LISBOA SCHOOL OF ECONOMICS & MANAGEMENT

MESTRADO

CIÊNCIAS EMPRESARIAIS

TRABALHO FINAL DE MESTRADO

DISSERTAÇÃO

RELATIONSHIP LENDING AND SME FINANCING IN THE AZORES

VÍTOR ALVES DOS SANTOS CRUZ

JUNHO - 2014

MESTRADO EM
CIÊNCIAS EMPRESARIAIS

TRABALHO FINAL DE MESTRADO
DISSERTAÇÃO

RELATIONSHIP LENDING AND SME FINANCING IN THE AZORES

VÍTOR ALVES DOS SANTOS CRUZ

ORIENTAÇÃO:
PROFESSOR DOUTOR JOSÉ DIAS LOPES

JUNHO – 2014

INDEX

Acknowledgements iii

Abstract iv

Resumo v

1. Introduction 1

1.1 Motivations for the Study 2

1.2 Objectives and Contribution of the Study 3

2. Literature review 4

2.1 The Importance of SMEs 4

2.2 The Importance of Bank Financing for SMEs 4

2.3 The Importance of Information 5

2.3.1 Moral Hazard and the Adverse Selection Effect 7

2.4 On Relationship Lending 7

2.4.1 Relationship Lending 7

2.4.2 Soft Information 8

2.4.3 Characteristics 9

2.4.3.1 Distance 9

2.4.3.2 Number of Relationships 10

2.4.3.3 Multiple Products 11

2.4.3.4 Trust 11

2.4.3.5 Length 12

2.4.4 The Effects and Benefits of Relationship Lending................................ 13

2.4.4.1 Information 13

2.4.4.2 Availability of Funds 14

2.4.4.3 Prices and Collateral 14

2.4.4.4 The Drawback of Relationship Lending.. 15

2.5 Drivers and Obstacles in Lending to SMEs... 15

2.6 SME Serving Profitability for Banks (an analysis by the International Finance Corporation)... 17

3. Methodology.. 18

4. Results 21

5. Conclusions 24

Bibliography 27

Appendices 32

Appendix I – Theoretical Framework for the construction of the Survey...... 32

Appendix II – Survey 36

Appendix III – Survey (Portuguese Version) 39

Appendix IV - Frequencies.. 42

ACKNOWLEDGEMENTS

I would like to start by thanking all the teachers I have had to this day, who gave me the knowledge and drive to invest and persist with my academic life. A special thank you to my supervisor, Dr. José Dias Lopes, for the time spent, for the patience and for the information provided, that allowed me to complete this study.

I am also grateful to the Chamber of Commerce and Industry of Ponta Delgada (Câmara do Comércio e Indústria de Ponta Delgada), and to all the SMEs that cooperated with me in this study, since without their help this would not have been possible.

A very big and very special thank you to all of my family. To my mother and father, for the guidance and support, for pushing me and keeping me in check. To my brothers, for the companionship and the laughs, especially when those are most needed. To my grandfather and grandmother, for teaching me important values such as dedication, appreciation and hard work. I'll do my best not to forget those.

Last, but not least, thank you to my friends and colleagues, for making school and academic life about more than just books. A special thank you to those who cooperated with me in this study.

ABSTRACT

Small and medium enterprises are crucial for economies all around the globe. However, their growth is constrained by strong difficulties in accessing the funds they imperatively need. This study reviews some the most common issues regarding SME finance, particularly difficulty accessing funds and Relationship Lending. It then aims to assess the perceptions of SMEs in the Azores region over those issues, to see if they match the literature considerations. The majority of the respondents claim they find it difficult to access finance from a bank, and consider trouble providing risk shifting factors and past success indicators as being the most important credit decision making criteria of banks. It is also found that most of the respondents are invested in a relationship with a bank, and those who are benefit from it, especially on collateral demands and on interest rates.

Keywords: Relationship Lending; SME; Information asymmetry; Bank finance;

Resumo

Pequenas e médias empresas desempenham um papel importante na economia mundial. No entanto, a elevada dificuldade em aceder aos fundos necessários muitas vezes limita o crescimento destas empresas. Este estudo tem como propósito analisar alguns dos mais debatidos problemas no que a financiamento de PMEs diz respeito, particularmente Relacionamento Bancário e dificuldades no acesso ao financiamento. Posteriormente, realiza um exercício comparativo entre a percepção de PMEs na Região Autónoma dos Açores e as mais comuns considerações presentes na literatura. A maioria dos inquiridos considera que o acesso ao financiamento bancário é difícil, e percepciona os critérios relacionados com garantias e com o histórico de crédito da empresa como os mais importantes para as decisões de concessão de crédito dos bancos. A maioria dos inquiridos considera igualmente estar envolvido em Relacionamento Bancário, retirando benefícios dessa relação.

Palavras-chave: Relacionamento Bancário; PME; Assimetria informacional; Financiamento bancário.

1. INTRODUCTION

The vast majority of enterprises (99,8%) in the European Union (EU) are Small and Medium Enterprises[1] (SMEs), accounting for 66,4% of the jobs provided (European Commission, 2013A). These companies play an important role in the economic dynamics of most countries, especially high and middle-income countries (Stein, 2002).

To be able to operate, most SMEs require access to finance (European Commission, 2013B). However, that is one of the most dominant concerns for SMEs (European Central Bank, 2013), mainly because of asymmetric information problems[2] (Berger & Udell, 1995). In this scenario, banks have significant importance, playing an important role in gathering crucial information for the lending decision process, especially when associated with Relationship Lending[3] (RL) (Berger & Udell, 1995).

This study provides an insight over the most common debated issues about SME finance. Then, through a survey, it aims to assess how SMEs in the islands of São Miguel and Santa Maria (Azores) percept some of this issues. SMEs play an important role in the economy of the region, providing 74,4% of the jobs (Instituto Nacional de Estatística, 2010). The study is of interest for these firms, since it may provide valuable insights by comparing their perceptions to extensive studies conducted in SME finance. To do so, it is first presented a literature review over the most common debated issues in the literature, and over the issues specifically related to the study: Access to bank finance and RL technology. Then, through a survey aimed at SMEs, answers are

[1] Enterprises that employ fewer than 250 and which have an annual turnover not exceeding 50 million EUR.

[2] SMEs are vulnerable to information problems, making it difficult for lenders to access their creditworthiness (Carbó-Valverde, Rodríguez-Fernández, & Udell, 2009).

[3] Lending technology that involves the collection of information over time for credit availability decision-making (Mudd, 2013).

collected that can be related to these issues. In the results section, those answers are presented. It then concludes with comparing the respondents' answers to the considerations in the literature.

1.1 Motivations for the Study

The main motivation for this study comes from the importance of SMEs for economies all around the globe, especially since the part these firms play in economic growth and job creation is especially important nowadays in times of economic crisis.

The reason the study was developed in the Azores region, specifically in the Eastern Group (Islands of São Miguel and Santa Maria), comes mainly from the fact that most of its companies are SMEs. Although this is not a particular distinguishing characteristic from the rest of the country, only 12 firms in the rank of the 100 largest firms in the whole Azores region are large enterprises (Espírito Santo Research, 2009). According to the president of the government, in 2012, the difficult situation firms were going through in the country had a specific and larger impact in the Azores region (Governo dos Açores, 2012). One reason pointed out for that was the bank financing crisis, being this type of financing crucial to the region's economic development (Governo dos Açores, 2012). Another motivation is the fact that the region leads the rate of business renewal in the country, where between March of 2013 and February 2014 the index of renovation of businesses was the establishment of 3,9 enterprises for each one dissolved (Governo dos Açores, 2014).

An aspect debated in the literature regarding SME finance is the particular difficulty that SMEs show in accessing finance and their historical tendency to rely on banks to do so (European Commission, 2013B). The generic perception among many authors that RL is a lending technology that benefits SMEs is also a common opinion, since it helps to overcome information problems particular to SMEs (Petersen & Rajan, 1994; Carbó-Valverde et al, 2009).

1.2 Objectives and Contribution of the Study

This study has two main objectives. The first one is to verify how SMEs in the Eastern Group of the Azores rate the difficulty in accessing bank credit, and if they do so accordingly with the literature. Along with this, the study analyzes their perception over the factors they think affect their chance in accessing finance, comparing this perception to the literature considerations. The second one is to verify if RL is common in region, and if SMEs perceive the benefits of this technology and the reasons why those exist accordingly with the reasons and justifications presented in the literature.

