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# Banking Relationship and Bank Financing: The Case of Vietnamese Small and Medium-sized Enterprises

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## **Abstract**

*Banking relationship is seen as a critical factor for Small and Medium-sized Enterprises (SMEs) in getting bank financing. In this study, I develop a model that examines the relative importance of inter-organizational and inter-personal banking relationships on firm bank financing, and report an empirical test from a sample of SMEs in the transition economy of Vietnam. The results support the central hypothesis that close banking relationships play an important role in getting bank financing. However, inter-organizational and inter-personal banking relationships are not equally important in helping SMEs access bank loans. The study provides theoretical and managerial implications.*

**Keywords:** Banking relationship, inter-organizational relationship, inter-personal relationship, bank financing, SMEs.

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## 1. Introduction

Finance has been viewed as a critical element for the expansion or diversification of small and medium size enterprises. Such growth could not have occurred without extensive participation by equity and debt lenders. Despite the rapid development of venture capital resources, small businesses continue to face a severe lack of alternatives in obtaining financing. Previous studies (e.g. Tenev et al., 2003; Van Auken, 2001; Coleman, 2000) indicated two predominant sources of financing in the capital structures of small businesses: equity and commercial banks.

Though most of the debt financing among SMEs is in the form of bank loans, empirical research showed that SMEs still have limited access to bank financing, and that limitation is frequently cited as being detrimental to small businesses. The reasons are that banks aim at maximizing their return through low-risk lending. However, in SMEs' lending, banks often face a high level of risk due to information asymmetry, leading to high agency costs in obtaining information to make lending decisions and in monitoring behavior (e.g. Howorth and Moro, 2006). Thus, the question "How do SMEs improve their access to bank financing?" has attracted great interest from researchers worldwide (e.g., Bodenhorn, 2003; Brau, 2002; Blackwell and Winter, 2000; Coleman, 2000; Deakins and Hussain, 1994).

In searching for solutions to increase SMEs access to bank financing, researchers agreed that a firm's professional management practices, effective networking and close relationships with banks are important mechanisms

for solving asymmetric information and agency cost problems and improving a firm's bank financing (Brau, 2002; Blackwell and Winters, 2000; Coleman, 2000; Binks & Ennew, 1997; Berger and Udell; 1995).

Relationships between SMEs and bankers (so-called banking relationships) play an important role in helping both lending institutions and borrowing firms (Ahlstrom and Bruton, 2006; Le et al., 2006; Peng, 2001; Peng and Lou, 2000). For lending institutions, banking relationship helps them obtain information, locate markets, and better secure their investments (Le et al., 2006, Nguyen, Le, and Freeman, 2006). For borrowing firms, banking relationships are the media through which firms gain access to resources, information, and support from banks (Peltoniemi, 2007).

In examining impacts of banking relationships on bank financing, previous studies have focused on different facets of banking relationships. Several researchers focused on the duration of banking relationships i.e. the length of time a firm has used a bank's services (e.g., Petersen and Rajan, 1994; Brau, 2002; Uzzi, 1999; Berger and Udell, 1995). Others have focused on the intensity of banking relationships (e.g., Uzzi, 1999; Bodenhorn, 2003). To reflect the degree of banking relationships between a firm and a bank, Uzzi (1999) also used the multiple degrees of services a bank provided to a firm. Bodenhorn (2003) used the number of bank loans the firm had received over a certain period. On the other hand, Brau (2002) used the number of banks a firm has relationships with as a reverse measurement of banking relationships. A common feature of

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these facets is that they all focus on the inter-organizational level of banking relationships.

Some researchers have focused on the interpersonal level of banking relationships (Backwell and Winter, 2000; Ennew, 1996; Binks and Ennew, 1997). The interpersonal relationships used by these researchers are participative links between bank officers and firm owners/managers. This is reflected in the degree of trust between firm owner/managers and bank officers, the approachability of bank officers, and the degree of business information sharing between the two parties. This type of relationship occurs mostly at a personal level.

