Sveriges lantbruksuniversitet
Swedish University of Agricultural Sciences

Department of Economics

The role of relationships in lending to farmers

- A study from the loan officer's perspective

Sofia Eriksson, Tina Olsson, Rebecca Servin

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The role of relationships in lending to farmers
- a study from the loan officer's perspective

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Uppsala, June 5, 2012

Sofia Eriksson, Tina Olsson & Rebecca Servin

Abstract

There have been significant changes in the agricultural sector during the past 20 years (Jordbruksverket, 2008). The development of today is towards deregulation and adaption to global market conditions. As farmers try to adapt to the changed and more competitive market conditions investments are often necessary (LRF Konsult *et al*, 2012). Loans to agriculture and forestry businesses have increased to record levels and debt has doubled over the past years. The financial turbulence of the past years has contributed to an increase of the meaningfulness and willingness of the banks to be able to understand and handle risks associated with agriculture and forestry (Breiding, 2010). Handelsbanken has during the last five years made a major expansion in the segment of farm and forestry clients.

When assessing finance to farm businesses, it can be a costly and complicated process for the loan officer to find the right objective information; therefore the personal contact and relationship between the loan officer and the credit applicant is a very important factor in the credit evaluation process (Akhavein *et al*, 2004). Yet little is known about how the relationship is established and which factors affect the relationship (Hedelin & Sjöberg, 1992; Bruns 2003). The farm- and forestry division of Handelsbanken is interested in investigating how the relationship between the bank and its clients is established and what factors are influencing the relationship.

The purpose of this study is to investigate how loan officers establish an understanding of applicants' personal character in the loan application process, and how that understanding together with the personal relationship that is formed between the loan officer and the credit applicant affects the credit evaluation.

The approach of this project is explorative. According to Kvale (1997) the aim of an explorative study is to search for new dimensions of the unit of analysis. The reason for choosing an explorative approach of the study is that there has not been much research about the lending relationship between loan officers and farmers (Lindstrand, 2003). This study consists of a theoretical framework where data was collected in order to obtain a general understanding about relationships and the problems and solutions associated with lending relationships. In order to obtain a deeper understanding of the characteristics of the relationship in the credit evaluation process, literature that describes the problem associated with lending relationships is studied. A case study including interviews with 16 loan officers working at Handelsbanken were conducted in March and April 2012, in order to collect data for studying the relationship between loan officers and farmers.

The conclusion that can be drawn from this study is that the loan officers establish an understanding of applicants' personal character in the loan application process by being interested in the credit applicant and his business. This creates legitimacy for the loan officer and he receives the credit applicants' approval, which creates trust in the relationship. A relationship built on trust leads to improved communication between the loan officer and the credit applicant. The good communication can increase the flow of information, which leads to the establishment of a mutual understanding. This understanding between the parties decreases the problems of information asymmetry in the credit evaluation process, which makes the process more efficient and viable in a long-term perspective.

Sammanfattning

Under de senaste 20 åren har det skett stora förändringar inom den agrara sektorn i Sverige (Jordbruksverket, 2008). Förändringarna har inneburit avregleringar av jordbrukspolitiken, vilket resulterat i lantbruksföretagare måste anpassa sig till alltmer marknadsmässiga krav och regelverk. Många lantbruksföretagare måste göra stora investeringar för att uppfylla de nya kraven och vara konkurrenskraftiga på marknaden (LRF Konsult *et al*, 2012). Investeringar innebär för många lantbrukare belåning av externt kapital, vilket också märks hos banker och kreditinstitut där utlåningsnivåerna till kunder inom den agrara sektorn fördubblats under de senaste åren. Den finansiella turbulens som råder på världsmarknaden sedan en tid gör att det är än viktigare att bankerna är insatta i och förstår förutsättningarna och riskerna med att bedriva skog- och lantbruk (Breiding, 2010). Handelsbanken är en av de svenska bankerna som under de senaste åren gjort en stor satsning inom detta segment genom att bygga upp en egen division för skog och lantbruk.

Det kan vara en kostsam och komplicerad process för bankerna att hitta trovärdig och objektiv information om lantbruksföretag (Akhavein *et al*, 2004). Den personliga relationen mellan kreditgivaren och kredittagaren kan därför vara av stor betydelse för att kunna göra en rättvis kreditbedömning. Det finns inte så mycket forskning gjord om vilken betydelse den personliga relationen har vid kreditbedömningar och vilka faktorer som påverkar relationen (Hedelin & Sjöberg, 1992; Bruns 2003). Handelsbanken skog- och lantbruk är intresserade av att få en djupare förståelse för hur relationen mellan kreditgivare och kredittagare etableras samt hur relationen påverkar kreditgivningsprocessen.

Syftet med denna studie är att undersöka hur kreditgivare skapar sig en förståelse för kredittagarens personliga egenskaper, samt hur denna förståelse påverkar kreditbedömningsprocessen.

Denna studie har ett explorativt angreppssätt. Enligt Kvale (1997) är syftet med en explorativ studie att söka efter nya dimensioner av studieobjektet. Ett explorativt angreppssätt passar denna studie eftersom ämnet ”betydelsen av relationen mellan kreditgivare och lantbruksföretagare” är relativt outforskat (Lindstrand, 2003). Denna studie består av ett teoretiskt ramverk för att ge en förståelse om affärsrelationer. Litteraturstudien består av en genomgång av vetenskapliga artiklar och böcker för att ge en djupare inblick i bankrelationer och relationens betydelse i kreditgivningsprocessen. För att applicera frågeställningen på lantbrukssektorn gjordes under mars och april 2012 en telefonintervjustudie med 16 skog- och lantbruksansvariga kredithandläggare inom Handelsbanken.