In a way, the contributions of the study overlap with its objectives. Insights about the first objective may give firm owners important information to consider when applying for a line of credit. They may more correctly consider the important credit decision-making criteria of banks. On the second objective, it may be of interest to many firm owners to more accurately know what potential benefits may come from RL. It may also provide an insight about if those benefits are generally observed, and if so, why that is.

From this point on, the study is structured as follows: the next section provides a grasp on the literature regarding SME finance. A description of the survey structure and its availability to SMEs in the region follow, in the methodology section. In the results section the answers to the survey are presented. In the conclusions section, those answers are compared and evaluated in light of the literature considerations.

2. Literature review

In this section, some of the most debated issues regarding SME finance and RL are presented.

2.1 The Importance of SMEs

A strong indicator of the importance of SMEs is that they account for a large share of companies in the private sector of most economies, as well as for a large share of the overall employment (Beck, 2007).

In many countries, the majority of jobs are provided by SMEs, and the SME sector has a very significant contribution to the national GDP[4] (International Finance Corporation, 2009).

According to the European Commission (2013B), new firms represent the most important source of new employment, creating more than 4 million jobs every year in Europe. They contribute, alongside entrepreneurship, to more competitive economies and innovation, encouraging new skills and capabilities and opening up markets (European Commission, 2013B).

2.2 The Importance of Bank Financing for SMEs

A survey on the access to finance of SMEs in the Euro area conducted by the European Central Bank (2013) concludes that access to finance is mentioned as the second most dominant concern for SMEs, only behind "finding customers". According to another survey on SME access to finance, performed by the European Commission, 50% of EU SMEs have taken out a loan in the past two years (Ipsos Mori, 2013).

SMEs need external financing to innovate and grow their activities, especially since they are important job creators and contribute both to competitiveness and innovation

[4] Gross domestic product

(St-Pierre & Bahri, 2011), and their ability to access external financing is a topic that deserves increased attention (Berger & Udell, 2006).

In the words of Petersen and Rajan (1994), in a frictionless capital market funds will always be available to firms with good investment opportunities. But that is not so. And due to these firms' importance, the extent to which a financial system will show itself as being able to support their growth is a measure of its efficiency (Petersen & Rajan, 1994).

Asymmetric information problems are a source of friction. They are a bigger issue to smaller firms, which explains why obtaining credit for them is a different process when compared to that of a larger firm (Berger & Udell, 1995). While large corporations are able to obtain credit in public debt markets, a small firm will usually depend on a financial intermediary, such as a commercial bank (Berger & Udell, 1995). This type of financing (bank financing) often is associated with a long-term relationship, and this relationship may play an important role in the gathering of information and in setting the terms of the loan (Berger & Udell, 1995). A bank might also play an important role in overcoming asymmetric information problems because the borrower will be able to disclose information to it without worrying about it spilling over to competitors (Boot, 2000).

Since SME's usually do not have access to organized capital markets, bank financing will often be the only alternative for external funding (Behr & Guttler, 2007).

2.3 The Importance of Information

Information, as well as bargaining, is a key element of loan contracting (Grunert & Norden, 2012).

Elyasiani and Goldberg (2004) state that it is crucial for prudent lenders to gather information about the credit worthiness of their borrowers. According to the same authors, to do so the lender may choose between different alternatives: he may require an application for the loan, along with specific financial information, or alternatively rely on his relationship with the potential borrower and on the information gathered through the provision of different financial services (Elyasiani & Goldberg, 2004). Through this means, the lender learns important information, which then relates to the probability of the potential borrower being able to repay the loan (Elyasiani & Goldberg, 2004).

When an officer of a bank lacks the adequate information to decide whether to fund or not a certain proposal, he will be dealing with the problem of asymmetric information (Deakins et al, 2010). When approached by a new business, the officer will have to face this, since the business does not have a trading history (Deakins et al, 2010).

Similarly, many SMEs will likely face the same problem. Because these are smaller firms, it will be unlikely that they are monitored by a rating agency or followed by the press (Petersen & Rajan, 1994).

For an SME, the informational gap that exists between an insider and an outsider is bigger than that of a larger firm, and that makes the provision of external finance more challenging (Berger & Udell, 2002). A small firm with an opportunity to invest in a worthy project may face trouble doing so, in a case where the potential lender lacks the information to verify the firm's access to the project, or to ensure that the funds will in fact go to that same project, and not another one (Berger & Udell, 2002).

Unlike it has been for larger firms, the information available about SMEs has historically been limited and difficult to access, because they are traditionally more opaque (Petersen & Rajan, 2002).

2.3.1 Moral Hazard and the Adverse Selection Effect

When the lender cannot verify that the potential borrower has access to a quality project, he faces the information related problem of adverse selection (Berger & Udell, 2002). If the lender has trouble ensuring the provided funds will not be diverted to an alternative project or purpose, he faces the moral hazard problem (Berger & Udell, 2002).

The essence of the adverse selection effect refers to the lender's inability to distinguish a good firm from a bad one, when confronted with a number of options (Hyytinen & Vaananen, 2006). In turn, the essence of moral hazard refers to problems the lender faces after providing the finance, and that may endanger the repayment (Hyytinen & Vaananen, 2006).

Both are information related problems, and have greater impact when a firm is young or small, which explains why that same firm will find it hard to raise money in the public markets (Petersen & Rajan, 1994). Because these borrowers tend to be more opaque, they pose a greater challenge for lenders (Cole, Goldberg, & White, 2004).

2.4 On Relationship Lending

This section reviews the most common stands within the literature regarding RL. The the characteristics that are more often observed in this kind of relationship and the benefits that usually result from it are analyzed. The characteristics can be looked upon as the factors that allow the RL technology to be implemented and that allow the borrower to collect benefits from it.

2.4.1 Relationship Lending

Although there are many ways of obtaining information for credit decision making, developing a long-term relationship between a lender and a borrower is especially well suited for opaque firms (Elyasiani & Goldberg, 2004). RL is an area of great interest for financial institutions and SMEs, since it allows the lender to gather relevant information about the creditworthiness and prospects of borrowers (Elyasiani & Goldberg, 2004).

Altman and Sabato (2007) find that managing credit risk for SMEs requires a specific procedure, especially since these firms are different from a credit risk point of view.

RL involves the collection of information that acts as the primary basis for decision-making on credit availability (Mudd, 2013). This information is acquired over time through contact with the firm, its owners, management and local community (Mudd, 2013). It is a powerful technology to overcome information problems in SME financing (Berger & Udell, 2002).

The close relationship developed with the borrower over time may help overcome problems of asymmetric information, by allowing the acquisition of borrower-specific information available only to the intermediary and the customer (Boot, 2000).

Boot (2000) defines RL around two dimensions: **proprietary information** and **multiple interactions**. According to his definition, RL is the provision of financial services by a financial intermediary that invests **in obtaining customer-specific information** and evaluates the profitability of these investments through **multiple interactions** with that same customer over time and/or across products.

2.4.2 Soft Information

Stein (2002) argues that the key distinguishing characteristic of lending to SMEs is that it relies heavily in information that is soft.

This information is not directly verified by anyone other than the agent who produces it (Stein, 2002). As an example: the case of a loan officer that works with a small company president and has come to believe he is honest and hard working. He is unable to unambiguously document these features in a report to pass along to his superiors (Stein, 2002).

The loan officer in direct contact with the borrower acquires this information and it often remains proprietary, because it is not easily observed, verified and transmitted to others (Berger & Udell, 2006). Soft data, such as information about the character and reliability of the firm’s owner, is difficult to quantify and communicate through normal transmission channels of banking organization (Berger & Udell, 2002).

The loan officer typically lives in the local community and has relevant information about the firm and its owner and about the business conditions in the community, making him or her the person in the bank with greatest access to the soft information (Berger & Udell, 2002).

2.4.3 Characteristics

In this section, the characteristics that are most commonly observed in relationships between lender and borrower, when the lender is a bank invested in RL with a borrower, are discussed.

2.4.3.1 Distance

Being that soft information is difficult to communicate, it is reasonable to accept that the decision to offer credit has to be made close to where this information is accessed (Petersen & Rajan, 2002).

Because of the informational opacity of SMEs, the collection of soft information requires contact between the lender and the borrower. This is facilitated by geographic proximity (Elyasiani & Goldberg, 2004).

However, Petersen and Rajan (2002) document that the physical distance between SMEs and their lenders has grown steadily and considerably. Also, they find that borrowers that start a relationship with a lender at a distance are communicating less in person.

