A Study of the Relationship Between Bank Size and Attitudes Toward Small and Medium-Sized Enterprise Lending

Xiaoqian Zhao
Yantai Nanshan University, Yantai 265700, China.

Abstract: This article is divided into three parts to explain the relationship between bank size and SME lending attitudes. First, the paper defines Small and Medium-sized enterprises and bank size. Secondly, the article classifies the lending techniques of banks in order to clearly analyze the attitude of bank size and Small and Medium-sized enterprises lending afterwards. In addition, the relative advantages of large banks and small banks are compared based on the above study. The comparison leads to the conclusion that small banks are more suitable to use relationship-based lending techniques.

Keywords: Enterprise Lending; Small Banks; Medium-Sized Enterprises; Financial Statements Lending; Asset-Based Lending

1. The Concept of Small and Medium-sized Enterprises

SME (Medium-sized Enterprise) is a concept of enterprise size form and is a relative concept. Since different countries and regions have different levels of economic development, there is no uniform standard for the definition of SMEs. Generally speaking, the international classification of SMEs is mainly measured from both qualitative and quantitative aspects. The qualitative criteria are mainly the organizational form of the enterprise, the position of the enterprise in the industry and the positioning of the enterprise in the market. So the qualitative criteria are generally three core characteristics: entrepreneurs with independent ownership, autonomous operation and smaller market share (Sun, 2015). According to the Notice on the Issuance of the Standard Provisions for SME Classification issued by the Ministry of Industry and Information Technology of China in 2011. SMEs are defined in China in the following chart:

Table 1: China's criteria for classifying SMEs in different industries   Unit: million

Industry / Income	Industry company	Building industry	Wholesale establishment	Retail industry	Transportation industry	Warehousing industry
Medium-sized enterprise	≥2000-40000	≥6000-80000	≥5000-40000	≥500-20000	≥3000-30000	≥1000-30000
Small enterprise	≥300-2000	≥300-6000	≥1000-5000	≥100-500	≥200-3000	≥100-1000

Resource: Small and medium-sized enterprise classification standards notice

1.1 The status and role of small and medium-sized enterprises

Small and medium-sized enterprises are the basic force to promote social and economic development, construct the main body of market economy and promote social stability. From a business perspective there is a coordinated relationship between large enterprises and SMEs. Large enterprises are more focused on big business, while many small needs require services provided by small enterprises to meet them. Although SMEs do not have as much influence as large enterprises bring to the world, they are an indispensable part of the socio-economic development when they are united.

2. The Concept of Bank Size

Since different countries and regions have different levels of economic development, there is no uniform standard for defining SMEs. The following illustration is based on the example of Chinese financial institutions.

According to the classification standards for enterprises in the financial sector announced on September 28, 2015, banking depository institutions with total assets of 400 billion yuan or less are small, medium and micro enterprises. Among them, those with total assets of 500 billion yuan and above are medium and bold enterprises, those with total assets of 5 billion yuan and above are small enterprises, and those with total assets of 5 billion yuan and below are micro enterprises. Please refer to the following chart for details.

Table 2: China's classification of banks of different sizes

Types of financial institutions / Total assets	Banking deposit financial institutions	Banking Non deposit financial institutions
Large and medium-sized enterprises	≥500 billion yuan	≥20 billion yuan
small enterprises	≥5 billion yuan	≥5 billion yuan
Micro enterprise	≤5 billion yuan	≤5 billion yuan

Resource: Financial industry enterprise classification standard regulations

3. Technical classification of bank loans

Banks may use different lending techniques when lending to SMEs. Therefore, in order to study which size of bank is more suitable for lending to SMEs, it is necessary to first clarify the classification of lending techniques. On this basis, the advantages of different banks of different sizes for different lending techniques can be discussed. According to Berger & Udell (2020), lending techniques can be classified into three categories: Financial Statements Lending, Asset-based Lending, Credit Scoring.

3.1 Financial Statements Lending

The financial statements lending refers to the financial statements provided by the loan applicant as the main reference for the bank to make lending decisions, and the financial information reflected in the statements is analyzed to give the final review results Berger & Udell (2002). Generally speaking, only large enterprises with standardized financial systems are able to provide relatively transparent financial statements and are easily favored by banks, which is difficult to be achieved by most SMEs in general.

3.2 Asset-based Lending

When using asset-based lending techniques, banks mainly refer to the collateral that the borrower can provide Berger & Udell (2002). Since these collaterals are a guarantee for the bank, they can effectively reduce the moral hazard in the lending agreement. Therefore, SMEs can use collateral even if they have difficulties in providing complete financial statements, which makes it less difficult for SMEs to lend. However, this type of loan also has significant disadvantages. It usually requires more complicated procedures, which can result in higher transaction costs.

3.3 Credit Scoring

Credit scoring is a new technique that relies on modern information technology to score and assign weights to various aspects of a customer's credit history and analyze them using mathematical and statistical methods in order to make decisions. This technique takes into account not only the financial information presented in the balance sheet, but also the financial position of the owner and the history of the credit history of the company.

4. Factors that banks need to examine when lending to companies

4.1 Risk resilience

The risk resistance of a business is an important factor for a bank to measure whether to lend to a business. From the point of view of the economic strength and business quality of SMEs is at the bottom of the entire ecosystem, beyond the financial capacity of the project will borrow money. Once the national economic situation changes, these SMEs are basically defenseless. Overall, the risk resistance of SMEs is very poor.