Slutsatsen av denna studie är att kreditgivaren skapar sig en förståelse för kredittagarens personliga egenskaper genom sitt intresse för kredittagaren och dennes verksamhet. Kreditgivarens intresse och förståelse skapar ett gillande hos kredittagaren, vilket resulterar i ökad legitimitet för kreditgivaren och skapar ett förtroende i relationen. En relation baserad på förtroende leder till förbättrad kommunikation mellan parterna. Förbättrad kommunikation mellan de båda parterna kan öka flödet av information i kreditbedömningsprocessen. Ökat flöde av information och en ömsesidig förståelse minskar problemen med asymmetrisk information. Detta resulterar i en effektivare kreditbedömningsprocess och ger bättre förutsättningar för att relationen ska vara hållbar i ett längre perspektiv.

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1 Introduction

This chapter gives an introduction to the financing of farm businesses. The chapter also includes a problem background, a problem formulation, the aim and the delimitations of the study.

There have been remarkable changes within the agricultural sector during the past 20 years (Jordbruksverket, 2008). The agricultural sector is traditionally signified by stable prices and a relatively constant demand of its products. These conditions have affected the requirements that lenders have had for farm businesses, and are the basis for the rules and regulations for financing of farm businesses today. The historically stable price and market conditions for farm products can be explained by governmental intervention in order to protect the domestic production of food. The development of today is towards deregulation and adaption to global market conditions. This requires cost efficient farm businesses and has lead to fewer and larger entities and greater pressure on prices (LRF Konsult, 2012). Because of the increased pressure and fluctuations on the markets, it becomes more difficult for banks to assess the future value of assets of the farm business.

As farmers try to adapt to the changed and more competitive market conditions investments are often necessary (LRF Konsult *et al*, 2012). Investments such as expanding or differentiating usually require external funding. Loans to agriculture and forestry businesses have increased to record levels and debt has doubled over the past years. The trend shows an increasing demand for investment capital as a result of the structural changes in agriculture. The financial turbulence of the past years has contributed to an increase of the meaningfulness and willingness of the banks to be able to understand and handle risks associated with agriculture and forestry (Breiding, 2010). The effects and strains in the agriculture sector differ from year to year. There are also many different lines of production within the agricultural sector, and there are different conditions and strains for each line. The difficulty of assessing a farm business is often to include all potential risks, and to identify the future sources of risk for different credit takers. Farm businesses are often owned and managed by the same one person, and are dependent on the values and risk attitudes of this person. Each farm business must therefore be evaluated individually from the possibilities and risks of each firm (LRF Konsult *et al*, 2012).

The agricultural sector is dominated by micro- and small sized businesses (LRF Konsult *et al*, 2012). The overwhelming majority, 85 per cent, of farm businesses are operated as a sole proprietorship, followed by 11 per cent of farm businesses operated in the form of incorporated businesses. Micro- and small sized businesses constitute a large proportion of all businesses in Sweden (Coull, 2011). A micro company is defined by the European commission as a company with less than 10 employees or a turnover of less than 2 million euro (www, European commission, 2009). A small business is defined as a company with less than 49 employees and a yearly turnover of less than 10 million euro. This segment of companies plays an important role in the creation of new jobs and constitutes the group that contributes the most to the growth in GDP. In addition, they are especially important for creating jobs in the rural parts of Sweden (Bruns, 2003).

In order for micro- and small sized businesses to grow and develop, fundings via external capital is often necessary (Binks & Ennew, 1997). The micro- and small sized businesses, including farm businesses, is an important group of customers for Swedish banks. The bank system stands for 92,7 per cent of the fundings to farm businesses (LRF Konsult *et al*, 2012). The remaining parts constitute of debt to suppliers and loans from family and relatives. There is an increasing competition for the customer segment of farm businesses among the banks. Many providers of credit have realised the potential of the agriculture- and forestry sector. Swedbank including Sparbankerna is the biggest actor today with around 35 per cent of the total market. Other prominent actors include Handelsbanken, Landshypotek, Länsförsäkringar, Danske Bank and Nordea.

In 2011, Handelsbanken had around 10,6 per cent of the market shares for loans to farm businesses and have during the past five years made an major expansion in the segment of farm and forestry clients (Handelsbanken annual report, 2010; LRF *et al*, 2012) in order to satisfy owners of farms and forests, who often have specific requirements in order to succeed with their business (Handelsbanken annual report, 2010). Handelsbanken's farm and forestry division offers special competence within the agriculture at all of the local offices in order to establish a strong local connection.

1.1 Problem background

It can be a problem for banks to evaluate the information that is required about a small company in order to ascertain the credibility and feasibility of the investment (Binks & Ennew, 1997). The firms in the farming sector are often sole proprietorships and the banks have no standardised routine for how to evaluate the information about these small-scale sole proprietorships (Bruns, 2003). Assessment of key figures and financial statements that are used for evaluating micro- and small sized businesses in other sectors can be applied on farm businesses, but there is no standardised model that takes into consideration all the factors influencing a successful investment in a farm business (Akhavein *et al*, 2004)

There are according to Kling *et al* (2003) three main reasons for why it is more difficult to identify the critical success factors for small firms.