Though there has been a general consensus regarding the importance of banking relationships, what is not clear is the relative importance of inter-organizational relationships and inter-personal relationships in helping firms assess bank loans. In addition, most studies, so far, concentrated on finding effects of banking relationships in loan availability, loan pricing, or collateral requirements. Though the speed of the bank loan application process is also important for SMEs to meet their business opportunities, no study so far investigates the impact of banking relationship on the speed of the bank loan application process. In addition, most research of banking relationship with SMEs is conducted in developed countries, where the institutional contexts are vastly different from transition economies.

Compared with their counterparts in developed countries, banks in transition economies face greater uncertainties, as well as height-

ened risks when lending to SMEs. These uncertainties and risks stem in part from the more volatile and immature institutional environment, the lower level of regulatory oversight, and the sheer pace with which the economy is growing from a relatively low base point (Nguyen et al., 2005). In addition, SMEs are a relatively new phenomena in these countries, and the banks lending to them are even more recent, so the requirements of stability, comparability and an adequately large database of past information are hard to obtain. In this context, it is extremely difficult for banks in such countries to reduce credit risk (Nguyen, 2005). In transition economies, relationships are seen as an effective substitution for well-established institutions (Ahlstrom and Bruton, 2006; Xin and Pearce, 1996).

To cover the gap in the literature, this paper examines the relative importance of two different types of banking relationships in helping SMEs access bank loans. Specifically, the paper develops a model that links two types of banking relationships with bank loan availability and speed of the bank loan application process, and reports an empirical test of that model in Vietnam. Vietnam is an ideal context for the study, with an extreme form of entrepreneurship that operates in the absence of well-established market institutions. Different banking relationships are effectively exploited by both banks and SMEs, allowing us to distinguish their relative importance in getting bank financing.

## **2. Literature review and hypotheses**

### ***2.1. Information asymmetry and lending***

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### *techniques*

With perfect information, market forces would enforce “good” banking practices, because profit-maximizing banks would choose strategies with zero probability of bankruptcy and loss. Deakins and Hussain (1994), however, point out the twin problems of moral hazard (monitoring problems) and adverse selection (risk assessment) faced by banks when they lend to any client. These problems emerge due to asymmetric information. Information asymmetry means a borrowing firm has more information about itself than a bank does. This reduces the bank’s ability to distinguish between good and bad lending risks.

Borrowers can make unseen business decisions for their own personal benefit, even though such decisions are costly to lenders (these problems are also known as a moral hazard). Regarding adverse selection, Deakins and Hussain (1994) divided this into two types: Type I errors, where the bank officer refuses to accept a proposal which turns out to be a business success and Type II errors, where the bank officer approves a proposition which then turns out to be a business failure. According to Deakins and Hussain (1994) and Fletcher (1995), bank officers are more concerned in avoiding Type II errors as Type I errors are often undiscovered and do not affect bank officer’s careers, unless the bank fails to meet their profitability targets. Theoretically, adverse selections would not occur if lenders had access to perfect information about borrowers.

Information asymmetry problems are more

serious with smaller firms (Coleman, 2000; Pettit and Signger, 1985). Research indicates that there is a mismatch between the true value and the reported data in SMEs’ financial statements and business plans (e.g., Le et al. 2006; Berger and Udell, 1995). The financial statements of SMEs lack consistency from year to year and usually do not disclose all-important information related to their firms’ business transactions. In addition, most small businesses lack skills in preparing financial statements and business plans. As a result, information on their financial conditions, profitability and profitability prospects may be incomplete and/or inaccurate. Moreover, Pettit and Signger (1985) contend that small firms have considerable flexibility, particularly in reacting to changes in technology or business conditions. This flexibility makes it easier for small firms to transfer assets (wealth) to other uses in response to a changing business environment, and this can alter the firm’s risk-return position and perhaps impact adversely for banks.