4.2 Cost and Management

For a larger bank, there are costs at every step of the process from lending to a business all the way through to recovery. In this regard, large-scale banks prefer to lend to larger companies that need more capital so that the bank will have higher interest income to cover the administrative costs that would be lost because of the loan.

4.3 Quality collateral

A business has quality collateral to pledge to a bank for a loan, which fundamentally enables the bank to have more information to lend to the business. SMEs do not have quality collateral assets and are less risk averse. Conversely, large companies have quality collateral that allows banks to fundamentally feel comfortable lending to them.

5. Features of Business Loans

From the above-mentioned situation, the mistrust of large-scale banks towards SMEs causes these banks not to lend easily to SMEs. Although small-scale banks lend mainly to SMEs, they cannot effectively meet the financing needs of many SMEs due to their single source of funds, poor channels for fund settlement and limited risk resistance. Therefore, the funds lent to SMEs are not very abundant. In addition, the characteristics of financing channels will be analyzed to explain why SMEs are suffering from loan difficulties.

6. Characteristics of SME loan channels

The characteristics of financing channels of SMEs are the primary characteristics of SME financing. The following chart shows SMEs in China as an example.

Table 3: SME Funding Channel Survey Statistics

Equity funding sources（%）						
Period	Major contributors	Reinvestment of retained earnings	Government Investment	Venture Capital	Other personal investments	Main Board Market Investment
≤2 years	28.94	0	5.5	0.2	3	0
2-4years	15.22	8.67	6	0.5	4.7	0
≥5 years	13.21	15.43	7.3	1	8.12	1.1

Debt-based funding sources（%）								
Period	Bank Mortgage	Credit Guarantee Loan	Lease Guarantee Loan	Business Credit Loans	Collateralization of notes receivable	Inventory Secured Loan	Non-financial institution loans	Loans from friends and family
≤2 years	16.2	12.26	0	9.3	0	0	3	21.6
2-4years	17.16	16.3	0	11.2	1	5	4	10.25
≥5 years	16.43	14.3	0	14.3	1.5	6.28	1	0

Resource: Yu Jiang, 2008. Study on credit financing of small and medium-sized enterprises by large commercial banks in China

As can be seen from the chart, the main sources of business funding during the start-up period are investments from major contributors and loans from friends and relatives, which provide more than 50% of the seed investment. Next, bank mortgage borrowing and credit guarantee borrowing support close to 30% of the funding. In addition, government investment and other personal investments underwrite close to 10% of the equity funding. Commercial credit loans also provide nearly 10% of the debt-based funding sources. In the early stage of SME start-up, the risk is high because the business risk and financial risk of the enterprise are both maximum and the development future is still uncertain. Therefore, the only equity investments other than corporate affiliates are trace amounts of venture capital and other personal investments, and the main board market investments are zero.

7. Measures to solve the financing difficulties of small enterprises

7.1 Maintain a close relationship between the bank and the business

Many foreign studies have argued that the duration of the bank-firm relationship can be used as a variable to measure the relationship between banks and firms. the study of Petersen and Rajan (1994) showed that the longer the duration of the relationship between banks and firms, the higher the probability of firms to obtain bank loans. Many subsequent studies have also followed their approach, such as Boot (2000) who found that the continuation of the sending relationship facilitates the reduction of loan difficulty and the improvement of loan terms for firms.

7.2 Improve the management of the enterprise itself

The organizational structure, financial management, and credit rating of SMEs are the three main aspects that directly relate to their financing ability (Zheng, 2016). As an organization whose main goal is profitability, the scientific nature of its structure not only affects the investment and financing plan in the short term, but also affects the long-term profitability and competitiveness of the enterprise. Therefore, it is an insurmountable step for SMEs to standardize their organizational structure in order to strengthen their financing ability.

7.3 Government Support

Although many SMEs have strong development potential, they are still in a disadvantaged position in the industry, which requires government support. The effectiveness of any policy to support SMEs requires a clear definition of what an SME is in the first place. This will ensure the effectiveness of the support policy and the flow of support funds to SMEs with genuine financing needs.

References

[1] Strahan, PE, Weston, JR, 1998. Small Business Lending and The Changing Structure of The Banking Industry. Journal of Banking and Finance.

[2] Steve Mercieca, Klaus Schaek, Simon Wolfe, 2009. Bank Market Structure，Competition, and SME Financing Relationships in European Regions. Joumal of Financial Services Research.

[3] Berger AR, Udell GF,1995. Relationship Lending and Lines of Credit in Small Firm Finance. Journal of Business.

[4] Berger A and Udell G, 2002. Small Business Credit Availability and Relationship Lending. The importance of Bank Organizational Structure. Economic Journal.

[5] Boot A and W.A, 2000. Relationship Banking: What Do We Know? Journal of Financial Intermediation.

[6] Ou XQ, 2007. Small and medium-sized enterprises play an important role in building a harmonious society. Xinhua News Agency. http://www.gov.cn/wszb/ zhibo91/content_673740.htm.

[7] Sun YL, 2015. Zhongxiao Qiye Rongzi Kunnan Jiqi Jiejueduice Yanjiu. [Research on Small and Medium-sized Enterprises' Financing Difficulties and Their Solutions].

[8] Berger AN, Saunders A, Scalise JM, Udell GE, 1998. The Effects of Bank Mergers and Acquisitions on Small Business Lending. Journal of Financial Economics.

[9] Financial industry enterprise classification standard regulations, 2013. https:// www.66law.cn/tiaoli/42560.aspx.

[10] Zheng Y, 2016. Yinhang Guimo dui Zhongxiaoqiye Daikuan de Yingxiangyanjiu. [A study on the impact of bank size on SME lending].