- Small firms often have limited resources for producing professional business plans, forecasts and budgets. Uncertainty and a volatile environment can also be influential. According to Kling *et al* (2003) it is up to the loan officer to find suitable and efficient variables that shows a fair and credible picture of the firm. In this, the relationship between the firm owner and the loan officer is a key factor.

- Small firms often experience difficulties in producing objective information. For start-up firms there is no historical information available about the firm. Credit evaluations of these kinds of companies are therefore based on the perception the loan officer gets about the firm owner as a person and about his capabilities as a business man.

- It is also difficult to apply standardized models and policies for credit to small firms since these operate under different conditions than large, already established businesses and must be evaluated from a more dynamic perspective.

As the majority of small scale farm businesses are operated in the form of sole proprietorship, which means that the owner of the firm becomes personally and juridical responsible for the affairs of the firm, the manager/owner is a key person for the development and future of the business (LRF *et al*, 2012; Broomé *et al*, 1998). As compared to incorporated firms, that are juridical entities and the personal responsibility of the firm manager is not as significant. Therefore, it is important that the loan officer have an understanding for the fact that the personal and entrepreneurial characteristics of the owner are important when evaluating credit for a small firm (Bruns, 2003).

1.2 Problem statement

The personal relationship between the loan officer and the farmer is of great importance for banks in the credit evaluation process (Berger & Udell, 2002; Bruns, 2003). When a bank choses to offer financing to farm businesses it is important that the bank has knowledge and understanding of the specific conditions of the farming sector in general and the situation of the farmer as an individual (Cole, 1998). Insufficient understanding of the credit applicant increases the problems with asymmetric information that can lead to higher costs for both the bank and the credit applicant (Harhoff & Körting, 1998; Berger & Udell, 2002).

It can be a costly and complicated process to find the right objective information when assessing farm business credit applications (Akhavein *et al*, 2004). Therefore the personal contact and relationship between the loan officer and the credit applicant is a very important factor in the credit evaluation process. Yet little is known about how the relationship is established and which factors affect the relationship (Hedelin & Sjöberg, 1992; Bruns 2003). Earlier studies in the area have focused on quantitative studies. A qualitative case study can add to giving a deeper understanding of how the loan officers establish an understanding for the credit applicants' personal characteristics, and can observe factors that cannot be measured in a quantitative study.

1.3 Aim

The purpose of this study is to investigate how loan officers establish an understanding of applicants' personal character in the loan application process, and how that understanding together with the personal relationship that is formed between the loan officer and the credit applicant affects the credit evaluation.

The aim will be answered through the following research questions;

- Why is a relationship of importance for evaluating a credit application from a farm or forestry business?

- How does the character of the loan officer and the credit applicant influence the relationship?

- What factors affect the relationship and how do these factors influence the relationship?

1.4 Delimitations

According to literature, the establishment of a relationship based on trust and mutual understanding between a loan officer and credit applicant is of particular importance in the process of evaluating small firms and within the agricultural sector (Berger & Udell, 2002; Broomé *et al*, 1998). This project is therefore limited to study the establishment of a business relationship between loan officers and credit applicants. The study does not take into consideration the content of the financial statements and figures that are a requirement for the credit applicant to present to the bank.

The case study is limited to Handelsbanken’s farm and forestry division. The idea of the study has emerged in collaboration with the manager of Handelsbanken’s farm and forestry division, who expressed an interest in learning about how the relationship between loan officers and farm- and forestry clients is established and what effect the relationship has on the credit evaluation process.

2. Method

This chapter explains the approach used in this study. The study consists of a literature review and a case study of loan officers of Handelsbanken about how they establish an understanding of applicants' personal character, and how that understanding together with the personal relationship that is formed between the loan officer and the credit applicant affects the credit evaluation.

2.1 Approach

This study uses a theoretical framework based on a review of the literature on the general understanding about relationships and the problems and solutions associated with lending relationships. In order to obtain a deeper understanding of the characteristics of the relationship in the credit evaluation process, literature that describes the problem associated with lending relationships have been studied.

A case study based on interviews with 16 loan officers working at Handelsbanken were conducted in March and April 2012, in order to collect data for studying the relationship between loan officers and farmers. Handelsbanken's farm- and forestry division is interested in investigating how the relationship between the bank and its clients is established and what factors are influencing the relationship. The loan officers were asked in open-ended interviews how they establish an understanding of applicants' personal character in the loan application process and how that understanding together with the personal relationship that is formed between the loan officer and credit applicant affects the credit evaluation.

The approach of this project is explorative. An explorative approach means that by identifying typical cases and relevant factors, the information obtained can contribute to a deeper understanding or discovery of problems (Kvale, 1997). Explorative studies can contribute to new paths of research or cover black holes of knowledge. According to Kvale (1997) the aim of an explorative study is to search for new dimensions of the unit of analysis. The reason for choosing an explorative approach of the study is that there has not been much research about the lending relationship between loan officers and farmers (Lindstrand, 2003).