Information asymmetry does not imply that banks fail to ensure good banking practices. Depending on each particular circumstance, banks can apply different lending techniques to reduce risks when lending to businesses (Coleman, 2000). Scholars have categorized the business lending techniques in use by financial intermediaries into four categories: financial statement lending, asset-based lending, credit scoring and relationship lending (Petersen and Rajan, 2002; Berger and Udell, 2002; Fletcher, 1995). The first three lending techniques are transaction-based lending. These lending techniques are based on “hard

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information” such as information from financial statements, quality of collateral or financial conditions and history of the principal owner. In contrast, the relationship lending technique is based on “soft” data. The information used in this technique is often “soft” data, such as information about the character and reliability of a firm’s owner. Compared with “hard” information, “soft” information is more difficult to quantify, verify, and communicate through the normal transmission channels of a banking organization. Relationship lending is based largely on proprietary information about a firm and its owner. This information is gathered through a variety of contacts over time and through interactions between a bank and bank officers with a firm and a firm’s owner. The accumulation of information over time helps mitigate information asymmetry between the lender and the borrower. Financial statement lending and credit scoring are based on a firm’s financial statements, the principal owner’s financial conditions, and a firm’s history. These two lending techniques are best suited for relatively transparent firms. Meanwhile asset-based lending and relationship lending are based either on the quality of available collateral or substantial amounts of proprietary information about a firm and its owner that is gathered by banks and bank officers through their contact and interaction with firms and their owners over time. These two techniques are most suitable for lending to firms, such as small businesses, that suffer information opacity.

## ***2.2. Banking relationships and bank financing***

Relationship lending is often considered as the most appropriate lending technique for collecting information on SMEs (Baas and Schrooten, 2006). A close relationship established between a SME and a bank ensures the SME’s access to a bank loan while giving the bank access to information about the borrowing SME. For a bank, a close relationship with a borrowing firm provides the bank with a clearer picture of the operating environment faced by the firm, a better understanding of the managerial attitude of a firm’s owner, and a more accurate overview of the prospects for a business (Binks and Ennew, 1997). As a result, a good relationship with small business customers leads to profitable market opportunities for banks.

For a borrowing firm, developing trusting relationships with a bank gives it a greater chance to receive suggestions, advice and guidelines from the bank. The firm then better understands and conforms to the “rules of the game” (i.e. procedures, regulations and requirements from the bank for bank loan applications). This helps the firm become more isomorphic with the lending context, enhance its legitimacy, and reduce transaction costs.

Close banking relationships significantly improve the flow and quality of information between the bank and the borrowing firm. It therefore helps mitigate information asymmetry, enhance firm legitimacy and consequently improve SMEs’ bank financing (Uzzi and Lancaster, 2003). Empirical research generally supports the view that closer banking relationships significantly affect bank financing to

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small firms. For example, Petersen and Rajian (1994) found that firms with close relationships with banks enjoy higher bank loan availability. Empirical researchers indicated that duration of the banking relationship, Bodenhorn (2003) and breadth of the relationships, Elsas (2005) are negatively related to the cost of credit

These relationships are even more important for firms in transition economies such as Vietnam. In the absence of effective market institutions and business data, banks in Vietnam face considerable uncertainties in lending to SMEs. Banks employ a combination of uncertainty avoidance techniques, and rely on trust, in lending to their SME clients (Nguyen et al., 2006). Thus, a close relationship with SME clients helps banks have more adequate and updated information about SMEs borrowers and therefore reduces the speed of the bank loan application process. From SMEs' perspective, developing a close relationship with banks would certainly help firms to gain better access to bank loans with more favorable covenants.

I, therefore, expect both types of relationships have a positive influence on bank financing and specifically:

*H1: Inter-organizational relationships between private SMEs and banks have a:*

*a) positive correlation with bank loan availability*

*b) positive correlation with the speed of the loan application process*

*H2: Interpersonal relationships between private SMEs and banks have a:*

*a) positive correlation with bank loan availability*

*b) positive correlation with the speed of the loan application process*

### ***2.3. An overview of bank lending to SMEs in Vietnam***

Vietnam is a typical transition economy characterized by a weak legal framework and a lack of strategic factor markets (e.g. underdeveloped capital market, lack of skilled workers). However, the banking sector has rapidly changed over last 20 years. Twenty years ago, there were only four state owned banks. Currently, there are 5 State owned commercial banks, 02 policy banks: Vietnam Development Bank– VDB, Social Policy Bank – VSPB, more than 35 Joint Stock Banks, about 37 representative offices of foreign banks, 04 Joint venture banks, 05 foreign banks and more than 900 People Credit Funds.