This is explained by the ability to collect, store, and process and communicate larger amounts of information (Petersen & Rajan, 2002). Most of this information is hard, and is available to lenders at a distance, who now have easy and timely accessible information about a potential borrower's creditworthiness, even without the soft information that would be able through close contact (Petersen & Rajan, 2002). At the same time, this information is different. It is stored, processed and distributed in a different way, and changes the nature of lending (Petersen & Rajan, 2002). If before there was a stronger emphasis in a strict screening before providing the loan, and costly monitoring after it, the lender now can more easily monitor the loan and quickly intervene if necessary (Petersen & Rajan, 2002).

Increased productivity of the lenders (Petersen & Rajan, 2002), and better small business credit-scoring methods (DeYoung et al, 2011), are primary drivers of increased borrower-lender distances.

2.4.3.2 Number of Relationships

Many SMEs tend to concentrate their borrowing from one source, although this concentration decreases as the firm increases in size (Petersen & Rajan, 1994). The explanation with stronger support for this is that multiple contacts may weaken relationships with the lenders (Petersen & Rajan, 1994).

Behr and Güttler (2007) claim that companies with an institution acting as the primary relationship banker will not usually have multiple bank relationships. However, they refer that this puts the bank in a position to exert market power over the firm, which may lead to hold-up problems for the borrower (Behr & Guttler, 2007). If in a relationship, one party is able to take advantage of increased bargaining power over the other, a hold-up problem occurs (Balkenborg et al, 2012). As an example, it may be costly for a buyer to switch suppliers, and the suppliers, knowing of this, raise their prices (Balkenborg et al, 2012).

This is a possibility when an investment in RL is made, since changing banks is costly to the firm because a new bank will not have the same amount and quality of information, charging a superior risk premium in order to make up for it (Behr & Guttler, 2007). These switching costs allow the relationship banker to extract margins that may not correspond to the risk of the loan (Behr & Guttler, 2007).

2.4.3.3 Multiple Products

Especially if the lender is a bank, the borrower may obtain from it more than just loans, building a relationship through multiple interactions (Petersen & Rajan, 1994).

A firm can add to the dimensions of the relationship by purchasing multiple services (Petersen & Rajan, 1994). This increases the amount of information available to the lender, as well as the precision of that same information (Petersen & Rajan, 1994). As an example, by monitoring a firm's savings account, a bank learns about the firm's financial condition (Petersen & Rajan, 1994).

Interaction over multiple products also allows the lender to spread the costs of producing information, reducing the cost of providing loans and services and potentially increasing the availability of funds to the firm (Petersen & Rajan, 1994).

2.4.3.4 Trust

In RL, trust is an important factor, making a bank more likely to renew or extend credit to a firm with which a relationship based on trust is maintained (Hérnandez-Cánovas & Martínez-Solano, 2008).

Hernández-Cánovas and Martínez-Solano (2010) find that trust in a relationship exceeds the importance of the length of the relationship. The same authors also state that when the relationships between banks and SMEs are based on trust, it not only improves their access to credit, but also reduces the cost of debt, although SMEs have to pledge more guarantees.

2.4.3.5 Length

A relationship between a lender and a borrower becomes more important the longer it exists, as the information flow between them gets better (Elyasiani & Goldberg, 2004).

The duration of the relationship can then be both a measure of its strength (Berger & Udell, 1995), and a measure of the private information the institution has about the firm (Petersen & Rajan, 1994).

Duration is an important dimension of a relationship because according to past experiences, the lender will expect a loan to be more or less risky (Petersen & Rajan, 1994). Assuming the relationship persists, it should reduce the expected cost of lending for the institution and increase its willingness to provide funds (Petersen & Rajan, 1994).

Through time, the bank's availability to provide funds increases, because the experience with the borrower allows the bank to reduce the risk assessment for each new loan (Hérnandez-Cánovas & Martínez-Solano, 2008). All of this because the bank learns about the honesty of the manager, the viability of projects and the borrower's risk, while becoming more accurate in predicting the firm's behavior and income and improving the relationship (Hérnandez-Cánovas & Martínez-Solano, 2008).

2.4.4 The Effects and Benefits of Relationship Lending

For Petersen and Rajan (1994), SMEs borrow a considerable portion of their debt from lenders who provide them information intensive financial services, and by concentrating their borrowing SMEs do not seem worse off, and may even improve the conditions on their access to finance.

In this section, it is reviewed the extent to which RL might be beneficial to SMEs.

2.4.4.1 Information

A strong benefit of RL is directly related to the major challenge SMEs face when in need of finance: they are vulnerable to information problems (Carbó-Valverde et al, 2009).

Therefore, the first benefit worthy of note is the facilitation of information exchange between the borrower and the lender (Boot, 2000). Through RL, the lender will have stronger incentives to invest in producing information about the borrower, and the latter will be more inclined to reveal information (Boot, 2000).

Other than that, Boot (2000) lists a number of other benefits. Those are contractual features, such as flexibility in contracts, through use of impalpable information that facilitates long-term contracting and makes renegotiation of contract terms easier. According to the same author, the relationship is a commitment between the borrower and the bank, based on trust and respect (Boot, 2000). All together, RL allows for extensive adjustments that make room for better control of potential conflicts of interest (Boot, 2000). A specific case occurs when collateral is involved, because since it requires frequent monitoring, it makes both the proximity and the relationship essential (Boot, 2000).

2.4.4.2 Availability of Funds

The information that is produced through a relationship is durable, which, together with economies of scale, suggests that a longer and stronger relationship should increase the availability of funds to the firm (Elyasiani & Goldberg, 2004).

Petersen and Rajan (1994) write that as a firm spends more time in a relationship, the available finance from institutions increases. This happens as the ties and the number of financial services increase, and as the borrower concentrates its borrowing with the lender. As the firm attempts to establish more relationships and borrows from multiple lenders, the available funds decrease (Petersen & Rajan, 1994).

It is defended, by Petersen and Rajan (1994), that the availability of funds is the primary benefit of RL, and that this benefit surpasses the one verified on the price of credit. This might be explained by the information monopoly the lender might exert on the borrower, or by the fact that firms would prefer more rather than cheaper credit, if offered a choice (Petersen & Rajan, 1994).

2.4.4.3 Prices and Collateral

If information asymmetry decreases over the time a borrower and a lender spend developing a relationship, it can be reasonably assumed this would lead to better loan conditions (St-Pierre & Bahri, 2011).

Banks overcome these asymmetry problems by producing and processing information, and by setting on the loan contracts the interest rates that will be charged, as well as the collateral required (Berger & Udell, 1995).

Berger and Udell (1995) find that longer relationships often result on lower interest rates, and decrease the probability of the firm having to pledge collateral.

2.4.4.4 The Drawback of Relationship Lending

In this section, it is further discussed the informational monopoly problems referred in section 2.4.3.2.

When new potential lenders do not have access to the information generated by the older and current lender, this same current lender acquires an information monopoly over the firm (Petersen & Rajan, 1994).

This is consistent with the claims of Hérnández-Cánovas and Martínez-Solano (2008), who state that RL might not be entirely beneficial to SMEs. This happens because it reduces the firm's flexibility to change banks, providing the lender with the power to charge higher interest rates (Hérnandez-Cánovas & Martínez-Solano, 2008). They find that SMEs with longer bank relationships have enhanced access to loans, but they suffer higher costs for their debt.

Although RL can be an effective technology in overcoming asymmetric information problems, this reduction of asymmetry is one-sided, remaining in the customer-bank direction (Behr & Guttler, 2007). The lender will have no incentive to increase the transparency level about the way it measures the loan risk and decides on the loan price, since a reduction on this lack of transparency could open doors to alternative sources of financing to the borrower, and put him in a position to renegotiate the conditions on the loan (Behr & Guttler, 2007).

2.5 Drivers and Obstacles in Lending to SMEs

Banks have a duty to protect their depositors' savings. Hence, when granting business loans, the decision must be based on the default risk and the borrower's ability to repay (St-Pierre & Bahri, 2011). Credit process is a critical bank function, having to ensure that funds will be provided as credit to customers who are both capable and willing to repay the loan and the interest (Bruns & Fletcher, 2008).

The risk preferences of borrowers and lenders differ. An investment in a project has two possible outcomes. It may generate a profit, if the project is successful, or the investment may be lost, if the project is unsuccessful (Bruns & Fletcher, 2008). If that same project is funded by a loan, that limits the borrower's potential loss, although it does not limit its profits, apart from the interest (Bruns & Fletcher, 2008). If the project is unsuccessful, the potential losses for the borrower are smaller than the lender's, because he loses the amount lent (Bruns & Fletcher, 2008).

That is supported by the fact that investors will have stronger incentive to use their own money to fund projects where there is less risk and more assurance of return, while borrowing money for riskier projects (Bruns & Fletcher, 2008). To deal with this potential problem, the lender needs to gather information that speaks to the probability of the borrower failing to repay the loan (Bruns & Fletcher, 2008).

