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## PRESS RELEASE

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### **Staying, dropping, or switching: the impacts of bank mergers on small firms**

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The impact of bank mergers on firm borrowers has been a question of interest for researchers and policy makers for many years. In particular, do bank mergers harm or benefit firm borrowers? Do bank mergers result in less credit for small firms? This paper addresses these questions by analyzing data on loan contracts between Belgian banks and small firms from 1997-2003, a period covering a wave of mergers in the Belgian banking sector.

We first distinguish firms with a single bank borrowing relationship from firms with borrowing relationships with multiple banks. For single-relationship borrowers it is also necessary to differentiate between the three alternatives of "staying," "switching," or "dropping" of bank-firm relationships following bank mergers. Firms with a single bank borrowing relationship that have their relationship with a merged bank terminated following the merger but that are able to "switch" to another bank will be less harmed than similar firms that "drop"; i.e., that have their relationship discontinued but that cannot replace the lost relationship with a new one. The latter find themselves with no access to bank credit. We track the performance of single-relationship borrowers during a three-year period following a drop, switch or stay. This allows us to measure the differing impacts of "staying", "dropping", and "switching" on small firms.

We find that the single-relationship borrowers of the target bank in a merger are significantly more likely to experience a drop of their relationship than are similar single-relationship borrowers of the acquiring bank or of nonmerging banks. We compare the performance of the target-bank droppers following a merger with the borrowers that stay with or switch from the target bank. We perform a similar comparison for borrowers of acquiring banks and of nonmerging banks. We find that "droppers" from each type of bank are much more likely to enter bankruptcy than are the "switchers" or "stayers". The "droppers" that do not enter bankruptcy also perform less well than "switchers" or "stayers" on several other performance measures. These results suggest that the single-relationship borrowers of target banks that were dropped following the merger did not terminate their relationship voluntarily.

At the same time, a factor that must be considered in analyzing the impacts of bank mergers is that target banks often become the target for a merger precisely because they were failing to get rid of their non-creditworthy borrowers. This suggests that some mergers may actually accomplish a desirable "cleansing" of the target bank's loan portfolio by eliminating the non-creditworthy borrowers. If such a cleansing is indeed occurring, the single-relationship borrowers of a target bank that are dropped following the merger should exhibit a lower survival rate and worse performance following the drop than borrowers that are dropped from either the acquiring bank or from nonmerging banks. We test this hypothesis and are able to reject it; the bank mergers that we study do not appear to have been motivated by the need to cleanse the target banks' loan portfolios of weak borrowers.

These results allow us to conclude that many of the firms being dropped from merged banks following the merger are indeed harmed by the merger. This conclusion has important policy implications, since single-relationship borrowers who lose their relationship without substituting a new one also lose their access to bank credit. Policy makers may thus have good reason to be concerned about the impacts of bank mergers on credit for small firms, given that in most countries a large proportion of small firms maintain single borrowing relationships.