The approach of the study can further be described as subjective/inductive (Holme & Solvang, 1997). The study aims at interpreting and explaining how loan officers establish an understanding of applicants' personal character in the loan application process, and how that understanding together with the personal relationship that is formed between the loan officer and the credit applicant affects the credit evaluation. The inductive approach is based on the empirical data and the observation that is to be described and then search for theories that describe what has been observed. Since the loan officer's perceptions are personal, it is important to be able to change and modify the approach as new information is revealed. Working with non-quantified, subjective factors it is difficult to know beforehand in what conclusions the study will end up. An alternative approach is called positivistic, and starts from theory to empirical data, i.e. a deductive approach consists of descriptive studies and explanatory tests of hypotheses (Holme & Solvang, 1997). A deductive approach uses representative samples based of a population, aiming to come close to the real average of the total population (a normal distribution curve). Whereas an inductive research approach uses intentional samples, for example a case study of a limited number of individuals or groups along a distribution curves, with no aim of generalizing the results. A problem with the inductive approach is that it can be difficult to transfer the results to other settings and to generalize the results. An inductive approach was best suited for this type of study, because when working with non-quantifiable, subjective factors it is hard to find information that is measurable and comparable to other observations and situational contexts. This study does not aim to generalize or confirm an observation. The aim with this study is rather to find patterns in the observation.

The aim of the study is the determinant for what approach to use (Backman, 1998).
Backman (1998) explains the difference between quantitative and qualitative approaches by saying that a quantitative method is measuring and using statistical material, while a qualitative approach on the other hand is more focused on describing the characteristics of something, using soft information and data. According to Denscombe (2000) qualitative research is about using several different methods and approaching the topic from an interpretative and explorative way. Advocates of the qualitative methods argue that it can be preferable when all types of material and information cannot be measured and quantified.

This project looks at soft data such as perceptions and feelings of trust and legitimacy; hence a qualitative approach is motivated. In accordance with the aim of this study, the qualitative approach is suitable for finding information to answer the aim of the study. The qualitative approach can give a deeper understanding of the relationship between the loan officer and the credit applicant and how the personal characteristics can influence a credit evaluation process. If a quantitative approach had been chosen instead it could have been more difficult to get a deeper understanding of the relationship and the personal characteristics, since these kinds of factors have not yet been quantified and measured. The case study is a part of the qualitative approach. A sample of the whole organization Handelsbanken farm and forestry division is selected in order to be able to understand what impact the lending relationship has on the credit evaluation process and what factors influence the relationship between the loan officers and farm and forestry clients at Handelsbanken's farm and forestry division.

2.2 Literature review

A literature review has been performed in order to get an idea about what other research on the topic has found and what factors earlier studies have found being of interest (Backman, 1998). Literature for this project was collected through a systematic search for peer-reviewed articles based on key words (table 1) in the reference database Web of Science and the e-article archive JSTOR. Additional searches in the e-article archives Science Direct and Emerald were conducted in order to be sure that no important articles had been overlooked.

Table 1. Search terms in literature review

"Bank*" "Credit*" "Credit evaluation*" "Credit allowance*"	A N D	"Relation*" "Relationship*" "Relationship lending*" "Trust*" "Communication*" "Information*" "Agency problem*"	A N D	Agricultur*" "Farm*" "Small business*" "Small firm*" " Start-up business*" "Start-up firm*" "Developing firm*"

The searches based on combinations of the key words resulted in over 100 articles. Since all of these are not of relevance to this project, articles were sorted and selected based on their title and abstract. Twenty articles were regarded to be of relevance for this project. Most of the articles are about lending relationships and small firms in general rather than farm and forestry businesses. The particular conditions and characteristics of relationships in the agricultural sector are included in the case study.

2.3 Case study

To be able to get an understanding for how loan officers establish an understanding of applicants' personal character in the loan application process, and how that understanding together with the personal relationship that is formed between the loan officer and the credit applicant affects the credit evaluation, a case study of Handelsbanken's farm and forestry division have been done. Handelsbanken is one of the largest banks in Sweden and is making a major expansion in the segment of farm- and forestry businesses (LRF *et al*, 2012).

The case study is based on 16 interviews with loan officers at Handelsbanken. An interview is a conversation between two or several parties with the purpose to answer a specific aim and is structured in a way leading to the answering of this aim (Kvale & Brinkmann, 2009). To find respondent that are suitable given the aim, the manager of Handelsbanken's farm and forestry division head office contacted the managers of the farm and forestry department for each of the six regions and asked them to name farm and forestry responsible loan officers that could be willing to participate in the study. Altogether 30 names of loan officers were collected from the six regions. Sixteen of these 30 loan officers were willing to participate in an interview. Given that the initial contact and request came from department managers might have positively affected the number of respondents. It gives the study greater legitimacy in the eyes of the loan officers when the managers had already approved it.

The loan officers participating in the case study have varying experience in the profession; some have worked a long time within the bank, while others are relatively new at their positions. Twelve of the 16 loan officers have a background in farming or forestry. Each interview took between 30 – 45 minutes. All of the loan officers participating in the case study are anonymous. Their anonymity is motivated in order to not expose the loan officers for situations that are sensitive and to allow for better possibilities to freely express their perceptions and opinions.

The purpose of a study should according to Kvale (1997) be formulated before beginning the interviews. It is important for the interviewer to give the impression of being open and interested and not to stress the respondent (Ryen, 2004). The person that is interviewed is according to Jensen (1991) supposedly more comfortable if he get access to the questions, are aware of the purpose of the interview and what the result will be used for before the interview is conducted. The reason for choosing qualitative interviews for this study is that this approach allows for discussion and the understanding of a situation from the real world, and in the perspective of the interviewee, i.e. the unit of analysis.