Bruns and Fletcher (2008) find that the lending officer's credit decision-making is affected by a number of factors, such as past performance, financial standing, competence within the business project, collateral, CEO tenure or risk-taking proclivity, among others. Some of these factors shift the risk-taking to the borrowing SME, such as collateral, making possible opportunistic behavior by the borrower less of a problem (Bruns & Fletcher, 2008). According to the same authors, past success indicators, such as financial standing and competence within the business project, play an important role in the decision-making, which suggests that for banks the past acts as a relatively good predictor of the future.

On interest rates, St-Pierre and Bahri (2011) write that the risk premium is determined by firm size, line of credit size, ability to repay, the relationship between the lender and the borrower and the length of that same relationship. However, the interest rate the bank charges does more than reflect the riskiness of the borrower, since it might itself affect the riskiness of the loan (Stiglitz & Weiss, 1981). This is related with the problems of adverse selection and moral hazard. Potential borrowers willing to pay higher interest rates may be worse risks, because they perceive their probability of repaying the loan to be low. On the other hand, high interest rates decreases the return on projects, and may induce the borrower to welcome projects with lower probability of success, but higher payoff when successful (Stiglitz & Weiss, 1981). So, by increasing interest rates or collateral on loans, the lender could increase the riskiness of his loan portfolio or discourage safer investors (Stiglitz & Weiss, 1981).

It is established that SMEs and newly created companies tend to pose a bigger risk for banks, which find in SME lending a higher rate of default (St-Pierre & Bahri, 2011). These firms lack trading history, and make factors such as previous experiences of the entrepreneur, together with his or her age and credit history, more important (Deakins et al, 2010).

Apart from that, banks perceive macroeconomic instability in developing countries and competition in developed countries to be the main obstacles for SME finance (Beck et al, 2008).

2.6 SME Serving Profitability for Banks (an analysis by the International Finance Corporation)

The SME market has been perceived as difficult, risky and costly in the past (International Finance Corporation, 2009). Nonetheless, recent evidence suggests that banks are investing and finding decent solutions to overcome this challenge, such as determining credit risk and lowering operating costs, being now able to serve the SME sector and do it with profit.

SME banking should be looked upon as an industry in transition, becoming a strategic target of banks worldwide, gradually overcoming the conception of being a market considered difficult to serve. This market is now served by a wide spectrum of banks, instead of just smaller banks with relationship-based models.

This is in part motivated by the shrinking margins in corporate banking, forcing banks to turn to the SME space. This, in turn, forces the banks in a position where they start to understand the particular needs of the SME segment, developing approaches to overcome the challenges of high credit risk historically associated to these firms.

Despite the challenges presented by the economic crisis, and even the uncertainty ahead, many banks appear to be invested in the SME sector, especially in emerging markets, often motivated by the importance of this sector to the national economy as a whole. This investment is also motivated by the understanding that SME banking goes beyond lending, and banks are now prioritizing non-lending products in order to provide total customer value.

However, the growth of SMEs continues to be undersupplied, since their needs for financial products and services are not fulfilled.

3. METHODOLOGY

This study has the purpose to analyze how SMEs percept some of the aspects that gather general consensus in the literature regarding SME finance, mainly SME access to bank credit and RL.

This study consists of a quantitative research. It is aimed to quantify the perceptions of the respondents and generalize results obtained through a sample of 48 answered online surveys, where each of the respondents represents a different SME. The data was then used to assess the validity of different created research questions.

1. **Objective 1:** verify how SMEs in the Eastern Group of the Azores region perceive the difficulties in accessing bank credit. Along with this, the study

analyzes their perception over the factors they think affect their chance in accessing finance, comparing this perception to the literature considerations.

From this objective, the following research questions are created:

RQ1: Do SMEs in the Eastern Group of the Azores region feel that accessing bank credit is difficult?

RQ2: Do the perceptions of SMEs in the Azores region over the criteria that affects their chances in accessing bank credit matches with the considerations of the literature?

2. **Objective 2:** The second one is to verify if RL is common in region, and if SMEs perceive the benefits of this technology and the reasons why those exist accordingly with the reasons and justifications presented in the literature.

To be able to fulfill this objective, the following research questions were created:

RQ3: Is Relationship Lending is a common practice in the region?

RQ4: Do SMEs that are involved in a relationship with a bank have access to the benefits the referred by the literature?

RQ5: Do SMEs perceive the reasons why the benefits from Relationship Lending occur in the same way the literature does?

The survey was built to be able to collect data that relates to the objectives defined. Being that the intention is to compare the perceptions of SMEs to the considerations of the literature, the survey was constructed based on those same considerations (see appendix I).

The reason why an online survey research method was chosen was for the convenient data gathering, being that the SMEs that were to be contacted on this study were far, and hard to reach through a paper survey. Also, by using an online survey through a survey software, the randomness of the study was ensured.

On the other hand, by using a survey, there is the risk of the respondent not fully understanding the questions, especially when answering online. Also, by using a survey and not interviews, the respondents might feel limited to the range of responses made available to them. But since this study is also a comparative exercise, wanting to see if the perceptions of the respondents match with the literature considerations, an online survey with a majority of closed-ended questions was chosen as the most adequate to do so.

The survey consists of 10 questions, and apart from questions 1 and 2, they are all closed-ended questions. On the closed-ended questions, some are two-pointed (questions 5 and 6), some are multiple choice (questions 4, 7 and 8) and others are scaled (questions 3, 9 and 10, where the last two are analyzed through a Likert scale). Also, some are contingency questions, since a response is only asked if the respondent provides a particular response in prior questions (questions 6, 7 and 8). Questions 1 and 2 are open-ended.

The survey was spread through the Chamber of Commerce and Industry of Ponta Delgada[5] (CCIPD) that made it available to enterprises that are associated with them, safeguarding the randomness of the study. The institution was contacted on March the 23rd, and agreed to cooperate. On May the 1st, the link to the survey was made available, and was sent to CCIPD associates, through their organization. The answers were collected using the Survey Monkey[6] service between May the 1st and May the

[5] An organization associated with natural and legal persons that perform activities related to trade, industry, tourism and services and are registered on the islands of São Miguel and Santa Maria, Azores, and whose main purpose is to promote the economic activity and to represent and defend the interests of its associates.

[6] A web survey development cloud based company.

31st, and were then analyzed using Microsoft Excel and SPSS Statistics software. 48 SMEs answered the survey.

The theoretical framework supporting the construction of the survey is presented on appendix I. The survey is available in appendix II and III, in English and Portuguese. The frequencies for each question in the survey are displayed in appendix IV.

4. RESULTS

In the literature review many of the most debated issues regarding SME finance were analyzed. That being done, and being the purpose of this study to analyze how SMEs percept some of these issues, it was important to build a survey that was adequate to do so.

Although some of the questions are contingency questions, most of them stand on their own, and are related to a specific issue. Therefore, they are analyzed one by one.

Questions 1 and 2 were included to ensure that the respondents were in fact SMEs. The respondents were asked to indicate their annual turnover and number of employees. The answers were then divided within 3 SME categories: Micro[7], small[8] and medium enterprises (SMEs that don't fit the micro or small categories). None of the respondents exceeded the limits on the questions, and all of the answers were valid for the purpose of the study. 87,5% of the respondents had an annual turnover lower than 2M EUR, and 12,5% were between 2M EUR and below 10M EUR. None had an annual turnover between 10M EUR and 50M EUR. Regarding the number of employees, 56,3% had below 10, 35,4% had between 10 and below 50 employees, while the remainder 8,3% of the respondents employed between 50 and up to 250 workers.

[7] Enterprise that employs fewer than 10 persons and has an annual turnover not exceeding 2 million EUR.

[8] Enterprise that employs fewer than 50 persons and has an annual turnover not exceeding 10 million EUR.

In question 3, the purpose is to analyze how SMEs in the region perceive the difficulty in accessing bank financing. To do so, a scale stretching from Very Difficult (1) to Very Easy (5) was built, on a 5-point scale. Most firms find it difficult to access bank financing, having 12 respondents (25%) selected Very Difficult and 19 (39,6%) selected Difficult.

In question 4, the intention was to obtain answers from the firms that could be compared to what the literature states to be the most common criteria considered in credit decision-making. Each respondent was asked to choose up to 4 aspects they thought were to have most negative impact on the chances to access bank credit. The two most selected answers, and the only two that were selected by more than 50% of the respondents, were: firm/owner has an unfavorable credit episode and trouble pledging the demanded collateral. Refusal or inability to provide information was the least common answer, being selected by only 14,6% of the respondents.

