Benevolence, integrity and ability: a survey of Italian SMEs and banks

Conference or Workshop Item

Benevolence, Integrity and Ability: A Survey of Italian SMEs and Banks

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Type of Paper: Refereed Research Paper

Purpose: Access to appropriate finance is crucial for the start-up, survival, growth and development of firms. The majority of entrepreneurs, especially in smaller firms, are reliant on the bank system. Previous research examines relationships between firms and banks from a transaction costs economics and/or agency theory point of view. This postulates an opportunistic base to human behaviour. An alternative set of assumptions about human nature encompass altruism and trust. Trust is relevant because it is a way to reduce complexity; it is the 'lubricant' in exchanges; it is crucial in situations of risk or high pressure, and it is among the building blocks of social capital, which have been shown to underpin access to resources for entrepreneurs. Trust is based on an assessment of ability, benevolence and integrity. This paper tests whether there is a relationship between trust and the cost of finance (i.e. interest rates).

Design/Methodology/Approach: The research is based in North East Italy. The conceptual framework was derived from trust and bank lending literature and was further developed and validated through interviews with entrepreneurs and bank managers. A pilot study, conducted in 2004, helped refine the survey instruments and constructs. A dyadic survey was completed in Spring 2005, i.e. we collected data from both banks and firms. Entrepreneurs were surveyed by telephone and bank managers completed a written questionnaire for each firm. The two parts of the survey were combined for analysis using a unique identifier.

Findings: Factor analysis reduced the trust items into three components representing ability, benevolence and integrity. Multivariate linear regression models tested the influence of the three trust factors on interest rates and the amount of credit. A negative relationship was found between ability and integrity and interest rates. In other words, higher levels of trust were associated with lower interest rates.

Implications: Trust is a key element in the entrepreneur – bank relationship, providing the opportunity to reduce agency costs. From the bank's point of view, trust mitigates adverse selection and moral hazard, reduces screening and monitoring costs and provides the potential for higher profits. For the entrepreneur, it reduces time required to comply with formal monitoring exercises and the requirements for collateral. Trust spirals, in that bestowing trust increases trustworthy behaviour.

Originality/Value: This paper is unique in assessing the role of benevolence, integrity and ability, i.e. the three aspects of trust, on interest rates.

Key Words: small firms, bank relationships, trust.

Introduction

The financing of small and medium enterprises (SMEs) is the subject of enduring academic and political debate (Howorth, 2001). As bank debt is the most common source of external funding for businesses of all sizes, and access to bank finance is crucial for entrepreneurs wishing to start-up or develop businesses, there is a regular stream of policy and academic research investigating debt financing. It has recently come to the fore again with the Basel II agreement. Previous research has highlighted the importance of relationships between entrepreneurs and banks (Binks and Ennew, 1997; Howorth, Peel and Wilson, 2003) and considers whether particular elements of the relationship can reduce agency problems and improve the flow of bank funding (Petersen and Rajan, 1994). However, bank relationships are usually examined from an economic perspective and the emphasis is nearly always on hard information as a means of reducing information asymmetries.

The basis of much of the previous work is an opportunistic assumption of human behaviour (Barney, 1990; Donaldson, 1990). Donaldson (1990) states "*the narrow and particular model of man in organisational economics of people as cheats and idlers is […] offensive.*" Barney (1990) argues that an alternative set of assumptions about human nature that include altruism or trust have just as much validity and can be integrated in traditional organisational economics. High levels of trust are purported to encourage trustworthy behaviour (Pettit, 1995; Nooteboom, 2003). Trust may therefore play an important role in reducing agency problems such as moral hazard and adverse selection. However, the role of trust in the relationship between entrepreneurs and banks has as yet only been alluded to and has not been explored in depth.

Literature on trust argues for its relevance in reducing transaction costs, and agency costs. At the same time, literature on relationship lending points out the importance of reducing agency problems to improve credit availability, to reduce the cost of credit and reduce the requirement for collateral and personal guarantees. Combining these two streams of research leads to our main research question: what is the influence of trust in bank lending outcomes for SMEs?