Though the banking sector in Vietnam has grown rapidly, gaining access to bank financing remains a perennial problem for SMEs in Vietnam. There are a number of factors inhibiting bank lending to SMEs. These factors relate both to “supply side” issues and “demand side” issues. Relating to the “supply side”, there are constraints that banks typically encounter. Examples are lack of reliable information relating to SMEs clients, high transaction costs resulted from the nature of SMEs – such as their incomplete business plans and inadequate financial records.... On the “demand side” typical constraints are: a small capital base and a lack of assets for collateral. These remain the greatest inhibitors for SMEs want-

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ing bank financing (Freeman and Le, 2007). Thus, establishing good relationships between banks and SMEs is believed to improve SME lending in Vietnam.

### **3. Research methodology**

#### ***3.1. Vietnam as the study context***

I have chosen Vietnam as an empirical setting to study the relative impact of different types of banking relationships on firm accessibility to bank loans. Vietnam is a particularly suitable context because the country has gone through a major economic transition process, and yet weaknesses in its formal institutions remain major obstacles for business (Meyer and Nguyen, 2005; Nguyen et al., 2006). SMEs, while burgeoning in number, remain largely as small, informal, and short-term oriented enterprises. The banking sector, on the other hand, is dominated by four state-owned commercial banks, that lend mostly to big enterprises. SMEs are seen as a new, lucrative, but very risky market for most banks in Vietnam (Nguyen et al., 2006).

In such a context, relationships have been used extensively and aggressively by both bankers and managers in doing business (O'Connor, 2000; Nguyen et al., 2006). Managers use relationships for different business purposes (Nguyen et al., 2005), including access to bank loans (Nguyen et al., 2006).

#### ***3.2. Sample and procedure***

My studied population was manufacturing SMEs in Vietnam. A stratified sampling strategy to collect data was adopted. Two main criteria to select firms for the survey were applied: geographical area and establishment

year.

Geographically, the distribution of the sampled firms included in the survey was similar to that of the country's population. Most contacted firms were from the South, followed by the North and the Central regions. To ensure that the surveyed sample provided a representative picture of Vietnam's SMEs, areas at different levels of development were included. Hence, geographically they range from the economic powerhouses of Ho Chi Minh City, Hanoi, Hai Duong and Binh Duong to provinces that have displayed slower economic development, such as Ha Tay, Nam Dinh, Thanh Hoa, and Nghe An.

Firms were also selected based on establishment year. A number of firms established before and after 2000 were determined for the survey. The reason in selecting 2000 as a cut-off date is that a New Enterprise Law was issued in 2000. This Law has eased the registration process. As a result, the number of newly established firms considerably increased after 2000.

Four key local researchers were hired, who were native to the main cities and provinces (Hanoi, Thanh Hoa, Nghe An and Ho Chi Minh City) where the survey was conducted. These local researchers worked at the target provinces' Planning Departments and Research Institutes of Universities. Local researchers were trained in both data collection methods and the meaning of each item in the questionnaire.

These local researchers then obtained lists of registered private manufacturing firms from

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the Tax Bureau and economic planning departments of targeted provinces. Based on two criteria (year of establishment and location), 400 private manufacturing SMEs were chosen from the list for the survey. The local researchers then personally contacted these firms, delivered the survey, and then followed-up and collected the surveys.

Of 400 questionnaires sent, 230 were returned, giving an average response rate of 57.5 percent. 214 collected questionnaires were usable for the research. I compared key characteristics (i.e., firm age, size, location) of firms in the sample with the whole population and found no significant differences. The sample satisfactorily represents the population.

