviors. This type of relationship, called subjection, creates an imbalance that can cause the flight of customers, and is gradually called into question.

A client in a position of power: The negotiating skills of clients with a high cultural, social or economic capital, enables them to impose themselves in a difficult situation to be heard, or even to reverse the dissymmetry using the bank. However, this position of the client depends both on the credibility of his threat of defection, and his weight in the portfolio of the banker Hirschman (1982) [19], because the departure of a client with modest resources only causes a low economic impact.

Conflictual relationship: describes customers who want to be heard by their bank without having the prerequisites necessary for the success of their approach (mainly the commercial interest). Often, these shortcomings add to the burden, render them ineffective, and turn them into an aggressive demand that prevents, if still possible, any dialogue.

Impact and challenges of the bank / company relationship: Like any exchange between two parties, through a coincidence of needs and therefore mutual satisfaction, a bank / business relationship is a double-edged tool. It certainly confers benefits, but does have some disadvantages.

Beyond the costs inherent in financial intermediation, bank credit has its own cost endogenously derived from the supervisory and control functions exercised by the bank during the customer relationship. The private knowledge specific to the borrower allows the bank to expropriate part of the profits of the customers. Indeed, as argued by Greenbaum et al. (1989), Sharpe (1990) and Rajan (1992) [20-22], the asymmetry of information on the side of the supply of bank credits allows a bank to extract information on its former customers with low risk of default as, unlike other banks, it knows that the borrower is less risky than the average. Information rent can be defined as the difference between the interest rate charged by the bank and the rate that would cancel out its profit. The anticipation of ex post informational rents causes ex ante distortions in the amount of capital invested [21], or the effort exerted by the client [22]. The duplication of monitoring costs then has its advantages. Rajan (1992) [22] shows that the client's choice of different sources of financing and the priorities for repayment can best circumscribe the information rent of the bank.

A risky relationship: In the Sharpe model, the bank that credits a customer knows if the project was successful or failed by receiving a perfect signal on the client's investment income. On the other hand, banks not contracting with a client observe with a risk of error the results of their activity. Here we find the idea that the customer relationship allows the bank to develop internal knowledge specific to the borrower. The stability of customer relationships is then explained by the fact that good quality customers are informally captured by their banks. This risk of capture is particularly present for small customers without much known quality. Indeed, it seems difficult to imagine that for large companies, the information available to the creditor bank or banks is substantially higher than that of other banks. On the other hand, it seems reasonable to consider that financial market information on the quality of small and medium-sized enterprises is not very precise or very reliable, since the creditor bank certainly has a significant comparative information advantage compared to other banks. In addition, if the different banks can observe the results of the surveillance activities of the other banks, a "stowaway" behavioral hazard may appear because each bank can rely on the supervision of the other banks to assess the credit risk of the banks. the borrower without having to carry out a monitoring activity themselves. This problem strengthens banks' incentive to make customer relationships exclusive and, as a result, increases the risk of customer capture.

Proposal for a Theoretical Model

In sum, we have tried through the analysis of a dozen documents published between 1950 and 2017, to trace the link between the company and its main bank, and to understand the motivations, the outstanding risks and the benefits stored by each party considering their informational authority. Indeed, for the bank, having a data on its customers represents an asset, or even competitive advantage [23]. However, a lack of information coming from the entrepreneur can be fatal. In a situation of asymmetry, or informational opacity, a bank may, by instinct of prudence, refuse to establish or deepen its relationship with a client, having in fact a great potential, and therefore sacrifice profit. Similarly, a suspicious customer, abstains from disclosing many of his accounting and financial information, for fear of capture. Aware of this interdependence between the company and its bank, we have identified through the literature the preponderance of a good customer relationship in order to surpass the information concern.

As mentioned above, the banks develop, by the CRM, specific information to each borrower. Nevertheless, it is important to evaluate the influence of the superiority of banking knowledge in establishing client relationships) [18-19]. A bank that lends to an enterprise learns more about its borrower quality than any other bank. We, therefore propose a two-variable model, explaining an explanatory and predictive link between the bank/enterprise relationship (Figure 1), and information asymmetry (the nature, form and meaning of the link will be studied later).

Conclusion

One of the reasons behind bankers' reluctance is that the risk they take is unpaid at its proper level. In the same day, an account manager can work on a file of hotelier, industrialist, merchant or service provider. He is unable to master every client's field activity, especially at the beginning of his career. This lack of knowledge can sometimes lead to misunderstanding. In addition to this, there is the lack of regular and "fresh" information on the evolution of the company. Most of the time, the banker has to settle for a late balance sheet (four to six months after the close of the balance sheet) and episodic oral information to form an opinion on the financial situation of the company. The banker does not

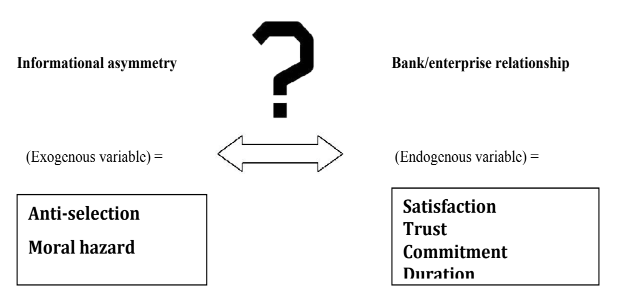

Figure 1: Bank/enterprise relationship.

benefit, as the manager, of feedback from the field, access to the company's information system, monthly dashboards or intermediate situations. He does not know the decisions made, the development of the order book month by month, the evolution of the market and competition. Difficult, under these conditions, to "feel", support, and support the company [24].

The quality of information improves certainly with the length of the relationship, but also with the number of financial services the bank offers its client. Moreover, as Fama (1985) [25] points out, the role of banks is not limited to the granting of credit; multi-production/distribution are even a fundamental attribute of banks. These complementary financial services (the issue and placement of securities, market studies and in particular the maintenance and monitoring of the books of accounts), provide additional information. On the other hand, the bank can spread its costs of producing information about the borrower on multiple products, decreasing the cost of intermediation and thus helping to increase the funds loaned to the client [26]. This assumption assumes that the intensity of the Bank-Company relationship allows a better understanding of the company's prospects, its ability to repay, its investment opportunities, its financial position ... etc. [27]. In general, customer relationships improve the efficiency and personalization of the product line, and consequently improve contract terms.

But the question that persists is the following: what is the future of the banking-business relationship, especially after the adoption of the new "Basel II" regulation, in a country like Morocco where relational culture and the informal character dominate the business community?

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