This paper looks generally at the role of trust in bank lending and then tests whether variables which measure different elements of trust are associated with differences in the interest rate charged to SMEs. We focus on a specific region in North East Italy which is viewed as a model of economic development. We examine two sub-regions that are similar economically, geographically and socially but have very contrasting banking systems. South Tyrol has a highly concentrated banking system and in some areas there is only one choice of bank, whereas Friuli Venezia Giulia has a competitive banking system with a wide choice of local and national banks. Hypotheses were derived from previous conceptual and empirical studies and from interviews with entrepreneurs and their bank managers in North East Italy. The validity of constructs and measures was tested in a pilot study. A dyadic survey was undertaken, in other words we questioned both bank managers and entrepreneurs about the same relationship. This allows a greater degree of confidence in the validity and interpretation of the results.

The paper proceeds as follows. In the next section we examine relevant literature from the two streams of bank lending and trust theories. This is followed by description of the quantitative methodology. The results of our survey are presented next. Finally, we consider the implications for entrepreneurs, banks and future research.

Relevant Literature

Bank Lending

Whilst the debate regarding the existence of credit rationing is unresolved, it is generally agreed that credit rationing is more likely to occur where information asymmetries are highest and that small firms in particular are more likely to suffer from informational opacity (Berger and Udell, 1995). Information asymmetries in bank-firm relationships (Sharpe, 1990), along with higher interest rates or collateral can increase adverse selection situations defined as "a situation in which a pricing policy causes only the least desirable customers to do business" (Brealey and

Myers, 1991). In the lender-borrower relationship it is a situation in which only the riskier entrepreneurs decide to do business because they can accept a higher cost due to riskier – but potentially more rewarding – projects. In this way, higher interest rates and collateral pledging can increase the riskiness of the portfolio and decrease bank's profit (Stiglitz and Weiss, 1981; Bester, 1985).

As the relationship between bank and firm evolves, it is argued that the risk for the bank is reduced and the credit availability for the firm increases because information asymmetries are reduced (Binks and Ennew, 1997). Earlier works by Petersen and Rajan (1994, 1995) and Berger and Udell (1995) – both focused on the United States – highlighted that small firms are more informationally opaque and therefore their lending process is more deeply affected by relationships. Later research, in Europe, (for instance, Angelini et al., 1998; Binks and Ennew, 1997; Harhoff and Körting, 1998) also suggests that bank relationships are important to small firms funding.

Where bank finance is transaction lending, usually for non-recurrent needs, the decision to lend is based on the evaluation of information from financial statements, and/or the provision of collateral, and/or credit scoring (Berger and Udell, 2002). These three lending technologies are all grounded on hard and public information, available and collected independently from the quality of the relationship. Relationship lending is different because it is based on recurrent needs (such as line of credit, overdrafts, etc.) and information is gathered beyond the relatively transparent data in official documents; information is gathered through a continuous process; and information remains confidential to the provider of funds and can be used to make other decisions (Berger, 1999). Relationship lending therefore leverages private information through contact over time with the firm, its owner, and its local community on a variety of dimensions (Angelini, et al., 1998; Berger et al., 2001; Cole, 1998; Nakamura, 1994). Private information is often soft data which, by definition, is difficult to summarise in a numeric score and is influenced by the context in which it is collected (Petersen, 2002). This indicates a central role for soft information in the lending process since "the essence of successful lending is overcoming asymmetric information problems between the borrower and the lender that would otherwise create incentives for borrowers to default their loans" (Goldberg and White, 1998). In other words, lenders are aiming to reduce the risk of moral hazard, defined by Brealey and Myers (1991) as "the risk that the existence of a contract will change the behaviour of one or both parties to the contract" or in this case, where the entrepreneur changes investment decisions after collecting the funds.

