# 4TH EBA RESEARCH WORKSHOP 18 - 19 NOVEMBER 2015

Discussing on "*Cyclicality of SME lending and government involvement in Banks*" by Behr P., Foos D. and Norden L.

Walter Vecchiato, EBA

*This contribution represents my own personal view*

# Cyclicality of SME lending and government involvement in Banks

- Very interesting investigation on the cyclicality of small and medium-sized enterprises (SME) lending by local German banks with vs. without a public mandate.
- The public mandate stipulates a deviation from strict profit maximization and a sustainable provision of financial services to local customers.
- Their conjecture is that **government involvement in banks lowers the cyclicality of SME lending**.
- The authors find empirical evidence that **banks with a public mandate are on average 25% less sensitive to GDP growth than other local banks**.
- They use a panel data from around 800 German banks spanning over 1987 to 2007
- DE Local Banks: Saving Banks with public mandate vs. Credit Cooperatives from the same location
- The authors control for location, size, funding structure, liquidity, credit-demand-side factors, etc. and they also use alternative measures of cyclicality, such as regional GDP growth, real growth in investments, etc.

# Research on government involvement in banks

- La Porta et al. (2002) “Government ownership of banks” Journal of Finance

This paper tests whether state-ownership of banks is correlated with bank-lending behaviour over the business cycle. They found that government-owned banks exhibit underperformance and inefficient credit allocation.

- Sapienza P. (2004) “The effects of government ownership on bank lending” Journal of Financial Economics ; Dinc S. (2005) “Politicians and banks: political influences on government-owned banks in emerging countries” Journal of Financial Economics

Lending of public banks is mainly driven by political motives.

- Micco A. – Panizza U. (2006) “Bank ownership and lending behaviour” Economics Letters

They find that state-ownership banks’ lending is less responsive to macroeconomic shocks than the lending of private banks.

- Behr P. – Norden L. – Noth F. (2013) “Financial constraints of private firms and bank lending behaviour” Journal of Banking and Finance

The authors show that the lending behaviour of small banks in Germany with a public mandate helps to reduce financial constraints of SMEs.

**The presented paper contributes to this literature by showing that the cyclicality of small banks’ SME lending depends on their mandate and business objectives**

# Reasons why state-owned banks may stabilize credit

- The government internalizes the benefits of more stable macroeconomic environment.
- Banks failures are more likely during recessions and depositors may think that public banks are safer because of their mandate, therefore, they can enjoy a more stable deposit base and be better able to smooth credit.
- Managers of state-owned banks could be lazier than private bank managers, due to less incentives.
- Politicians can influence the lending of public banks in order to maximize their probability of re-election. (Local) politicians may be Board members in (local) state-owned banks.

**The authors rule out this "political explanation" with an additional empirical analysis.**

**They also rule out "moral hazard" checking that the lower cyclicality of Saving Banks' SME lending does not come with additional risk-taking.**

## Notes on “Cyclicality of SME lending and government involvement in Banks”

- “Landesbanks” are excluded from this study, even if government involved, because more active in complex financial services and international banking.

Here the state influence is often much more tangible.

**What happens when comparing Landesbanks with privately owned commercial banks?**

Recently, one Landesbank had an agreement in the EU state aid proceeding. Therefore, **moral hazard should be addressed with more investigations**.

*Sample Context*

- @2013 : 27% total assets in DE were held by banks with government involvement (of which 13% by saving banks). Saving banks’ lending to non-banks accounts for 19%.
- @2013: 9% total assets in DE were held by cooperative banks, that account for 13% of total lending to non-banks.

*Saving and Cooperative banks are regionally oriented and focus mainly on lending to local SMEs.*

# Notes on "Cyclicality of SME lending and government involvement in Banks"

- well extended and very representative data sample

461 Savings banks (85% total assets @2013) and 330 Cooperative banks (63% total assets @2013)

- Obs. spanned over 1987-2007 (20 years)

Just around 2 years of ("mild and short") Recessions : '92-'93 and '02-'03

**What about on prolonged and more severe recession that started from Lehmann's default (Sept. 15$^{th}$ 2008)?**

**Is the link between Loan growth and GDP growth still counter-cyclical for public banks?**

- The empirical analysis, performed in the paper, is conducted by estimating a <u>dynamic panel regression model</u>, that allows the authors to find evidence that savings banks are less cyclical than cooperative banks.