STUDY SUMMARY

Relationship Banking in India

Promoting frequent communication between loan officers and clients can help banks learn about the reliability of existing and potential clients. However, there is little evidence on how personalized interactions influence client behavior. This randomized evaluation tested whether the intensity of personalized interaction between borrowers and loan officers in India influenced borrowers' repayment behavior and found that clients with personal relationship managers at the bank had better repayment behavior but were not more satisfied with their loans overall.

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COUNTRY
India

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PROGRAM AREA
Small and Medium Enterprises

TOPIC
Access to Finance

TIMELINE
2007-2009

Policy Issue

It is difficult for banks to assess the credit risk of small and private firms because financial information on these potential borrowers is often unverifiable or hard to obtain and loan contracts are difficult to enforce if the client decides to default. One solution tested in this paper to substitute for the lack of enforceability by increasing the loyalty of clients by establishing close ties between the bank and the borrower: we test whether relationship lending improves the loan performance by establishing a personal relationship between the borrower and the lender through frequent interactions.

Promoting close relationships between loan officers and their clients might not only help banks learn about the reliability of a borrower but also has the potential to change the borrower's behavior. For example, a borrower might feel a sense of personal responsibility towards his or her loan officer and hence be more hesitant to default. If having a personal tie with the loan officer makes banking easier, the client may be reluctant to switch to a different bank given that building new relationships takes time and effort. However, past research has overlooked this dimension of relationship lending, and there is little evidence on whether and how personal interactions with lenders change borrowers' behavior.

Evaluation Context

ICICI bank is the largest commercial bank in India. In 2005, ICICI introduced a small business loan that did not require any collateral and allowed overdrafts, essentially functioning like a credit card. The target group of borrowers included small manufacturers, trading companies, and service providers.

To reduce overhead costs, ICICI wanted to avoid assigning individual loan officers to interact with each client. Instead, the bank relied on computer-based credit scoring and minimal interaction between the borrower and the bank when introducing the product. Credit appraisal was based on characteristics such as business type, information about the client's reliability as a borrower as inferred from past bank statements, references, credit reports, and financial information based on unaudited financial statements or income tax returns. Accounts with more than three late payments or warnings per year risked losing loan renewals or being closed.

Details of the Intervention

In partnership with ICICI, the researcher used a randomized evaluation to test whether close personal ties between the bank and the client can affect the loyalty and repayment behavior of clients. The researcher randomly assigned 1,319 borrowers to four groups that varied in the level of personalized attention borrowers would receive:

High Intensity (320 borrowers): The bank matched borrowers with a personal relationship manager who they could contact via phone or email. Each personal relationship manager called their client every other week to establish trust with the client and to check if the client had any administrative issues with the loan (for example, if monthly statements had not been received or if checks had not been deposited). If the client missed a payment deadline, the relationship manager would also remind the borrower to pay on time to avoid late fees.

Medium Intensity (339 borrowers): Borrowers in this group received the exact same treatment as the "high intensity" group with two exceptions: clients did not receive phone numbers of their relationship managers and instead of interacting with a dedicated relationship manager, their contact manager varied randomly with each biweekly call.

Low Intensity (324 borrowers): Borrowers did not receive any regular calls from relationship managers and received only a reminder call when a payment due date was approaching. The bank randomly assigned callers to clients and made no attempt to establish a personal relationship between the caller and the client.

Comparison Group (336 borrowers): Borrowers did not receive regular calls or any other follow up. They received text message reminders in addition to their monthly account statements as part of the standard bank policy.

Results and Policy Lessons

Overall, clients assigned to personal relationship managers had better repayment behavior compared to those not assigned to any relationship managers, and the bank rewarded them with more favorable loan terms. While borrowers assigned to a dedicated relationship manager were more responsive to calls from the bank compared to borrowers in contact with multiple managers, they also complained more.

Impacts on repayment behavior: Building a relationship between managers and clients reduced late payments and, in particular, reduced the likelihood of repeated late payments. Borrowers in the "high intensity" and "medium intensity" groups had on average about 0.1 fewer late payments relative to the comparison group. Among borrowers who made at least one late payment, those who were assigned personal relationship managers (i.e. those in the high and medium intensity groups) were more than 20 percentage points less likely to have a second late payment relative to those in the comparison group. The “low intensity” treatment did not have a significant impact on late payments.

Better repayment among borrowers helped them secure more favorable terms with the bank. Borrowers in the “high intensity” and the “medium intensity” groups were more likely to receive a designation from the bank that qualified them for automatic renewals of their loans relative to the comparison group. Borrowers in the “high intensity” group were also more likely than the comparison group to receive an offer to increase their loan size when their accounts were renewed.

Impacts on client complaints and satisfaction: Borrowers with a dedicated relationship manager were 1.6 percentage points more likely to respond to the biweekly calls compared to those with multiple relationship managers, who responded 87 percent of the time. However, borrowers with dedicated relationship managers logged more complaints than borrowers with multiple managers, and they were less likely to have their complaints resolved. One potential explanation is that having a dedicated relationship manager increased clients’ expectations, which in turn made them more likely to make complaints and demand improved service. There was no evidence that borrowers with dedicated relationship managers were more satisfied with their loans overall.

Sources

Antoinette Schoar, “The Personal Side of Relationship Banking.” Working Paper.