### **3.3. Variables and measurement**

I initiated this research with semi-structured interviews with 15 bank officers and 7 SMEs' owners based on a series of open-ended questions. I then developed a draft questionnaire based on literature reviews and findings from in-depth interviews. The first draft of the questionnaire was distributed to 6 people belonging to the academic and business community to check its face validity. The questionnaire was then adjusted and was sent to 43 private manufacturing SMEs to test its face validity. The final version of the questionnaire was further adjusted based on the results of this pretest. This final version was sent to a larger target population of Vietnamese manufacturing SMEs. A full set of variables was as follows:

#### *Independent variables*

The key independent variable is banking relationships. *Banking relationships* are

reflected through two aspects: inter-organizational relationships and inter-personal relationships. Following Uzzi (1999), I measured inter-organizational relationships by the number of a bank's services used by a firm. To examine the interpersonal relationships between SME owners and their bank's credit officers, SME owners were asked to respond to a series of attitudinal statements about their relationships with their bank's credit officers (where 5 = strongly agree and 1 = strongly disagree). These statements explore the nature of the relationships in terms of the respondents' level of trust, information sharing, approachability, and joint problem solving arrangements between SME owners and their bank credit officers. This measure was adapted from Ennew (1996) and Nguyen (2005).

#### *Dependent Variables*

In this research, bank financing was measured by the bank loan availability and the speed of the bank loan application process. For bank loan availability, the SMEs that used the bank loan were coded as 1 and SMEs that did not use the bank loan were coded as 0. The speed of the loan application process was subjectively measured. Respondents were asked the possibility that their (hypothetical) application for a loan of about VND 400 millions (equivalent to about US\$20,000) would be quickly processed, on a 5 point-scale (1 = very unlikely, 5 = very likely). The scale is adapted from Buttner and Rosen (1992).

#### *Control variables*

Based on previous studies (Van Auken, 2001, Coleman, 2000; Berger and Udell, 1995

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and Le et al., 2006), and results from interviews, I controlled for firm age, legal forms of ownership, owner experience, owner education, owner sex, and bank ownership (i.e., state owned or non-state owned banks).

#### **4. Results**

##### ***Measurement validity***

A factor analysis for all 17 items was conducted, measuring attributed variables (i.e. banking relationship variables). Seventeen items were loaded onto 5 factors that had Eigenvalues of greater than 1, and accounted for 65.198 percent of explained variance. One factor that have Cronbach's alpha of less than .65 were dropped (Devellis, 1991). Factors that had Cronbach's alpha of greater than .65 were selected for further testing (Please see table 1). In general, the results were consistent with theoretical categories.

According to the results of factor analysis and reliability testing, inter-personal relationships with bankers had four factors, including emotional trust, knowledge trust, approachability of bank officers, and personal information sharing. Therefore, "Inter-personal relationships with bankers" was calculated by taking the average of these four factors.

##### ***Descriptive statistics***

Thirty percent of the respondents (65 firms) reported that they did not borrow from a bank (a bank loan/capital ratio of 0). Almost all of these firms had not even applied to any bank, indicating that they have not had a need for a bank loan. In addition, these firms would not be in the best position to estimate bank loan availability and the speed of bank loan applica-

tion process. Therefore I separated respondents into two groups: 1) those who have not borrowed from banks, and 2) those who have borrowed from banks. I then created two dependent variables. The first one (for the whole sample) – Probability of having a bank loan – is a binary variable (Yes/No) on having a bank loan. The second one (only for those who had bank loans) – Availability of bank loan – is a continuous variable with reported positive ratios of bank loan/total capital.

Table 2 presents descriptive statistics and correlations of key variables. The results show that Inter-organizational banking relationships and Inter-personal banking relationships were positively associated with Probability of having a bank loan ( $p < .01$  and  $p < 0.05$ ). The average firm in the sample has been in business for 7 years and had 70 employees.

##### ***Hypotheses testing***

I first checked and corrected for violations of the normality assumption and multicollinearity problem by using a correlation matrix and the tolerance value or its inverse – the variance inflation factor (VIF). The results indicated an inconsequential collinearity among variables. These independent variables were acceptable for running regressions (Hair et al., 1998).