Kvale (1997) recommends that an interview guide is constructed in order to secure that the questions are following a theme and are relevant for answering the aim of the study. An interview guide can be constituted in different ways, structured or unstructured (Lundahl & Skärvad, 1999). A structured interview is when the questions have a certain order that is quite strictly followed, while an unstructured interview is when the questions has no fixed order and are open during the entire interview. If the researcher is using an interview template that is formed in between these two it is called semi-structured. During a semi-structured interview, the questions are prepared in advanced but they are often complemented with follow-up question and the respondent is asked to elaborate and expand his answers. In accordance with Kvale's (1997) recommendation, an interview guide was compiled in a semi-structured template (appendix 2). The questions were relatively open, allowing for the respondent to expand the answers and for us to ask complementing questions if something was unclear or the respondent answered in a way deviating a lot from the other respondents or the secondary data. Since the approach of the study is explorative and inductive, questions could be eliminated or added to the interview guide as the study proceeded.

The interview guide was arranged in groups of questions to get an understanding of how the lending relationship is perceived by the loan officers (appendix 2). A letter explaining the subject and the purpose of the study was attached in order for the loan officers to be able to prepare for the interviews (appendix 1). The letter was e-mailed to the 30 loan officers we had been given permission to contact. All of these are working with farm and forestry clients at Handelsbanken, and they are geographically distributed throughout Sweden. They were asked to confirm their participation in the study by suggesting two dates suitable for us to call them for an interview. In this first email, the interview questionnaire was also attached. This letter was sent out to the loan officers so they were aware of the questions they would be asked.

A telephone interview is an easy and cheap way to do interviews (Denscombe, 2000). Telephone interviews was decided to be the most appropriate method since it would not be possible to do personal interviews with 16 individuals situated all over Sweden, in terms of time and economical resources. Telephone interviews are preferred over questionnaires by mail, since the soft information we were asking questions about required the possibility to ask additional questions in order to get a deeper understanding of the reasoning of the loan officers. A written questionnaire would not have given the desired result and depth of the answers. We were at least two persons during the interviews, one asking the question and the other taking notes. This is a good way to ensure that the information is accurately understood and that nothing important is forgotten. None of the interviews were recorded. The reason for this is that recordings can inhibit the respondents to be honest and open (Ejvegård, 2009). One of the interviews was performed at the office of the loan officer. A personal interview can give a feeling of what the situation and environment can be like when the loan officer and client meet.

The analysis of the empirical material is based on the information compiled in the theory and literature review chapters, chapters three and four. The results are not aiming at drawing any general conclusion, but only to compile and understand the answers of this particular group of respondents. The results of the case study are to some extent compiled in a quantitative way, this in order to support and enhance the qualitative result. One way of working with an inductive research approach is to continue the interviews as long as new information is generated until the point of empirical saturation is reached. In this study an empirical saturation was reached after 16 interviews, no new information was revealed and the loan officers were giving similar answers to most of the questions. If one loan officer says that he finds the appearance of the farmer important in order to trust the farmer, and another loan officer says that he thinks that it is important that the farmer wears an appropriate outfit, we have chosen to interpret both those answers as meaning that the physical appearance of the farmer is of importance.

2.4 Reliability and validity

It is important that all data is critically reviewed in order to give the study scientific value (Ejvegård, 2009). There is always a risk of misunderstanding and incorrect interpretation of answers in an interview situation.

The measure of reliability of a study deals with the usefulness of the unit of measurement and the reliability of the measuring tools used (Lundahl & Skärvad, 1999). The reliability is of particular importance in deductive studies, where the ability of results to be generalized is more important. Validity shows whether a method investigates what it claims to investigate and how good the data is reflecting the reality. The information that is used in the theory and literature review stems from peer-reviewed scientific articles and has been cited and used in several other studies. Many different sources of data and information strengthen the validity of a study (Yin, 2003). A problem when measuring validity can be the language, i.e. the respondent does not understand what the researcher is asking. This can be a problem in this study in the sense that we have a more theoretical understanding and approach to the problem, while the loan officers have the practical experience from evaluating credit applications and establishing relationships with farmers. Since we have used open questions and been able to ask complementing questions, and because of the open dialogue been able to explain and communicate with the loan officers we have secured a certain validity of the result. An additional factor that eliminates the risk of misinterpretation of information due to language problems is the fact that we have interviewed 16 loan officers that have been relatively consistent in their answers. The aim of the study is not to draw any general conclusions but for this particular case, the answers of the 16 loan officers are consistent regarding the majority of the questions, which strengthens the validity of the study and might suggest a certain degree of reliability.

3 Theoretical framework

The theories presented in this chapter include agency theory, which addresses problems that often occur in the business relationship. Relationship theory, trust, information and communication are important in order to solve and reduce agency problems.

3.1 Agency Theory

Agency theory is about the relationship between the principal and the agent (Jensen & Meckling, 1976). An organisation can be defined as a network with many relationships between the organisation and its stakeholders. The relationship is built on a contract between the principal and the agent where the principal assigns the agent to perform some kind of service on his behalf. When collaborating with different actors, there is always a problem with risk sharing (Eisenhardt, 1989).

Agency theory is based on the assumption that both parts in this relationship are utility maximizers, which can lead to three kinds of problems (Eisenhardt, 1989).

- The first problem is that the principal and the agent have different risk preferences, different goals or different attitudes towards risk.
- The second problem is that the agent will not always work to do the best in the view of the principal.
- The third problem is that it is very costly for the principal to monitor that the agent works and follows the principal's interests.