We would argue that all the different sources of information are leading up to a decision as to whether or not to trust the entrepreneur. Where trust is low, the general perception of riskiness will be greater and interest rates will be higher to compensate for this. In addition, contracts will be more stringent with tight terms and conditions regarding, for example, monitoring and collateral. However, trust might be lower due to a lack of soft information or because soft information is seen as less credible. This can lead to clumsy blanket solutions which fail to discriminate between high and low risk firms. Such contracts have a high cost to banks and do not necessarily guarantee trustworthy behaviour, as we will see from the following discussion of theories of trust.

Trust

Although previous studies have not examined trust in this specific context, there are a number of earlier studies on trust which provide indications that it is relevant to the entrepreneur bank relationship. Trust is a crucial element of decision making under conditions of complexity (Lewis and Weigert, 1985), risk (Weick, 1993) and scarce information (Luhmann, 2000), which is exactly the situation faced by banks lending to SMEs. Higher levels of trust reduce agency problems (Ring and Van den Ven, 1992; Wicks et al., 1999; Zaheer et al., 1998), the costs of transactions (Macaulay, 1963; Nooteboom et al., 1997; Rooks et al., 2000), the costs of monitoring and control (Lewicki and Bunker 1996; Mayer et al., 1995; Zand, 1972), and the use of legalistic remedies (Sitkin and Roth, 1993), which indicates that it could reduce costs for banks and SMEs. Trust improves relationships (Gulati, 1995; Fisman and Khanna, 1999;

Robinson, 1996; Tsai and Ghoshal, 1998) and cooperation (Jones and George, 1998; Ring and Van den Ven, 1994), which would improve information flows and reduce the likelihood of moral hazard.

Trust assumes different forms, which depend on situations, backgrounds and relationship histories. Lewicki and Bunker (1996) outline different levels of trust including calculus based trust based on rational choice; knowledge based trust based on repeated interaction; and identification based trust based on shared values. Additional or alternative constructs include institution based trust (Ring and Van den Ven, 1992) which is based on ex ante deterrents such as reputation, support from critical mass, etc.; conditional and unconditional trust (Jones and George, 1998); and weak, semi-strong and strong trust (Barney and Hansen, 1994).

This illustrates that it is important that we define what we mean by trust. There is no such thing as a common definition (Hosmer, 1995). Trust is frequently confused with co-operation. Although co-operation is often an outcome of trust, they are distinct factors and co-operation can exist without trust. It is also important that in the relationship between entrepreneur and bank, trust is not confused with situations of "lock in" due to information capturing (Howorth et al., 2003). Mayer, Davis and Schoorman (1995) provide one of the best and most used definitions, which builds on previous work as well as incorporating the non-rational aspects of trust. They state that trust is *"the willingness of a party to be vulnerable to the actions of another party based on the expectation that the other will perform a particular action important to the trustor, irrespective of the ability to monitor and control that other party"* Mayer et al. (1995). We use this definition of trust.

As in defining trust, there is no agreed description of how trust is determined. Jones and George (1998) argue that people's values, attitudes, moods and emotions interact and help the initiation, growth and evolution of trust. Initially, trust is expected to be based mainly on calculus although some question if this is trust at all. Calculus trust is based on an *economic calculation* (Lewicki and Bunker., 1996), is conditional on future behaviour (Jones and George, 1998) and may involve contracts.

As relationships are repeated and norms established, the parties may feel increasingly secure (Ring and Van den Ven, 1994) and trust may progress to knowledge-based trust (Lewicki and Bunker, 1996), i.e. trust based on predictability that is grounded in the prior knowledge of the trustee. Regular communication is needed since trust is strongly based on intense relationship and reciprocal testing (Lewicki and Bunker, 1996). Unconditional (Jones and George., 1998) or identification based trust (Lewicki and Bunker, 1996) implies identification with others' ideas, desires, intentions and a strong reciprocal understanding. Unconditional trust helps the development of strong co-operation and supports forms of governance that leverage it: psychological contracts can substitute for formal contractual safeguards decreasing the likelihood of the termination of the relationship when a breach of commitment occurs (Ring and Van den Ven, 1994).