To study how inter-organizational banking relationship and inter-personal banking relationship influence banking financing to SMEs, the bank loan availability and the speed of bank loan application process (DVs) were regressed against these above variables. The regressions were modeled as follows:

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**Table 1: Results of factor analysis and reliability testing**

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<b>Description of evaluation criteria</b>	<b>Factor loading</b>
<b>Factor 1: Emotional trust</b>	
SMEs' owner-managers learn about the bank credit official(s) (background, personal life, habits, etc.)	<b>.750</b>
SMEs' owner-managers attend bank official(s)'s important life events (e.g. wedding or funeral of their family's members)	<b>.806</b>
When appropriate, SMEs' owner-managers give this bank official(s) some gifts.	<b>.800</b>
SMEs' owner-managers get together with bank official(s) on some holiday occasions	<b>.746</b>
<b><math>\alpha = .814</math></b>	
<b>Factor 2: Knowledge trust</b>	
The bank official(s) is available to help in crisis	<b>.685</b>
SMEs' Owner-managers are confident in the advice from their bank officials	<b>.847</b>
Owner-managers are confident that their banks understand their businesses	<b>.698</b>
The bank officials often come forward with positive suggestions to help SMEs' businesses	<b>.790</b>
<b><math>\alpha = .811</math></b>	
<b>Factor 3: Approachability</b>	
SMEs' owner-managers prefer to avoid contact with bank official	<b>.707</b>
The bank officials are not interested in the owner-manager's business	<b>.851</b>
Owner-manager feels intimidated when dealing with bank	<b>.778</b>
<b><math>\alpha = .754</math></b>	
<b>Factor 4: Personal information sharing</b>	
SMEs' owner-managers share with the bank credit officials some of their own personal information (e.g. Background, personal life)	<b>.762</b>
SMEs' owner-managers feel free to share with bank credit officials their ideas, feelings, hopes, or problems that may not directly relate to business.	<b>.793</b>
<b><math>\alpha = .708</math></b>	

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**Table 2: Correlation matrix**

	Mean	Std.	1	2	3	4	5	6	7	8	9	10
1. Owner Education	1.63	.968	1									
2. Owner Experience	12.25	7.227	-.125	1								
3. Sex	.20	.400	-.016	-.014	1							
4. Company age	7.394	5.251	-.056	.353**	-.034	1						
5. Company Ownership	3.03	.779	.211**	-.065	.098	-.085	1					
6. Bank ownership	1.247	.4320	-.051	-.154*	.094	-.128	.025	1				
7. Inter-organizational banking relationships	4.04	1.305	-.160*	.050	.122	.136*	-.180**	.057	1			
8. Inter-personal banking relationships	3.105	.6178	-.051	.086	-.086	.300**	-.192**	-.116	.310**	1		
9. The Availability of Bank loan (%)	23.68	22.222	.064	-.078	.020	.136	-.135*	-.014	.356**	.436**	1	
10. Speed of Bank Loan Application Process	3.18	1.338	-.006	.053	.101	.087	-.056	.040	.333**	.353**	.230**	1
11. Probability of having a loan			.104	-.042	-.006	.116	-.104	.024	.340**	.347**	.706**	.152*

\*\* Correlation is significant at the 0.01 level (2-tailed).

\* Correlation is significant at the 0.05 level (2-tailed).

$F$  (bank loan ratio) =  $f$  {(control variables: firm's owner's experience, education, sex, firm's ownership, firm's age, bank's ownership), (inter-organizational banking relationship), (inter-personal banking relationship)}

$F$ (speed of bank loan application process) =  $f$  {(control variables: firm's owner's experience, education, sex, firm's ownership, firm's age, bank's ownership, inter-organizational banking relationship), (inter-personal banking relationship)}

One problem at this stage was that there was a large proportion of firms (31.3%) that had not got any loan from banks. This created a problem of non-normal distribution in the bank loan availability variable. Moreover,

firms that had not borrowed were not in a good position to provide reliable answers to other dependent variables, such as bank loan/collateral ratio and interest rate premium. Therefore, two steps were taken in testing the hypotheses. In step 1, the data was split into two groups (firms that did borrow from banks and those that did not). Logistic regression then was used to examine if the factors influence the probability of getting a bank loan. In step 2, only firms that borrowed from banks were selected, and then examined if the variables of interest influenced the bank financing variables (bank loan availability, and speed of bank loan application process), using hierarchical regression. I present the results of each step in return.