In a business relationship, focus has to be on the contract between the principal and the agent, this since the problems usually start here, in the form of different goals and different attitudes towards risk (Eisenhardt 1989). It is important to find an agreement that work in the best way for both the principal and the agent in order to avoid these problems. For the organisation to be competitive, an important factor is how they are able to solve the agency problems, different types of companies and organisations have different strategies for solving the agency problems (Fama & Jensen, 1983)

3.1.1 Asymmetric information

Asymmetric information is about how the principal and the agent have different information about themselves and each other and different conditions about how to handle the situation (Rapp & Thorstensson, 1994). There is always one part that has more information than the other one when starting the collaboration. It is not always the agent that is the one with the best access of information. The principal can be the one that has the best information and the highest knowledge. According to Andrén *et al* (2003) asymmetric information is something that can be seen more clearly in small business. The reason for this is that the owner of the small business usually has more information than the external stakeholders have about the owner's attitude towards risk, his business plan and goals.

For external stakeholders it is a problem that it can be more costly for the principal to find information about the business (Richardson *et al*, 1985). If there is a large gap between the agent and the principal, the agent can become more reluctant to trust the principal. Other problems that can occur from asymmetric information in the relationship are problems with moral hazard and adverse selection.

3.1.2 Moral Hazard

Moral hazard problems can occur when there is information asymmetry between the principal and the agent (Mishkin, 1990). This is something that can occur when the principal needs to put a value on the work that the agent has performed. Moral hazard problems occur when the agent acts opportunistically in order to meet his own interests on the expense of the principal. This is something that the principal must have mind when analyzing the agent. The parties must know that there is always a risk associated with every collaboration and transaction. The principal has to assess information about the agent and his capabilities and ideas in order to know if the collaboration has the potential to be successful.

3.1.3 Adverse selection

This type of problem is about one part trying to exploit the situation, when the principal do not reveal all information, on the expense of the agent (Mishkin, 1990). Rapp & Thorstensson (1994) explain that it is the way the contract is designed that shows how the relationship is built on information and risk between the principal and the agent and the risk of a negative sample. The negative sample occurs when it is difficult to distinguish a person's characteristic from other persons in the group.

The traditional examples about adverse selection are the insurance business and the market for used cars (Akerlof, 1970). Those who wants to have an insurance are often the once who has the highest risk for accidents. This leads to a higher price for insurance even for people with a lower risk for accidents. The insurance company cannot distinguish between an "a good" or "a bad" client. It is therefore necessary for the company to have a higher price to lower the risk they have for this client. As an effect of asymmetric information on both of these markets the quality are affected in a negative way. This is the same in the used-car market, the seller always know more about the car then what the buyers do. The buyer is not able to distinguish between a good car and a bad car. The buyers are therefore not interested in paying the price of a good car, since there is no way for him to be certain that it really is a good car. Therefore, the owner of a good car will be unable to get a higher price for the car. The effect of this is that many good cars will disappear from the market, which results in a lower quality on the cars at the market.

3.1.4 Transaction costs

In all business relationships, costs will occur when the parties are assessing and monitoring each other (Hultkrantz & Nilsson, 2004). The costs, according to theory called transaction costs, will be higher when there is a risk of agency problems between the parties. In a world with perfect market conditions with no competition, there will not be any transaction costs. Transaction cost consists of three parts contact costs, contract costs and monitoring costs.

Contact costs are costs that occur when two or several parts try to get to know each other in order to do business (Hultkrantz & Nilsson, 2004). Information about price and quality are developed and negotiated, and are included in this cost. Contract costs are costs that occur when parts are negotiating a contract. The last type of transaction cost that can occur is control- and monitoring costs. These include the cost for the risk that one part is not able to fulfill the commitments of the contract. If there are continuous transactions between two parts, the trust between them will increase and can lead to lower transactions costs (Hultkrantz & Nilsson, 2004). One example is that the contact costs can be lower if the parties are already known and familiar with each other and does not have to find all new information about the partner. The same applies on the monitoring costs since one part does not have to spend resources on controlling and monitoring the other part to fulfill the contract.

3.2 Relationship theory

Relationships between people have always existed (Dwyer et al, 1987). Business relationships were recognized when people began to exchange goods and service with each other. A relationship is something that occurs when two parties have a mutual need of each other, common interests or goals. It is important that the parties have similar values, and a mutual commitment to the task. According to a study by Håkansson & Snehota (1995) relationships grow stronger over time and one good experience of cooperation often leads to a continued collaboration.

During the relationship, the parties start to trust and adapt to each other. Earlier experiences the parties have of relationships have an effect on how a relationship develops (Ljung *et al*, 1998). The individuals that are involved in the relationship affect the development of it with their way of communicating and maintaining the relationship. The values and motives of the individuals will also have an effect on the quality and duration of the relationship. Strong relationships are based on mutual trust (Morgan & Hunt, 1994). The level of trust between the parties determine how much information they will share with each other. With a higher level of trust, the uncertainty and risk will be lower. A second factor affecting the relationship is satisfaction. It is important that all parts in a relationship feel satisfied with the relationship. If this is the case, it is more likely that they will maintain the relationship and in that way establish a long lasting relationship.

A relationship is affected by several different characteristics of the parties involved (Gadde & Håkansson, 1998). The complexity of a relationship depends on the parties involved, and their characteristics. It takes more developed interaction in a complex relationship with many actors involved. Dependence in a relationship is about one part’s need to maintain the relationship in order for him to reach his objectives. With the dependence in a relation follows power. The distribution of power in a relationship is usually not symmetric; it is not common for both parties in a relation to have equal amount of power and dependence. The distribution of power can alter between the parties during the course of the relationship. If the distribution of power is overly asymmetric, there is a risk that the weaker party eventually leaves the relationship.