Question 5 has the purpose to analyze the extent to which SMEs in the region are invested in RL. To do so, it was asked directly to the respondents, following Boot's definition (2000) of RL, if they were in a long, diverse and close relationship with a bank from which they acquired different services and products. Only 6 of the respondents (12,5%) don't consider to be involved in a relationship with a bank that fits Boot's definition of RL, while the remaining 42 (87,5%), consider to be.

Questions 6, 7 and 8 are RL related, and are built to be answered considering the respondent's experience and perception on the matter. Everyone that answered no in question 5 was asked to skip to question 9.

In question 6, the intent is to see if the respondents that are invested in RL consider it to be easier to access credit with that bank, and if they are able to do so in more favorable conditions.

Since 6 respondents answered no in question 5, only a total of 42 answered to question 6. Out of those 42, 23,8% don't feel like they benefit from a credit related aspect in the relationship, while 76,2% do. Similar to question 5, respondents that answered no in question 6 are asked to skip to question 9.

Question 7 has the purpose of checking if the relationship related benefits the respondents consider to experience match with the ones considered in the literature. A total amount of 32 respondents (66,7% of the total sample) answered this question, since 16 answered no either in question 5 or 6.

Less demanding collateral (62,5%), and Better interest rate (56,3%), were the most selected answers, and the only ones chosen by more than 50% of the respondents. No need to pledge collateral was not selected by any of the 32 respondents, ability to access more finance was selected by 37,5%, and access the full amount of the loan asked was selected by 31,3%. Only 2 respondents didn't feel like they did benefit from any of the options provided.

Question 8 aims to see if the respondents perceive why the benefits from RL happen for the same reasons the literature does.

As it was in question 7, 32 respondents (66,7% of the sample) answered this question. They were able to select any of the options provided.

None of the respondents felt like none of the options provided had an impact or made room for a credit related benefit. The bank develops a better understanding of the business (28,1%), and the bank has a physical presence near the firm (15,6%), were the least selected options.

The Bank having an easier time financially analyzing the company (90,6%), bank having privileged knowledge on how the company is managed (68,8%) and Trust (68,8%), were all very commonly selected.

Question 9 was included to be able to assess the general perception of SMEs about the potential benefits of RL, and do so including input of all the respondents.

A five-point scale, ranging from Strongly Disagree (1) to Strongly Agree (5) was created, and most of the respondents felt that a longer, more intense and diverse relationship with a bank may create value for the company. None strongly disagreed with the statement, while 45,8% of the respondents partially agree with it and 37,5% strongly agree. The mean was 4,15.

Question 10 (with a scale identical to the one in question 9) was introduced to obtain the respondents' perceptions over SME sector profitability for banks. Most of the respondents (45,8%) partially agree with the statement, while the option partially disagree was the second most common (20,8%). The mean here was 3,54.

5. Conclusions

As it has been referenced before, the focus of this study was to analyze some of the most common debated issues within the literature regarding SME finance, and then, through a survey, confront the authors' conclusions on some of this issues with the perception of a number of SMEs in the Eastern Group of the Azores, a region highly dependent on these firms and that leads the rate at which businesses are renewed in the country.

The answers of the respondents in question 3 of the survey verify the occurrence of **RQ1**. The majority of the respondents consider it to be difficult to access bank financing, which is accordant to the European Commission's (2013A) statement that access to finance is expensive and difficult in Portugal.

From the answers to question 4 of the survey, **RQ2** is verified. The respondents consider that trouble pledging collateral (a risk shifting factor) and having an unfavorable credit history (past success indicator) to be the strongest negative factors affecting a firm's ability to access credit. These criteria are referred by Bruns and Fletcher (2008) as having the strongest effect in the probability of accessing finance. The respondents don't, however, seem to percept information problems to have the same weight as the literature does, specifically according to Deakins, Whittam and Wyper (2010), who define asymmetric information problems as the situation where a bank lacks the adequate information to decide whether or not to fund a certain proposal. Either by declining or by being unable to provide required information, a firm aggravates the asymmetric information problem. And since it is crucial for lenders to assess the credit worthiness of the borrowers (Elyasiani & Goldberg, 2004), not considering this could negatively affect the difficulty an SME would find in accessing credit. On the other hand, the answer pattern may also be explained by most of the respondents being invested in RL, since this technology facilitates the information exchange (Boot, 2000).

RL seems to be common in the region, and also seems to have the positive impact claimed by Berger and Udell (1995). Therefore, **RQ3** and **RQ4** are verified. A concise 87,5% (out of 48 respondents) claims to be invested in RL, and out of those that are (42 respondents), 76,2% feel like they benefit from a credit related aspect from that relationship. Having to pledge less demanding collateral and benefiting from a better interest rate were the most common selected benefits, which suggests that in the region the price of credit and the demanded collateral benefits surpass that of the availability of funds. This supports the allegations of Berger and Udell (1995), who claim that both collateral and loan rate conditions improves with RL, and not the ones of Hérnandez-Cánovas and Martínez-Solano (2008), who find that SMEs with longer banking relationships suffer higher costs for their debt, while having more access to loans. On the other hand, it cannot clearly be stated that these results go against the considerations of Petersen and Rajan (1994), who find a small effect of relationships in credit price, because the impact of the loan rate the respondents seem to observe is not measured. However, Petersen and Rajan (1994) state that availability of funds is often the priority choice of SMEs, and therefore is the main benefit of RL. In this study, that was clearly not the case, since ability to access more finance and access to the full amount of the loan asked were both less common answers.

As for the respondents' perceptions on why these benefits exist, from the analysis of question 8, the bank having physical presence near the company appears not to be considered as important as other characteristics of the relationship. This is in line with the results of Petersen and Rajan (2002), who find that borrower-lender distances are increasing. Being easier for the bank to financially analyze the firm, bank acquiring privileged knowledge on how the company is managed and the existence of trust between the bank and the business owner are understood by the respondents as an important dimension of the relationship. This is accordant with Petersen and Rajan's (1994) considerations, as well as with the ones of Hérnandez-Cánovas and Martínez-Solano (2008). **RQ5** is therefore verified. Still, it is worthy of note that the respondents appear to feel that the bank being in contact with the local community has low influence in generating credit related benefits. On a similar note, the bank developing a better understanding on the activity of the business also isn't considered by the respondents to have considerable impact on possible benefits.

By including the input of the respondents that are either not invested in a relationship with a bank or that don't see any credit related benefit in it, on question 9, the general perception was still that a strong number of the respondents felt like RL has potential to create value for a business.

The International Finance Corporation (2009) claims that banks are being forced to turn and look upon the SME segment in a different, more favorable way, and the majority of the respondents seem to partially agree that the SME segment is looked upon as profitable by banks.

Concerning the limitations of the study, the first one has to do with the number of answers to the survey acquired. According to the National Institute for Statistics (Instituto Nacional de Estatística, 2010), in 2008 there were 3969 SMEs in the whole Azores region. Considering that number, the conducted study was only able to gather the perception of approximately 1,2% of the total number of SMEs in the region. Even though the number 3969 refers to the whole archipelago, and the study conducted only aims at the SMEs established in the Eastern Group (2 out of 9 islands), the conclusions still have to be looked upon as possibly limited, since the majority of the SMEs are concentrated in the Eastern Group. Another limitation has to do with this question: to what point does the current economic situation and the financial crisis that has been installed since 2007/2008 affects the answers and the perception of the respondents, and to what extent?

As for further suggestions, it could be of use to SMEs to conduct a study aimed at the perceptions of banks in the region, in a way to analyze the criteria they most commonly use on their credit concession decisions. This study helps SMEs to compare their perceptions with the ones of the literature. A study that allowed the firms to compare their perceptions with the standards and criteria most used by banks in their area may provide them valuable insights.

BIBLIOGRAPHY

Altman, E., & Sabato, G. (2007). Modelling Credit Risk for SMEs: Evidence from the U.S. Market. *Abacus , 43 (No 3)*, 322-357.

Balkenborg, D., Kaplan, T., & Miller, T. (2012). A Simple Economic Teaching Experiment on the Hold-Up Problem. *The Journal of Economic Education , 43 (4)*, 377-385.

Beck, T. (2007). Financing Constraints of SMEs in Developing Countries: Evidence, Determinants and Solutions. *Financing Innovation-Oriented Businesses to Promote Entrepreneurship* (pp. 1-34). Seoul: World Bank Development Research Group.

Beck, T., Demirgüç-Kunt, A., & Pería, M. (2008). Bank Financing for SMEs around the World. *The World Bank Development Research Group , Policy Research Working Paper 4785*, 1-40.

