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Cultural differences and the structure of loan syndicates

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ABSTRACT

Do cultural differences between lender and borrower affect the structure of the loan syndicate? Analyzing 8031 syndicated loans to US borrowers signed between 1986 and 2007, we find that lending shares are higher for foreign arrangers than domestic arrangers. Among foreign arrangers, lending shares further increase with cultural distance. We interpret this as a result of an increased moral hazard problem driven by higher information and effort costs faced by foreign arrangers. However, previous interactions between borrowers and arrangers can reduce moral hazard, hence culturally distant arrangers are able to form diffused syndicates.

1. Introduction

This study investigates whether cultural differences between the arranger and the borrower affect the structure of the loan syndicate. In the syndicated loan market, the arranger negotiates the terms of the contract with the borrower, and then invites participants to fund part of the loan. In order to avoid the cost associated with multiple-creditor monitoring, participants delegate monitoring and administrative

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responsibilities to the arranger who bears the monitoring cost in return for additional fee income (Boot and Thakor, 2000; Hauswald and Marquez, 2006). This setting can however reduce the incentive of arrangers when there is no net advantage of acting as a delegated monitor (Diamond, 1984). This incentive problem for the delegated monitor can be severe if gathering private information requires substantial additional cost, as is the case when the distance – either geographically or culturally – between borrower and lender is large. Arrangers have to bear the monitoring cost, yet retain only a fraction of the loan. Therefore, arrangers could lack the incentive to provide the optimal level of efforts (Ivashina, 2009; Lin et al. 2012; Sufi, 2007). Because monitoring efforts are costly and unobservable, arrangers must retain a higher share of the loan in order to credibly commit to a sufficient level of monitoring *vis-à-vis* the syndicate's other participants (Diamond, 1984). Otherwise, a moral hazard problem would arise (Bharath et al., 2011; Holmstrom and Tirole, 1997; Sufi, 2007). In this study, we investigate whether this moral hazard problem is especially severe for foreign arrangers who are culturally distant, whether it affects the syndicate structure and how it can be overcome. We hypothesize that cultural distance between arrangers and borrowers increases monitoring cost and moral hazard. Consequently, we expect that distant arrangers need to retain higher lending shares in order to credibly commit to proper monitoring.

In this study, we perceive the existence of natural and cultural barriers in the communication between arrangers and borrowers. Geographical distance alone constitutes such a barrier (Mian, 2006). Furthermore, translations are required to effectively communicate in case of differing languages, which might create mis-understandings because words are interpreted differently across cultures. Furthermore, Adair et al. (2001), Brett and Okumura (1998) and Ting-Toomey (2007) argue that cognitive, behavioral and emotional constraints hinder effective communication among different cultures while sharing similar norms and codes facilitates communication. For example, senior managers are given high status in Asian cultures and are selected as negotiators, but they might find it inappropriate to negotiate with younger, more subordinate people chosen in Anglo-Saxon cultures. Managers from individualistic and egalitarian cultures prefer direct and straightforward communication. Thus, they have a different idea of how to efficiently and effectively communicate than managers from hierarchical cultures who prefer to pass information through multiple managerial layers. Overall, these attributes are determining factors in the process of negotiation and financial contract design. More specifically in the context of syndicated lending, distance, as well as language and cultural differences make the arranger's monitoring task more difficult.

This study relates closely to two prominent studies and provides complementary evidence as far as distant lenders are concerned. First of all, Mian (2006) provides empirical evidence that greater cultural and geographical distance between a foreign bank's headquarters and its local branches leads to reduced lending to "informationally difficult" yet fundamentally sound firms that require relational contracting. On the other hand, Petersen and Rajan (2002) show that lender productivity and technology improvements increase access to credit for remote firms, enabling such firms to move beyond local loan markets and communicate with lenders in more impersonal ways. Contrary to Petersen and Rajan (2002), we argue that although communicating with lenders and getting hard information is relatively easy due to technology advancements, acquiring soft information is still an obstacle. Geographical distance, legal or cultural differences can also hinder the acquisition of information. As noted by Giannetti and Yafeh (2012), cultural differences increase contracting cost. The effect may be non-pecuniary, if interaction with culturally distant borrowers increases the lenders' disutility from writing the contract. We therefore look specifically at cultural differences in the syndicated loan market.

The existing evidence regarding borrower–lender distance focuses on loan pricing and gives evidence of spatial price discrimination, that is, a negative relationship between borrower–lender distance and loan cost.[1] In contrast, we study the impact of borrower–lender distance on syndicate structure. There are a number of studies investigating the asymmetric information problem by analyzing syndicate structure. These studies differ, however, with respect to the proposed syndicate structure determinants; either it is the borrowers' opaqueness, lead arrangers' reputation or both.[2] One strand of the literature confirms

[1] See Agarwal and Hauswald (2010), Degryse and Ongena (2005), Giannetti and Yafeh (2012) and Knyazeva and Knyazeva (2012).

[2] See Schure et al. (2005) for a theory of loan syndication. Note that the decisions on whether to syndicate a loan and how to structure the syndicate are related to the decision of loan tranching. Here, lenders decide to split a loan deal into separate tranches with different lender groups forming separate, tranche-specific syndicates. For a discussion of the determinants and economic value of tranching see Cumming et al. (2015) and Maskara (2010).