There is a circular relationship between trust, information, influence and control (Zand, 1972). Strong initial trust helps willingness in exchanging accurate and complete information with others, allowing another's influence, and the acceptance of control (i.e. a higher dependence on others). These four aspects are not only linked in a sequential looping but also directly reinforce one another both increasing and decreasing trust: an entrepreneur who trusts others will provide relevant and comprehensive information but when they "encounter low-trust behaviour initially, they hesitate to reveal information, reject influence and evade control" (Zand, 1972). Interestingly, and of relevance here, when excessive formalisation and controlling activity is carried out, distrust emerges and the likelihood of unco-operative behaviour increases (Ring and Van den Ven., 1994). On the other hand, high levels of trust inspire greater trustworthiness and lead to a spiralling effect in the development of trust (Nooteboom, 2003).

Trusting others is dependent on the characteristics of the trustor and more specifically his/her propensity to trust others, and the specific characteristics of the situation and/or the target of trust (Creed and Miles, 1996). The propensity to trust is grounded on values and principles that are considered intrinsically desirable (Jones and George, 1998) and on a general faith in humanity (McKnight et al., 1998). Trust does not operate in a de-contextualized world. The trustor's perception and interpretation of the context of the relationship affects both the need for trust and the evaluation of trustworthiness (Mayer et al., 1995). Context takes into consideration the culture in general (Hofstede, 1981), the social constraints (i.e. pressure of social rules, conventions, etc.) and institutional constraints (i.e. legal system, institutions, etc.) (Hardin, 1996), as well as the environment in general (Bhattacharya et al., 1998).

Another factor which affects the formation of trust is the risk involved. There are two aspects to risk, probability and size. In this context probability is the risk that the entrepreneur will act opportunistically. Size refers to the size of loss which would occur should the entrepreneur act opportunistically. Size is only the loss which would affect the bank manager and therefore is closely linked to how much responsibility the bank manager has for the downside of their lending decisions.

Ability , Benevolence and Integrity

Trust literature provides a very long list of elements that affect context specific trust formation. In this context, relevant factors are those which are expected to influence the bank's assessment of the entrepreneur's trustworthiness. Mayer et al. (1995), group the factors of trustworthiness into ability, benevolence and integrity. Ability looks at aspects such as skills, competences, etc. and is domain specific. Trust based on ability does not necessarily generalise to other situations. Ability has repeatedly been shown to be an important factor in the assessment of trustworthiness (Butler, 1991; Lewis and Weigert, 1985). The corollary has also been evidenced in venture capital investment decisions (Harrison, Dibben and Mason, 1997): the most significant barrier to development of trust in this context is the low perceived competence of the entrepreneur.

Benevolence is the extent to which a trustee is believed to voluntarily do good to the trustor. Often, benevolence is viewed as relationship specific and more relevant to relationships between people rather than organisations. More precisely, there is little opportunity for the firm to do good to the bank or to the bank manager. Therefore, the definition of benevolence in entrepreneur – bank relationships is extended to a general willingness to voluntarily do good to others in line with Nooteboom et al.'s (1997) habitualization. This might be evidenced by community involvement, such as charity work, schools, and local politics, which may be linked to the perception of shared values. Benevolence may also extend to looking after employees.

Integrity is the perception that the trustee adheres to a set of principles considered acceptable by the trustor. It is neither relation specific nor context specific but is person specific. Integrity (i.e. morality and ethical principles) is not linked to skills or competences (morality is not a matter of knowledge or skills) or is it relation specific (morality is over and above each kind of specific relationship). Morality and ethical principles are elements of the personal background. Nooteboom et al. (1997) identify the same factor when they stress that "one dimension of trust is the institutionalisation of values and norms that constitute an ethics of transactional relationships" (Nooteboom et al. 1997). According to Sitkin and Roth (1993), higher levels of benevolence and integrity decrease distrust because of perceived increases in the congruence of values between trustor and trustee.