Behr, P., & Güttler, A. (2007). Credit Risk Assessment and Relationship Lending: An Empirical Analysis of German Small and Medium-Sized Enterprises. *Journal of Small Business Management , 45 (2)*, 194-213.

Berger, A., & Udell, G. (2006). A more complete conceptual framework for SME finance. *Journal of Banking & Finance , 30*, 2945-2966.

Berger, A., & Udell, G. (1995). Relationship Lending and Lines of Credit in Small Firm Finance. *Journal of Business , 68 (No 3)*, 351-381.

Berger, A., & Udell, G. (2002). Small Business Credit Availability and Relationship Lending: The Importance of Bank Organisational Structure. *The Economic Journal , 112*, 32-53.

Berger, A., Cowan, A., & Frame, W. (2011). The Surprising Use of Credit Scoring in Small Business Lending by Community Banks and the Attendant Effects on Credit Availability, Risk, and Profitability. *Journal of Financial Services Research , 39*, 1-17.

Berger, A., Frame, W., & Ioannidou, V. (2011). Reexamining the Empirical Relation Between Loan Risk and Collateral: The Roles of Collateral Characteristics and Types.

Financial Intermediation Research Society Conference (pp. 1-24). Minneapolis: Federal Reserve Bank of Atlanta.

Boot, A. (2000). Relationship Banking: What do we Know? *Journal of Financial Intermediation , 9*, 7-25.

Bruns, V., & Fletcher, M. (2008). Banks' Risk Assessment of Swedish SMEs. *Venture Capital , 10 (No 2)*, 171-194.

Carbó-Valverde, S., Rodríguez-Fernández, F., & Udell, G. (2009). Bank Market Power and SME Financing Constraints. *Review of Finance , 13*, 309-340.

Cole, R., Goldberg, L., & White, L. (2004). Cookie Cutter vs. Character: The Micro Structure of Small Business Lending by Large and Small Banks. *Journal of Financial and Quantitative Analysis , 39 (No 2)*, 227-251.

de la Torre, A., Pería, M., & Schmukler, S. (2008). Drivers and Obstacles to Banking SMEs. *The World Bank Development Reconomics Research Group , Policy Research Working Paper 4788*, 1-30.

Deakins, D., Whittam, G., & Wyper, J. (2010). SMEs' Access to Bank Finance in Scotland: An Analysis of Bank Manager Decision Making. *Venture Capital , 12 (No 3)*, 193-209.

DeYoung, R., Frame, W., Glennon, D., & Nigro, P. (2011). The Information Revolution and Small Business Lending: The Missing Evidence. *Journal of Financial Services Research , 39*, 19-33.

Elyasiani, E., & Goldberg, L. (2004). Relationship Lending: A Survey of the Literature. *Journal of Economics and Business , 56*, 315-330.

Espírito Santo Research. (2009). *Região Autónoma dos Açores Potential Sectorial.* Banco Espírito Santo, Research Sectorial. R.A. Açores: Banco Espírito Santo.

European Central Bank. (2013). *Survey on the Access to Finance of Small and Medium-Sized enterprises in the Euro Area.* Frankfurt: European Central Bank.

European Commission. (2003). *Commission Recommendation of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises* . Brussels: Official Journal of the European Union.

European Commission. (2013B). *Entrepreneurship 2020 Action Plan.* Brussels: European Commission.

European Commission. (2013A). *Ficha SBA de 2013 Portugal.* European Commission.

Governo dos Açores. (2012, April 18). *Carlos César diz que falta de financiamento bancário e medidas de austeridade do governo central são a causa da crise nos Açores*. Retrieved May 12, 2014, from www.azores.gov.pt: http://www.azores.gov.pt/Portal/pt/entidades/pgra/noticias/PGR+aud.htm?mode=category

Governo dos Açores. (2014, April 8). *Criação de empresas nos Açores é maior do que no resto do país*. Retrieved May 12, 2014, from www.azores.gov.pt: http://www.azores.gov.pt/Portal/pt/entidades/vp/noticias/Criação+de+empresas+nos+Açores+é+maior+do+que+no+resto+do+pa%C3%ADs.htm

Grunert, J., & Norden, L. (2012). Bargaining Power and Information in SME Lending. *Small Business Economics , 39*, 401-417.

Hernández-Cánovas, G., & Martínez-Solano, P. (2010. Relationship Lending and SME Financing in the Continental European Bank-Based System. *Small Business Economics , 34*, 465-482.

Hyytinen, A., & Vaananen, L. (2006). Where do Financial Constraints Originate from? An Empirical Analysis of Adverse Selection and Moral Hazard. *Small Business Economics , 27*, 323-348.

Instituto Nacional de Estatística. (2010). *Estudos sobre Estatísticas Estruturais das Empresas 2008.* Instituto Nacional de Estatística.

International Finance Corporation. (2009). *The SME Banking Knowledge Guide.* Washington D.C.: World Bank Group.

Ipsos Mori. (2013). *2013 SMEs's Access to Finance Survey.* Brussels: European Commission.

Mudd, S. (2013). Bank Structure, Relationship Lending and Smal Firm Access to Finance: A Cross-Country Investigation. *Journal of Financial Services Research , 44*, 149-174.

Petersen, M., & Rajan, R. (2002). Does Distance Still Matter? The Information Revolution in Small Business Lending. *The Journal of Finance , LVII (No 6)*, 2533-2570.

Petersen, M., & Rajan, R. (1994). The Benefits of Lending Relationships: Evidence from Small Business Data. *The Journal of Finance , XLIX (No 1)*, 3-37.

Stein, J. (2002). Information Production and Capital Allocation: Decentralized versus Hierarchical Firms. *The Journal of Finance , LVII (No 5)*, 1891-1921.

Stiglitz, J., & Weiss, A. (1981). Credit Rationing in Markets with Imperfect Information. *The American Economic Review , 71 (No 3)*, 393-410.

St-Pierre, J., & Bahri, M. (2011). The Determinants of Risk Premium: Tha Case of Bank Lines of Credit Granted to SMEs. *Journal of Development Entrepreneurship , 16 (No 4)*, 459-476.

APPENDICES

Appendix I – Theoretical Framework for the construction of the Survey

Topic/Subject/(Question)	Author(s)	Content
Annual turnover **(1)** Number of employees **(2)**	European Commission (2003)	"The category of micro, small and medium-sized enterprises (SMEs) is made up of enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding EUR 50 million, and/or an annual balance sheet total not exceeding EUR 43 million."
Considering your experience, how do you rate the difficulty in accessing bank finance? **(3)**	European Central Bank (2013)	" (…) 'Finding customers' remained the dominant concern (…) 'Access to finance' was mentioned by the second largest percentage of euro area SMEs"
	European Commission (2013A)	"In 2012, access to finance remained difficult and expensive for SMEs in Portugal"
The firm/owner has an unfavorable credit episode **(4)**	Bruns & Fletcher (2008)	"Another interesting observation is that the three most important factors are all related to the past success of the company"
	Deakins, Whittam & Wyper (2010)	""Entrepreneurs seeking to start new businesses will find it more difficult because of the lack of any trading history. In such circumstances previous experience, age and credit history of the entrepreneur will be important.
Trouble pledging the demanded collateral **(4)**	Bruns & Fletcher (2008)	"Out of the four factors that have the strongest effect on the probability of supporting credit, three relate to tangible features that reduce the risk of the bank and shift the risk-taking to the borrowing SME, namely past performance, financial standing, and collateral."
Refusal or inability to provide certain specific information **(4)**	Elyasiani & Goldberg (2004)	"It is important for prudent lenders to gather information about the credit worthiness of the borrowers."
	Deakins, Whittam &	"Asymmetric information exists in situations in which bank officers will not have 'perfect'

	Wyper (2010)	information on funding proposals."
The amount of the loan asked **(4)**	St-Pierre & Bahri (2011)	"Our study of the sample revealed that the determinants of risk premium are firm size, line of credit size (…)."
Purpose of the loan **(4)**	Berger & Udell (2002)	"Small firms with opportunities to invest in positive net present value projects may be blocked from doing so because potential providers of external finance cannot readily verify that the firm has access to a quality project (…)."
Firm size **(4)**	St-Pierre & Bahri (2011)	"Our study of the sample revealed that the determinants of risk premium are firm size, line of credit size (…)."
Firm age **(4)**	Deakins, Whittam & Wyper (2010)	"Entrepreneurs seeking to start new businesses will find it more difficult because of the lack of any trading history."
Absence of a prior relationship with the bank **(4)**	St-Pierre & Bahri (2011)	"Our study of the sample revealed that the determinants of risk premium are (…) the relationship between the banker and the entrepreneur and the length of the relationship with the bank."
Can your company claim to have a long, diverse and close relationship with a bank, acquiring different services and products from it (online banking, savings account, etc.)? **(5)**	Boot (2000)	"We define relationship banking as the provision of financial services by a financial intermediary that: i. Invests in obtaining customer-specific information, often proprietary in nature; and ii. Evaluates the profitability of these investments through multiple interactions with the same customer over time and/or across products."
Do you think that with that bank it is easier to access a line of credit, and do so in more favorable conditions? **(6)**	Berger & Udell (1995)	"Evidence indicates that small firms with longer banking relationships borrow at lower rates and are less likely to pledge collateral than are other small firms."
	St-Pierre & Bahri (2011)	"It is reasonable to think the information asymmetry should decrease over time as the relationship between banker and entrepreneur develops, leading to better loan conditions."