**Table 3: Logistic Regression on Probability of Getting Bank Loan**

	B	S.E.	Wald
Owner Education	.433	.208	4.324*
Owner Experience	-.021	.027	.619
Owner sex	-.528	.457	1.337
Firm ownership	-.020	.252	.006
Firm Age	.033	.043	.613
Bank ownership	.432	.424	1.039
Inter-organizational relationship	.729	.177	16.951***
Inter-personal relationship	1.261	.379	11.068***
Constant	-6.742	1.791	14.164***
-2 Log likelihood	193.020 <sup>a</sup>		
Cox & Snell R Square	.240		
Nagelkerke R Square	.340		
Chi-square	55.873***		
Percentage of correct prediction	80.4		

Note: <sup>a</sup>) p<.1; \*) p<.05; \*\*) p<.01; \*\*\*) p<.001

Table 3 summarizes the logistic regression results.

That model was statistically significant with  $\chi^2 = 55.873$  ( $p < .001$ ), indicating that the variables as a set reliably distinguished firms that got a bank loan from those that did not. The model reliably classified the firms into groups with a 80.4 % success rate overall.

The Wald criterion showed that inter-organizational banking relationship (number of bank services used by the firm) and inter-personal banking relationship were positively related to having a bank loan ( $p < .001$ ), supporting hypotheses 1a and 2a.

In step 2, only firms that borrowed from banks were selected. I then examined if the

variables of interest influenced the bank loan availability and the speed of the bank loan application process, using hierarchical regression. First, control variables (owner education, owner experience, owner sex, firm ownership, firm age, bank ownership) were included in the equation (Model 1). Second, independent variables (inter-organizational banking relationship, inter-personal banking relationship), were entered (Model 2). Table 4 summarizes the regression results.

#### *Availability of bank loan (bank loan ratio)*

The control model was significant at  $p < .1$ . When variables of interest (inter-organizational, inter-personal banking relationships) were entered in the main model, the model was significant at  $p < .001$  (adjusted  $R^2 = .192$ , F

**Table 4: Summary of Regression Results**

	Availability of Bank loan		Speed of Bank loan Application Process	
	<i>Control Model</i>	<i>Main Model</i>	<i>Control Model</i>	<i>Main Model</i>
Owner Education	.084	.132	-.023	.048
Owner Experience	-.195*	-.228*	.015	-.040
Owner sex	.132	.127	.164*	.147*
Firm ownership	.071	.118	-.057	.016
Firm age	.248*	.152	.190*	.136
Bank ownership	-.072	-.008	-.003	.040
Inter-organizational relationship		.109		.308***
Inter-personal relationship		.378***		.405***
F Model	2.099 <sup>a</sup>	4.621***	1.621	8.476***
Adjusted R <sup>2</sup>	.051	.192	.075	.322
R <sup>2</sup> change		.147		.290
F change		11.091***		26.937***

Note: <sup>a</sup>)  $p < .1$ , \*)  $p < .05$ ; \*\*)  $p < .01$ ; \*\*\*)  $p < .001$

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model = 4.621,  $p < .001$ ,  $F$  change = 11.091,  $p < .001$ ) (See Table 4). Inter-organizational relationship was not significantly related to the availability of bank loan, but inter-personal relationship was significantly ( $\beta = .378$ ,  $p < .001$ ) and positively related to the availability of bank loan. These results suggest that the stronger the inter-personal relationship between the firm owner and the bank officer is, the higher the availability of bank loans is to the firm (Hypothesis 1b was supported) but the more a firm uses services from the bank was not significantly related to a bank loan availability to the firm (Hypothesis 1a was rejected).

#### ***Speed of bank loan application process***

The control model was not significant. However, firm sex ( $\beta = .164$ ,  $p < .05$ ) and firm age ( $\beta = .190$ ,  $p < .05$ ) were positively related to the speed of bank loan application process, suggesting that female owned firms and firms with a more established history enjoy faster speed of bank loan application process. Other control variables had non-significant relations with the speed of bank loan application process in both models.