The bank manager's assessment of ability, benevolence and integrity could be based on multiple sources of information and might include information from third parties within the community, including referrals and gossip. Harrison et al., (1997) highlight the importance of a referral in building initial trust. Third party sources may provide an assessment of the trustworthiness prior to meeting through the reputation which an entrepreneur (or bank manager) has in the community. Good reputation increases the possibility of entering a relationship because it improves one's perception of trustworthiness (Dasgupta, 2000). The peculiarity of reputation is that it depends on information availability as well as information processing and interpretation. So for example, in the above instance, it is knowledge of community involvement rather than community involvement per se which is important. This highlights that information flows and interpretation are not under trustee control. Quite often, information may be partial, as third parties may transfer only the information which the other seems to be interested in (i.e. only those which are consistent with their view towards trust or distrust).

Having considered context-specific determinants of trust in the entrepreneur- bank relationship we move on now to look at outcomes associated with trust. Various authors (Lewicki and Bunker, 1996; Lewis and Weigert, 1985; Mayer, et al., 1995; Ring and Van den Ven, 1992; Wicks et al., 1999; Zaheer et al., 1998; Zand, 1972) point out the impact in reducing agency costs but do not pay attention to how this reduction happens and there is little formal description of the impact of trust on information asymmetries or agency costs.

The interesting fact is that through leveraging trust a reduction in agency costs can be gained. As previously stated (Zand, 1972) trust is evolutionary and information asymmetries, agency problems and transaction costs can be reduced thanks to initial trust (but can be also be increased because of initial distrust). Leveraging the evolution in the direction of improving and developing trust can make both trustor and trustee better off. Furthermore, Rooks et al. (2000) find that the less a transaction is embedded institutionally (i.e. based on institutions like law, courts, contracts etc.) and the more it is based on trust, the greater is the effort put into the transaction. In other words, leveraging trust implies more effort in making a relationship work and the greater effort can reduce risk and generate savings in monitoring costs from the principal's (bank) point of view. There is also evidence that trust promotes trustworthy behavior, which affects the repayment or default of obligations. This is another circular aspect of trust in that bank managers with high levels of trust in an entrepreneur are more likely to assist them in not defaulting. High levels of trust are expected to be associated with increased availability of finance and reduce the need for agency risk control mechanisms such as collateral and personal guarantees. Theoretically, the reduction in risk should be reflected in the price of finance (interest rate) which is expected to be lower where there are high levels of trust.

To summarise, the trust which is bestowed on an entrepreneur is expected to be based on an assessment of the entrepreneur's ability, benevolence and integrity. This process will be influenced by the propensity to trust and emotional base of the bank manager, among other characteristics. The trust formation process will be influenced by the entrepreneur's characteristics insofar as they are known or understood by the bank manager. Therefore previous interactions, shared values, community involvement, secondary sources of information and gossip (third party information) will all influence trust formation. Outcomes of the process are in two stages, the lending outcomes themselves and the behaviour of the entrepreneur following the lending decision. Trust influences ex post behaviour of the entrepreneur indirectly through lending outcomes and directly through its positive effect on trustworthy behaviour. Thus, high levels of trust are expected to be associated with lower risk, which should be reflected in a lower cost of finance. In this paper we test whether there is any evidence of a negative association between trust and interest rates. Measures of trust are derived from earlier studies, qualitative interviews and a pilot study. The following section describes the methodology adopted.

Research Method

As we are examining a relationship between two parties it is important that data are collected from both entrepreneurs and bank managers. Previous studies on bank relationships have tended to collect data from only one point of view. We conducted a telephone survey of owner managers of SMEs and then their bank managers filled out a postal questionnaire on each firm.

