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So what do I get? The bank's view of lending relationships ☆

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Abstract

While many empirical studies document borrower benefits of lending relationships, less is known about lender benefits. A relationship lender's informational advantage over a non-relationship lender may generate a higher probability of selling information-sensitive products to its borrowers. Our results show that the probability of a relationship lender providing a future loan is 42%, while for a non-relationship lender, this probability is 3%. Consistent with theory, we find that borrowers with greater information asymmetries are significantly likely to obtain future loans from their relationship

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lenders. Relationship lenders are likely to be chosen to provide debt/equity underwriting services, but this effect is economically small.
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1. Introduction

The special nature of lending relationships has been the subject of extensive theoretical and empirical research in finance.[1] While there is no precise definition of "relationship banking," scholars broadly agree that if a financial intermediary's decision to supply various services to a firm is based on borrower-specific information that the intermediary collects over multiple interactions (over time as well as across multiple products), and further, if this information is proprietary (available only to the borrower and the intermediary), the intermediary is engaged in relationship banking (for a detailed discussion, see Berger, 1999; Boot, 2000). Existing theories predict that the establishment of strong lender-borrower relationships can generate significant benefits for the lender.[2]

Empirical evidence on the benefits of banking relationships has largely focused on documenting these benefits to the *borrower*. This literature can be broadly classified into two distinct approaches. The first approach uses indirect tests to establish the value of banking relationships. Specifically, James (1987) and Lummer and McConnell (1989) find a positive stock market reaction to the renewal of lending relationships and thereby establish the value-enhancement role of relationships to borrowers.[3] The second approach attempts to estimate the effects of relationships on borrowers directly by examining the impact that such relationships have on the cost and availability of credit. This approach is best characterized by Petersen and Rajan (1994) and Berger and Udell (1995), who find, among other things, that the stronger (i.e., the longer the duration of) the relationship, the greater the credit availability and the lower the collateral requirements.

In contrast, the focus of our paper is on establishing the existence and the nature of the benefits of relationship banking from the perspective of the *lender*, a subject that has attracted far less attention in the literature. Indeed, relationship studies do not provide any guidance with respect to the sources of these benefits to lenders and how the value created by establishing such relationships is shared between lenders and borrowers.[4] Thus, an

[1] See Boot (2000) and Ongena and Smith (1998) for an extensive survey of this literature.

[2] The benefits could come from multiple sources such as the ability to share sensitive information (Bhattacharya and Chiesa, 1995), more flexible contracts compared to public debt (Berlin and Mester, 1992; Boot et al., 1993), the ability to monitor collateral (Rajan and Winton, 1995), and the ability to smooth out loan pricing over multiple loans (Berlin and Mester, 1999). A relationship lender can also benefit from potential monopoly (holdup) power of the lender (e.g., Sharpe, 1990; Rajan, 1992), which allows the lender to charge its captive borrowers excessive rates for loans. Berlin (1996) provides a good overview of these issues of relationship lending.

[3] Further evidence is provided by Slovin et al. (1993) and Dahiya et al. (2003a), who document a *negative* impact of the potential *termination* of lending relationships on the borrower's market value. Ongena et al. (2003) report similar results for capital-constrained Norwegian borrowers when banks of such borrowers face distress.

[4] One study that attempts to indirectly measure the relationship benefits to the lenders is Dahiya et al. (2003b). They find that a bank's share price drops when its borrower announces default. The stock price decrease is much

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