A long-term perspective is advantageous in most relationships, since it takes time for the parties to get to know each other and establish trust (Morgan & Hunt, 1994). In a relation that have lasted a long time the parties have collected information and experience about each other which makes transactions and processes more efficient. Commitment is an important factor in a relationship with the objective to last a long time. Morgan and Hunt (1994) defines commitment as an exchange where the parties find the relation being of such importance that it motivates maximal efforts in order to maintain the relationship. Commitment is together with trust the two factors that according to many theorists are the most important in order to establish a valuable business relationship.

3.3 Trust & Legitimacy

Trust is a key variable in order to build a strong relationship (Fisman and Khanna 1999). According to Blomqvist (1997) many researchers finds trust as an important factor for the success of a business. Gambetta (1988) describes trust as*"one of the basic variables in human interactions*".

Trust between two individuals or parties can be formed by positive experiences of previous interactions (Lehmann & Neuberger, 2001). Information is according to Fisman and Khanna (1999) often mentioned as a key factor in literature about trust. There can, according to Fisman and Khanna (1999), be a negative correlation between trust and information, as a person with less propensity to feel trust spend more time and energy on finding information and finds monitoring important in order to reduce opportunism and asymmetric information. Risk and information are two factors that are necessary for trust to exist (Blomqvist, 1997). According to Granovetter (1992) "*the person who knows completely need not to trust*".

Trust between the participants in a transaction is not included as a factor in the neo-classical economy theory (Blomqvist, 1997). On a perfect market with identical actors and perfect competition and information there is no information asymmetry and the market functions will control and impede opportunistic behaviour. With the shift towards more focus of markets functioning under imperfect competition with a smaller number of actors not being perfectly rational, the building of long-term relationships has become more important.

According to Blomqvist (1997) several authors, including Barber (1983), Usunier (1990) and Sako (1992) has a two-dimensional definition of trust in business contexts. Actors in a business relationship need to trust both the personal and organizational capabilities of each other. Usunier (1990) calls this, trust in competence and goodwill trust. Both factors are needed in order to create legitimacy for the participants in the relationship. Trust in competence includes managerial and technical capabilities and skills. Good-will trust includes the parties' sense of moral responsibility, benevolence and positive intentions towards each other. Zucker (1986) described trust as mutual confidence, where one actor trusts another actor to do what he has promised. Thus, trust can be explained as a function of excepted behaviour in the future.

Legitimacy is established when the parties trust that the counterpart will behave as he is expected to. Mathews (1993) describes legitimacy as congruence and approval between an organization's activities and values and the norms in the situational context that the organization is a part of.

"Legitimacy is a generalized perception or assumption that the actions of an entity are desirable, proper or appropriate within some socially constructed system of norms, values, beliefs and definitions" (Suchman, 1995, p.574)

Legitimacy is, according to Suchman (1995) a resource required by an organization in order for it to operate, just like money or human capital. According to Blomqvist (1997) a trusting relationship based on legitimacy is gradually developed. The first impression and reputation are important factors, as the first contact is said to set the tone and a second chance to prove ones trustworthiness is not always given. According to Blomqvist (1997) the level of trust is constantly changing in a relationship. This can be because humans change their behaviour or the organizational culture change and evolve.

3.4 Communication & Information

Dahlkwist (2004) explains communication as “all contact between people”. There are different types of communication; one way- and two-way communication. One way is for example mass media, when the sender controls the information flow. In two-way communication on the other hand the receiver has a chance to interact in the exchange of information. This type of communication reduces the risk for misunderstanding and both parts have a chance to feel involved in decisions (Dahlkwist, 2004). Communication is an interaction between two parts and in order to be successful it is important that both parts are open to each other (Eide, 2006). Jacobsen & Thorsvik (2002) explain the communication process by using a communication model (figure 1).

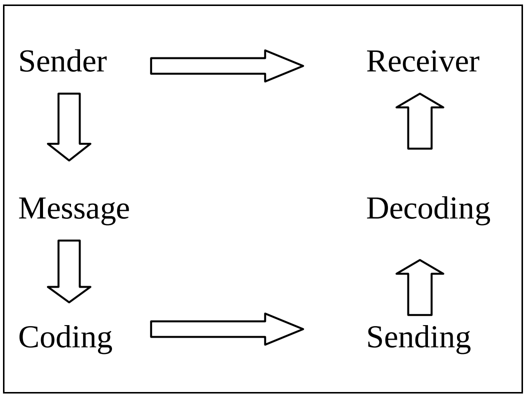

Figure 1. The communication model. Own preparation from Jacobsen & Thorsvik, 2002, p 335.

The process starts with a sender wanting to send a message to a receiver (Jacobsen & Thorsvik, 2002). The sender gives the message a code and decides what should be communicated. According to Jacobsen & Thorsvik (2002) communication is about management, coordination and control. It is also an important tool for the sender to be able to give the receiver as much information and knowledge in order for him to be able to make a decision. When the receiver receives the message, he has to decode it in order to understand the meaning. The last step in the process is that the receiver gives the sender feedback on the messages, this shows that he has understood the message. A problem can occur if the sender and receiver do not match verbally or non-verbally (Dahlkwist, 2004). The receiver includes his personal experience and perceptions when decoding the message, which can lead to the message being misinterpreted. Peoples past experience, knowledge, and environment were the conversation takes place and the expectations on the conversation can have an impact on how the message is interpreted. It is not only the verbal messages that we communicate; there are also the non-verbal, such as vision, smell and hearing. What will be remembered are the things that are different from the normal. Therefore it is important to think about how behaviour and appearance affects the first impression.