The study is based in North East Italy, which is an economically successful region in terms of contribution to national GDP and is characterised by many small, often family-run, firms, sometimes in small industrial clusters (e.g. the Manzano district for chairs or Spilimbergo for cutlery). Two different areas of the region (South Tyrol and Friuli Venezia Giulia) were selected because they are very similar economically and socially but have contrasting banking systems. Both areas are on the Italian border and have a special legal status that gives autonomy to the local government. South Tyrol lies on the Austrian border, is strongly influenced by German culture and mainly German speaking. The small cooperative local banks – the focus of this study – are called by the German name – Raiffeisenkasse – not the Italian one – Banca di

Credito Cooperativo. Friuli Venezia Giulia is an area next to the Austrian and Slovenian border. Just as South Tyrol bridges German and Latin cultures, Friuli Venezia Giulia is a bridge between Latin, Slav and German cultures. In many ways, the social and economic fabric of the two areas is similar.

The banking systems of the two areas have interesting differences. South Tyrol has a very concentrated banking system: two local banks (Sparkasse and Volkbsank) cover all the area together with the Raiffeisenkassen. The Raiffeisen system consists of 52 strongly localised very small cooperative banks, which totalled 191 branches (Raiffesisenverband Südtirols, 2003). The Raiffeisen strategy discourages competition and no two Raiffeisenkassen cover the same area. Small firms in South Tyrol will usually have only one choice of local bank. Large national banks operate only in the urban areas and target larger firms. This concentrated banking system is due to a number of factors, which are peculiar to this region. Firstly, employees need to speak German and Italian and all documents must be in both Italian and German. Secondly, local culture is closed towards organisations from outside the area; the economy in the mountain rural areas is strongly based on agriculture and this sector in South Tyrol is very peculiar: to deal with these customers, banks needs specific skills and local expertise that national banks do not possess. Consequently, the larger banks limit the number of branches, do not enter the market and do not buy local banks.

In contrast, Friuli Venezia Giulia has a very competitive banking system with 16 small cooperative banks called Banche di Credito Cooperativo totalling 168 branches. On average, in Friuli Venezia Giulia each cooperative bank has a higher number of branches and volume of deposits than in South Tyrol. In contrast to South Tyrol, there is competition among banks as two or more local co-operative banks could cover the same area. All the major national banks and many other large banks operate successfully in this area. As in South Tyrol, cultural and historical reasons account for the different banking system. The local culture is less closed towards organisations from outside the area and the larger banks have been developing ties with the area since the 1960s. During the1980s and 1990s new banks entered the market as a result of acquisition of other local banks. Larger banks' strategies in this area are very aggressive as, in contrast to South Tyrol, no particular local expertise is required to deal with rural customers. Thus, each bank operates in a variety of areas across the region and targets both large and small firms.

A multi-stage dyadic methodology was adopted. By this we mean that both bank managers and entrepreneurs were questioned at three different stages of the data collection process. During 2004, interviews were held with 20 entrepreneurs and 6 bank managers to develop and validate the conceptual framework. Theoretical sampling was employed to select bank managers and entrepreneurs for interview. They represented a variety of Raiffeisenkassen and Banche di Credito Cooperativo and different areas geographically and economically. Interviews were conducted in the first language of the interviewee, either Italian or German. Two questionnaires were developed, one for bank managers and one for entrepreneurs, and a pilot study conducted to assess validity, understanding, reliability and operationalisation of the constructs. Following the pilot study, two questions with low validity were dropped and wording of other questions clarified. Questionnaires were developed in Italian and translated into German and English by bilingual native speakers and reverse translated for reliability.

A random sample of firms was provided by each bank. A telephone survey of entrepreneurs was conducted in their first language, either German or Italian and following a maximum 5 telephone calls a noteworthy 80% response rate was achieved. A postal survey of bank managers collected data on the financials of each firm, the lending relationship and an assessment of 10 measures of ability, benevolence and integrity. Agricultural firms were excluded from the sample frame because of the peculiarity of the sector: the firms are quite small, often only sole traders and there are a large number of part time farmers, plus the agricultural sector is widely supported by grants. Complete and valid responses from both sources, i.e. entrepreneurs and bank managers, on all the variables included in this analysis, were received for 137 firms.