The main model was significant (adjusted  $R^2 = .322$ ,  $F = 8.476$ ,  $p < .001$ ). Inter-organizational relationship ( $\beta = .308$ ,  $p < .001$ ) and inter-personal banking relationship ( $\beta = .405$ ,  $p < .01$ ) were positively and significantly associated with the speed of bank loan application process. These suggested that firms using more services from banks and having better interpersonal relationships with banks enjoy faster speed of loan application processes.

Hypotheses 2a and 2b were supported.

### **5. Discussion**

This research examines the relative importance of two types of banking relationships: inter-organizational and inter-personal banking relationships on SMEs' accessibility to bank loans. Two types of banking relationships are empirically tested, using data collected from a sample of Vietnamese manufacturing SMEs. The result generally supports the central hypothesis that close banking relationships play an important role in getting bank financing. However, the result indicates that inter-organizational and inter-personal banking relationships are not equally important in helping firm access bank loans.

Overall, this study provides strong evidence to support the critical role of banking relationships on bank financing. The findings suggest that the speed of the loan application process and the probability of getting bank loans increases as a firm buys more services from the bank, and as the firm owner-manager spends more time developing inter-personal relationships with bank officers. These results are consistent with previous studies (Berger and Udell, 1995; Peterson and Rajan, 1994; Nguyen et al., 2006), which emphasized that banks accumulate information about borrowers through direct contacts with firm owners/managers and use this information in making lending decisions. As a result, firms with stronger banking relationships enjoy a higher availability of bank loans. This result was also consistent with the results from the interviews. Consider the following quote from an owner-

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manager of an SME:

*“Banks generally do not communicate well with customers on lending procedures and their requirements on collateral documents properly beforehand. However, if a firm’s owner-manager has a close relationship with bank officers, the firm can get advice and guidelines from the bank officer before submitting its bank loan application. Building close relationships with bank officers can help firms reduce the time of its loan approval process and improve its accessibility to bank financing”*

#### ***Theoretical Implications***

The current literature provided evidence that banking relationships have a value. By separating inter-organizational and inter-personal relationships and examining the impact of these two dimensions into one study, this research suggests that inter-personal relationships appear to be more important than inter-organizational relationships in influencing bank financing. This is consistent with current literature on personal relationships (or *Guanxi*) that tends to dominate studies on networking in Chinese or Confucian-based cultures (Redding, 1990; Xin and Pearce, 1995).

Most previous studies used the number of years that a firm has conducted business with its current bank or borrowing concentration (i.e. number of banks from which the firm borrows - inverse measure) as a measure of strength of inter-organizational relationship between the firm and the bank (e.g., Petersen and Rajan, 1994; Brau, 2002). In the context of transition economies, the duration of bank-

firm relationships may have a limited variance due to the short history of SMEs. This study examines another aspect of inter-organizational relationships, the variety of banking services the firm buys from the bank. It is clear that not only the duration of firm-bank relationships but also the variety of banking services used by firms has special importance in bank loan accessibility and loan terms to the firm. This suggests that number of services partners used from each other could be an effective measure for inter-organizational relationships in the context of transition economies.

#### ***Managerial implications***

The most important implication for managers is that banking relationships is the most valuable element for getting bank financing. Firm owners should purposely attempt to build relationships with banks/bank officers. However, along with inter-personal relationships, inter-organizational banking relationships (diversity of banking services) would also improve firm accessibility to bank financing. A simple advice to small business owners is to choose a bank and buy several services from the bank. Shopping around, trying to look for the cheapest bank for each service, and/or diversifying a banks portfolio are not advisable because they may hurt firm-bank relationships.

The relative importance of various factors influencing bank financing has particular relevance for SMEs in Vietnam and other transition countries. In these countries, the future development of the economies is greatly dependent on SMEs’ development. In the

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absence of effective market institutions that provide reliable business data and secure contracts, both banks and SMEs are forced to rely extensively on their direct interactions and relationships. In time, the countries' institutions may well develop, allowing banks to use more standard data and lending procedures

that can be commonly seen in the West. Until then, SMEs need to work actively with banks and directly demonstrate their creditworthiness. Vietnam is not unique in this respect and these issues are also apparent in other transition economies.

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