Get a more favorable interest rate than you would from another bank **(7)**	Berger & Udell (1995)	“The collateral findings are also consistent with loan rate findings- in both cases, borrowers with longer relationships receive easier loan terms from their banks”
	Petersen & Rajan (1994)	“We find a small effect of relationships on the price charged by lenders. The length of an institution's relationship with the firm seems to have little impact on the rate.”
There is no need to pledge collateral **(7)**	Berger & Udell (1995)	“Our empirical result is that collateral is less often pledged in a mature relationship.”
The collateral required is less demanding than it would be with another bank **(7)**	Berger & Udell (1995)	“The collateral findings are also consistent with loan rate findings- in both cases, borrowers with longer relationships receive easier loan terms from their banks (lower rates, fewer collateral requirements)”
Have access to a larger line of credit; Get the full amount that was applied for **(7)**	Petersen & Rajan (1994)	“Both effects reduce the lender's costs of providing loans and services, and the former effect increases the availability of funds to the firm.”
	Elyasiani & Goldberg (2004)	“The area of greatest concern is credit availability to small business. Because of scale economies and durability of information, a firm having a longer and a stronger pre-existing relationship with its bank should have greater availability of funds and/or lower cost of funds.”
It is easier for the bank to financially analyze the company, because it has access to the firm’s savings, debit and credit information, etc. **(8)**	Petersen & Rajan (1994)	“The lender can learn about the firm's sales by monitoring the cash flowing through its checking account or by factoring the firm's accounts receivables.” “The empirical results suggest that the availability of finance from institutions increases as the firm spends more time in a relationship, as it increases ties to a lender by expanding the number of financial services it buys from it, and as it concentrates its borrowing with the lender.”
The bank has privileged knowledge about how the firm is managed **(8)**	Hérnandez-Cánovas & Martínez-Solano (2008)	“Banks learn about the honesty of the manager, the viability of the projects, and the borrower’s risk as the borrower pays back their loans. In addition, the bank’s accuracy in predicting the firm’s behavior and its future income improves with the relationship.”
There is trust between the bank and the business owner **(8)**	Hérnandez-Cánovas & Martínez-Solano (2008)	“As for the existence of trust, a bank is more likely to renew financing to the firms with which it maintains a relationship based on trust.”

The bank develops a better understanding on the business activity of the firm **(8)**	Berger & Udell (2002)	“Additional information may also be gathered through contact with other members of the local community, such as suppliers and customers, who may give specific information about the firm and owner or general information about the business environment in which they operate.
The bank is physically present near the firm, which contributes to a better understanding of its integration in the local community **(8)**	Petersen & Rajan (2002)	“Our finding that the physical distance between lender and borrower has expanded and that the interaction between the two has become less personal is consistent with the intuition that information technology is replacing the traditional role of the loan officer.”
	Berger & Udell (2002)	“Relationship lending is generally associated with the collection of `soft' information over time through relationships with the firm, the owner, and the local community.”
		“Additional information may also be gathered through contact with other members of the local community, such as suppliers and customers, who may give specific information about the firm and owner or general information about the business environment in which they operate.”
Having a longer, more intense and diverse relationship with a bank may create value for the business **(9)**	Berger & Udell (1995)	“Evidence indicates that small firms with longer banking relationships borrow at lower rates and are less likely to pledge collateral than are other small firms.”
	St-Pierre & Bahri (2011)	“It is reasonable to think the information asymmetry should decrease over time as the relationship between banker and entrepreneur develops, leading to better loan conditions.”
Banks consider small and medium enterprises to be a profitable segment **(10)**	International Finance Corporation (2009)	“SME banking is an industry in transition. From a market that was considered too difficult to serve, it has now become a strategic target of banks worldwide.”
		“Despite the recognized importance of the SME sector, evidence indicates that SMEs continue to be undersupplied with the financial products and services that are critical to their growth.”

Appendix II – Survey

1. Annual Turnover.

2. Number of Employees.

3. Considering your experience, how do you rate the difficulty in accessing bank finance?

a. Very Difficult

b. Difficult

c. Moderate

d. Easy

e. Very Easy

4. Choose up to 4 criteria you think may contribute to increase the difficulty to access bank finance.

- The firm/owner has an unfavorable credit episode;
- Trouble pledging the demanded collateral;
- Refusal or inability to provide certain specific information;
- The amount of the loan asked;
- Purpose of the loan;
- Firm size;
- Firm age;
- Absence of a prior relationship with the bank;

5. Can your firm claim to have a long, diverse and close relationship with a bank, acquiring different services and products from it (online banking, savings account, etc.)? If your answer is no, skip to question 9.

- Yes
- No

6. Do you think that with that bank it is easier to access a line of credit, and do so in more favorable conditions? If your answer is no, skip to question 9.

- Yes
- No

7. In what way do you feel that the relationship benefits you? Choose the options you agree with.

- Get a more favorable interest rate than you would from another bank;
- There is no need to pledge collateral;
- The collateral required is less demanding than it would be with another bank;
- You have access to a larger line of credit;
- Get the full amount that was applied for;
- None of the above

8. From what characteristics of the relationship you believe these benefits result? Choose the options you agree with.

- It is easier for the bank to financially analyze the firm, because it has access to the its savings, debit and credit information, etc.;
- The bank has privileged knowledge about how the firm is managed;

- There is trust between the bank and the business owner;
- The bank develops a better understanding on the business activity of the firm;
- The bank is physically present near the firm, which contributes to a better understanding of its integration in the local community;
- None of the above;

9. Having a longer, more intense and diverse relationship with a bank may create value for the business.

- Strongly disagree
- Disagree
- Undecided
- Agree
- Strongly agree

10. Banks consider small and medium enterprises to be a profitable segment

- Strongly disagree
- Disagree
- Undecided
- Agree
- Strongly agree

Appendix III – Survey (Portuguese Version)

Portuguese

1. Volume de negócios da empresa.

2. Número de trabalhadores da empresa.

3. Considerando a sua experiência, como classifica o grau de dificuldade para obter financiamento bancário?

- Muito difícil
- Algo difícil
- Moderado
- Algo fácil
- Muito fácil

4. Escolha até 4 fatores que considere poderem contribuir mais acentuadamente para um maior nível de dificuldade no acesso ao financiamento bancário.

- A empresa/gestor apresenta um episódio de crédito desfavorável;
- Dificuldades em prestar as garantias bancárias exigidas;
- Recusa/dificuldade em fornecer determinada informação;
- A dimensão do empréstimo pedido;
- O objetivo do empréstimo;
- A dimensão da empresa;
- A idade da empresa;
- A ausência de relacionamento prévio com o banco;

5. Pode a empresa afirmar ter com determinado banco uma relação longa, próxima e diversificada, com prestação de vário serviços e produtos (online banking, depósitos, empréstimos, etc.)? Se responder não, passe à questão 9.

- Sim
- Não

6. Pode afirmar que, junto desse banco, apresenta menor dificuldade em obter financiamento e consegue-o de forma mais favorável? Se responder não, passe à questão 9.