Results

Bank managers' opinions of each entrepreneur relating to 10 variables assessing ability, benevolence and integrity aspects of trust were assessed on 5 point Likert scales where 1 was equal to strongly disagree and 5 equal to strongly agree. These were entered into a principal components analysis to test whether they grouped together in factors which denote ability, benevolence and integrity. This provides a reduced number of variables for later analysis as well as testing the validity of the constructs. Two variables were excluded from the analysis due to low validity. Results from principal components analysis of the remaining eight variables are presented in Table 1. All the assumptions of the PCA model were satisfied. Three factors were extracted accounting for 74% of the variance. A high value denotes a heavy loading (influence) on that factor. Most of the variables had their highest loading on the factor they conceptually belong to, except the variable 'The entrepreneur pays attention to the needs of his/her employees' which loaded highest on 'ability' whilst also having a similar, but lower, loading on 'benevolence'. Similarly, the variable 'the entrepreneur is consistent in his/her behaviour and decisions' also had a side loading of more than 0.5 on 'ability'. These results are understandable as 'ability' clearly encompasses a wide range of aspects and we might expect some overlap with other dimensions of trust. This also highlights the interdependence of different aspects of trust and the difficulty in empirically separating constructs which may seem clear cut conceptually.

Table 1: Ability, Benevolence, Integrity: Principal Components Analysis

	Component		
	Ability	Integrity	Benevolence
The entrepreneur knows very well the market in which she/he operates	**.768**	.274	.056
The entrepreneur is good at selecting the needed resources	**.823**	.083	.187
The entrepreneur is good at managing the resources	**.842**	.173	.163
The entrepreneur is good at understanding the market evolution	**.751**	.336	.073
The entrepreneur is very involved in the community	.102	.145	**.935**
The entrepreneur pays attention to the needs of his/her employees	.560	.230	**.480**
The entrepreneur is totally honest during negotiations with commercial partners	.178	**.899**	.207
The entrepreneur is consistent in his/her behaviour and decisions	.555	**.610**	.090
Eigen Value	4.25	0.94	0.71
Kaiser Meyer Olkin Measure 0.871 Bartlett's Test of Sphericity sig 0.000 Total % of variance 73.86%			

Extraction Method: Principal Component Analysis. Rotation Method: Varimax with Kaiser Normalization.

Overdraft interest rates ranged from 3 to 12.75% with a sample mean of 5.64%. The three factors of trust were entered into a multivariate linear regression model to test their influence on overdraft interest rates. Control variables were included to hold constant the other influences on interest rates. Turnover is a measure of company size and a traditional proxy for the riskiness of the firm. Smaller firms are assumed to attract greater risk and therefore a negative association is expected with interest rates. The length of the relationship controls for information asymmetries with longer relationships associated with reduced information asymmetries. A negative relationship is thus expected with length of relationship. Overall amount of financing indicates the profit potential of the firm for the bank and therefore this is also expected to have a negative association with interest rates. The three trust factors relating to ability, benevolence and integrity are also expected to be negatively related to interest rates with higher levels of trust leading to lower interest rates.

The results of this test are reported in Table 2. Model statistics are all satisfactory with a significant F test, R squared of 0.207 and tests for multi-collinearity showing tolerances of 0.74 or above. The results show that all the variables attract the expected signs except the 'benevolence' factor score.

Lower interest rates appear to be associated with higher turnover, longer relationships, higher overall financing and an increased perception of ability and integrity. However, integrity is not significant in the equation and the standardized coefficient highlights that this variable contributes very little explanatory value. This suggests that integrity of the entrepreneur is not a relevant factor in determining overdraft interest rates. So whilst it could be assumed that honesty is seen as a good thing, it does not appear to affect this particular lending outcome. The other variables with negative signs are all significant at the level of 10% or less indicating that they are associated with the level of interest rates. Benevolence attracts a positive sign in contrast to expectations. On further investigation it can be seen that the benevolence factor is most heavily influenced by the variable representing the entrepreneur's involvement in the community. Contrary to predictions this result indicates that involvement in the community appears to be viewed negatively by the bank manager in determining a firm's lending outcomes. This is an area which warrants further investigation but we suggest that it could be perceived that heavy involvement in the community detracts from an entrepreneur's commitment to managing their firm. All the reported relationships were stable and levels of significance similar across a number of different estimations of the model which indicates robustness of results.

