

The Effect of Market Structure and Relationship Lending on the Likelihood of Credit Tightening

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Abstract

This paper contributes to the debate on the effect of banking market competition jointly with the lending relationship on the availability of credit by adding new empirical evidence from an European market. By using a unique panel database of Italian firms, we aim to analyse the determinants of the likelihood of a tightening lending policy, and to assess the market conditions under which banks and firms are able to establish a beneficial long-term relationship. This study provides tests that examine (1) whether establishing strong lending relationships translates into a lower probability of being credit tightened by the banking system, (2) whether the market structure does directly affect the probability of tightening, and (3) whether the value of the relationships for the borrower is affected by the local credit market structure, i.e., if more intense lending ties influence the probability of tightening more in highly concentrated than in competitive markets.

The results support the hypothesis that the likelihood of credit tightening is lower for firms having closer lending relationships, after controlling for their riskiness and for other firm-specific characteristics. Furthermore, all else being equal, the probability of tightening is decreasing in credit market concentration, and intense lending relationships reduce such probability more in highly concentrated than in competitive markets.

Keywords: relationship lending, credit market competition, credit tightening.

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