- Sim
- Não

7. De que forma sente que essa relação lhe é benéfica? Assinale as opções que entender.

- Consegue uma taxa de juro mais favorável;
- Não lhe são exigidas garantias bancárias;
- A exigência de garantias bancárias é menor;
- Consegue um montante de empréstimo;
- Consegue a totalidade do montante de empréstimo pedido;
- Nenhuma das anteriores;

8. De que aspetos da relação entende que resultam esses benefícios? Assinale as opções que entender.

- O banco tem maior facilidade em formular uma análise financeira da empresa, por ter acesso aos depósitos empresa, movimentos de débito e crédito, etc.;

- Há um maior conhecimento por parte do banco sobre a forma como a empresa é gerida;
- Há um nível de confiança superior entre o banco e o/a gestor(a) da empresa;
- O banco tem um melhor entendimento sobre a área de negócio da empresa;
- O banco tem presença física junto da empresa, o que contribui para uma melhor compreensão da sua integração na comunidade local;
- Nenhuma das anteriores;

9. Manter uma relação de maior duração, intensidade e diversidade com um banco pode criar valor para uma empresa.

- Discordo totalmente
- Discordo parcialmente
- Indiferente
- Concordo parcialmente
- Concordo totalmente

10. Os bancos consideram lucrativo o segmento de mercado composto por pequenas e médias empresas.

- Discordo totalmente
- Discordo parcialmente
- Indiferente
- Concordo parcialmente
- Concordo totalmente

Appendix IV - Frequencies

TABLE I
ANNUAL TURNOVER

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Not exceeding 2M	42	87,5	87,5	87,5
	Between 2M and not exceeding 10M	6	12,5	12,5	100,0
	Total	48	100,0	100,0	

TABLE II
NUMBER OF EMPLOYEES

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Below 10	27	56,3	56,3	56,3
	Between 10 and below 50	17	35,4	35,4	91,7
	Between 50 and up to 250	4	8,3	8,3	100,0
	Total	48	100,0	100,0	

TABLE III
DIFFICULTY ACCESSING FINANCE

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Very Difficult	12	25,0	25,0	25,0
	Difficult	19	39,6	39,6	64,6
	Neutral	12	25,0	25,0	89,6
	Easy	3	6,3	6,3	95,8
	Very Easy	2	4,2	4,2	100,0
	Total	48	100,0	100,0	

TABLE IV
FIRM/OWNER HAS AN UNFAVORABLE CREDIT EPISODE

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Not Selected	22	45,8	45,8	45,8
	Selected	26	54,2	54,2	100,0
	Total	48	100,0	100,0	

TABLE V
TROUBLE PLEDGING DEMANDED COLLATERAL

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Not Selected	16	33,3	33,3	33,3
	Selected	32	66,7	66,7	100,0
	Total	48	100,0	100,0	

TABLE VI
REFUSAL/INABILITY TO PROVIDE INFORMATION

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Not Selected	41	85,4	85,4	85,4
	Selected	7	14,6	14,6	100,0
	Total	48	100,0	100,0	

TABLE VII
THE AMOUNT OF THE LOAN

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Not Selected	25	52,1	52,1	52,1
	Selected	23	47,9	47,9	100,0
	Total	48	100,0	100,0	

TABLE VIII
PURPOSE OF THE LOAN

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Not Selected	33	68,8	68,8	68,8
	Selected	15	31,3	31,3	100,0
	Total	48	100,0	100,0	

TABLE IX
FIRM SIZE

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Not Selected	30	62,5	62,5	62,5
	Selected	18	37,5	37,5	100,0
	Total	48	100,0	100,0	

TABLE X
FIRM AGE

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Not Selected	39	81,3	81,3	81,3
	Selected	9	18,8	18,8	100,0
	Total	48	100,0	100,0	

TABLE XI

NO PRIOR RELATIONSHIP WITH THE POTENTIAL LENDER

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Not Selected	32	66,7	66,7	66,7
	Selected	16	33,3	33,3	100,0
	Total	48	100,0	100,0	

TABLE XII

FIRM IS INVESTED IN A LONG, CLOSE AND DIVERSE RELATIONSHIP WITH A BANK

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	No	6	12,5	12,5	12,5
	Yes	42	87,5	87,5	100,0
	Total	48	100,0	100,0	

TABLE XIII

DO YOU SEE A CREDIT RELATED BENEFIT IN THAT RELATIONSHIP

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	No	10	20,8	23,8	23,8
	Yes	32	66,7	76,2	100,0
	Total	42	87,5	100,0	
Missing	Asked to ignore	6	12,5		
Total		48	100,0		

TABLE XIV

BETTER INTEREST RATE

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	No	14	29,2	43,8	43,8
	Yes	18	37,5	56,3	100,0
	Total	32	66,7	100,0	
Missing	Asked to ignore	16	33,3		
Total		48	100,0		

TABLE XV

NO NEED TO PLEDGE COLLATERAL

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	No	32	66,7	100,0	100,0
Missing	Asked to ignore	16	33,3		
Total		48	100,0		

TABLE XVI
COLLATERAL REQUIRED IS LESS DEMANDING

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	No	12	25,0	37,5	37,5
	Yes	20	41,7	62,5	100,0
	Total	32	66,7	100,0	
Missing	Asked to ignore	16	33,3		
Total		48	100,0		

TABLE XVII
ABILITY TO ACCESS MORE FINANCE

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	No	20	41,7	62,5	62,5
	Yes	12	25,0	37,5	100,0
	Total	32	66,7	100,0	
Missing	Asked to ignore	16	33,3		
Total		48	100,0		

TABLE XVIII
ACCESS THE FULL AMOUNT OF THE LOAN ASKED

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	No	22	45,8	68,8	68,8
	Yes	10	20,8	31,3	100,0
	Total	32	66,7	100,0	
Missing	Asked to ignore	16	33,3		
Total		48	100,0		

TABLE XIXN
ONE OF THESE

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	No	30	62,5	93,8	93,8
	Yes	2	4,2	6,3	100,0
	Total	32	66,7	100,0	
Missing	Asked to ignore	16	33,3		
Total		48	100,0		

TABLE XX
EASIER FOR THE BANK TO PERFORM A FINANCIAL ANALYSIS ON THE FIRM

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	No	3	6,3	9,4	9,4
	Yes	29	60,4	90,6	100,0
	Total	32	66,7	100,0	
Missing	Asked to ignore	16	33,3		
Total		48	100,0		

TABLE XXI
THE BANK HAS PRIVILEGED KNOWLEDGE ON HOW THE FIRM IS MANAGED

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	No	10	20,8	31,3	31,3
	Yes	22	45,8	68,8	100,0
	Total	32	66,7	100,0	
Missing	Asked to ignore	16	33,3		
Total		48	100,0		

TABLE XXII
TRUST

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	No	10	20,8	31,3	31,3
	Yes	22	45,8	68,8	100,0
	Total	32	66,7	100,0	
Missing	Asked to ignore	16	33,3		
Total		48	100,0		

TABLE XXIII
THE BANK DEVELOPS A BETTER UNDERSTANDING ON THE ACTIVITY OF THE BUSINESS

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	No	23	47,9	71,9	71,9
	Yes	9	18,8	28,1	100,0
	Total	32	66,7	100,0	
Missing	Asked to ignore	16	33,3		
Total		48	100,0		

TABLE XXIV
THE BANK HAS PHYSICAL PRESENCE NEAR THE FIRM, BETTER UNDERSTANDING ITS INTEGRATION IN THE LOCAL COMMUNITY

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	No	27	56,3	84,4	84,4
	Yes	5	10,4	15,6	100,0
	Total	32	66,7	100,0	
Missing	Asked to ignore	16	33,3		
Total		48	100,0		

TABLE XXV
NONE OF THE ABOVE

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	No	32	66,7	100,0	100,0
Missing	Asked to ignore	16	33,3		
Total		48	100,0		

TABLE XXVI
A LONGER, CLOSER AND DIVERSE RELATIONSHIP MAY CREATE VALUE FOR THE BUSINESS

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Partially disagree	3	6,3	6,3	6,3
	Undecided	5	10,4	10,4	16,7
	Partially agree	22	45,8	45,8	62,5
	Strongly agree	18	37,5	37,5	100,0
	Total	48	100,0	100,0	

TABLE XXVII
DESCRIPTIVE STATISTICS (QUESTION 9)

	N	Minimum	Maximum	Mean	Std. Deviation
A longer, closer and diverse relationship may create valu for the business	48	2	5	4,15	,850
Valid N (listwise)	48				

TABLE XXVIII
BANKS CONSIDER SMALL AND MEDIUM ENTERPRISES TO BE A PROFITABLE SEGMENT

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly Disagree	2	4,2	4,2	4,2
	Partially disagree	10	20,8	20,8	25,0
	Undecided	5	10,4	10,4	35,4
	Partially agree	22	45,8	45,8	81,3
	Strongly Agree	9	18,8	18,8	100,0
	Total	48	100,0	100,0	

TABLE XXIX
DESCRIPTIVE STATISTICS (QUESTION 10)

	N	Minimum	Maximum	Mean	Std. Deviation
Banks consider small and medium enterprises to be a profitable segment	48	1	5	3,54	1,148
Valid N (listwise)	48				