Table 2: Multivariate Regression: Dependent Variable Overdraft Interest Rate

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
(Constant)	6.482	.243		26.627	.000		
Turnover Last year	-2.391E-07	.000	-.253	-3.129	.002	.936	1.069
Length of relationship with the firm	-.036	.013	-.246	-2.720	.007	.746	1.340
Overall amount of financing provided to the firm	-3.596E-07	.000	-.145	-1.700	.092	.842	1.187
ABILITY factor score	-.299	.145	-.171	-2.067	.041	.895	1.118
INTEGRITY factor score	-.003	.133	-.002	-.020	.984	.857	1.167
BENEVOLENCE factor score	.223	.149	.119	1.493	.138	.954	1.048
R squared = 0.207; F = 5.64 (sig 0.000)							

Conclusion

To summarise, trust is a key element in the entrepreneur bank relationship, providing the opportunity to reduce agency costs. In assessing all the different sources of information bank managers are making a decision on the trustworthiness of the entrepreneur with regard to their ability, benevolence and integrity. Following a very rigorous methodology our analysis indicated that the ability of the entrepreneur is the most important factor in the decision to trust an entrepreneur and this was reflected in lower interest rates. The integrity of the entrepreneur appears to be much less important, but this is also a much more difficult concept to assess. Benevolence had the opposite effect to that predicted but we believe that this can be explained by considering the main predictor of this factor, i.e. community involvement. High levels of community involvement could be seen as detrimental to the effective management of the firm.

Implications for Entrepreneurs and Banks

It is clear that high levels of trust can reduce agency costs. From the bank's point of view trust mitigates adverse selection and moral hazard, reduces screening and monitoring costs and this will lead to increased profits. For the entrepreneur it would require less effort spent on providing information for bank monitoring purposes and less requirement for collateral, which is often a sticking point in practice. It should be noted that trust is not some airy fairy notion which is nice to have but that bestowing trust actually increases trustworthy behaviour in the other party and a spiral of trust ensues. Entrepreneurs who perceive that high levels of trust are being placed on them are more likely to act in a trustworthy manner and thus ceteris paribus, the likelihood of moral hazard and/or loan default is lessened. The interviews undertaken here also highlighted the two-way nature of trust and showed that a lack of trust can exist on the part of entrepreneurs and can make them less likely to behave in a trustworthy manner. Banks and entrepreneurs should consider ways of strengthening their relationship in order to develop a deeper trust which will benefit both parties.

Entrepreneurs and advisers should note that a similar conceptual framework can be applied to other investment decisions such as business angels or venture capitalists. It would be interesting to compare and contrast the validity in these alternative contexts.

Implications for Future Research

Clearly, this is an area which requires further research to tease out the complex influences and causal effects. The constructs we used were derived from previous studies in the trust literature. Our results highlight the need to test constructs in a variety of contexts and cultures to assess their validity.
Longitudinal case studies would provide additional insights into how decisions are made, where attitudes and relationships change and the factors that influence them. Examination of individual cases throughout the lending decision process would reveal detailed information on negotiation behaviour, the development or breakdown of relationships and trust, outcomes and ex post behaviour. This paper focused on a particular region of Italy which had an interesting and contrasting banking system. Future studies might explore these issues theoretically and empirically in comparative contexts. Alternative banking systems and cultures should be studied. The conceptual framework presented here may also be tested in alternative investment decisions, such as those of business angels or venture capitalists.

Overall, we would suggest that the evidence and theory development presented in this paper indicate that the entrepreneur's bank relationship is an important topic for future research and further studies should be encouraged. It would be especially interesting to examine the assessment of an entrepreneur's integrity which was not shown to be influential in this study.

"Honesty is praised and left to shiver" Juvenal

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