4 Literature review

This chapter presents the result of the literature review based on scientific articles, books and research reports, chosen in accordance with the aim of the study. The chapter presents the credit evaluations process, followed by the importance of relationship in the credit evaluation process. The actors influencing the relationship are described, followed by the factors influencing the relationship between the loan officer and the credit applicant.

4.1 The credit evaluation process

The financial system is determined by legal rules regarding financial instruments and the regulations of the banks, but also by banking practices and social customs affecting the relationship between banks and borrowers (Lehmann & Neuberger, 2001). Long-term relationships between banks and their customers characterize a bank-oriented financial system, which is prevalent in Sweden (Broomé *et al*, 1998).

The credit process is regulated in the Swedish law ”Bankrörelselagen (1987:617)” Chapter 2, 13 § 1 st.

“Credit can only be allowed if the applicant on good terms can be expected to fulfil the contract. Security in terms of realty, assets or other forms of security is demanded. The bank can refrain from such security if it is seen as unnecessary or if there are other specific circumstances to refrain from demanding security.”

Every bank and loan officer is tied by the bank secrecy (Jansson & Westman, 2005). This means that banks are legally obliged to not expose information about its clients to anyone external to the bank. The purpose of the bank secrecy is to establish trust between the bank and its clients. Information protected by the bank secrecy is primary of economic character, but does also include information of personal character.

Credit arrangements often have a long-term perspective (Svedin, 1992). The arrangement is between two parties, the firm manager and the bank. These parties often have different objectives for the credit arrangement so the credit must be analyzed from the perspective of both parties. The credit applicant wants to secure finance at the lowest possible cost. From the perspective of the bank the credit is analyzed on the basis of what it can generate in terms of economic returns, the profitability of the credit in relation to the estimated risk and what security is demanded. Credit should only be allowed if it is highly probable that the bank will regain the money. Furthermore the suitability and matching of the credit in relation to the rest of the credit portfolio of the bank is assessed. The credit should match the credit profile, including risk- and equity profile of the bank.

The credit evaluation process is based on a number of factors, which according to Broomé *et al’s* (1998) model includes (figure 2);

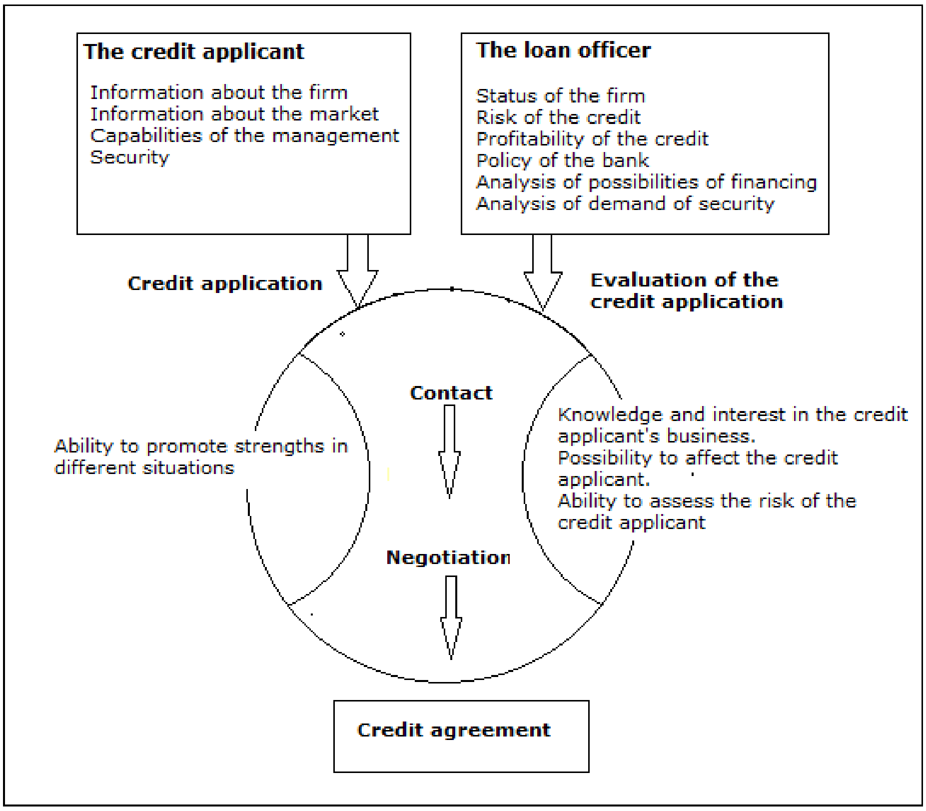

Figure 2. The credit evaluation process. Own preparation from Broomé et al 1998, p. 51.

The figure describes the arguments from the point of view of the credit applicant and the loan officer (Broomé *et al*, 1998). The credit applicant presents a credit application with information about his firm, his capabilities and the market based on his need for credit. The loan officer assesses the credit application from the policy of the bank, analyse of the firm and the risk of the credit in relation to the potential profitability of the client. Further, the loan officer analyzes the possibilities of financing and the requirements for security.

The assessment of these arguments from the credit applicant and the loan officer leads to the negotiating process (Broomé *et al*, 1998). The credit applicant's ability to promote his strengths in different situations is viewed against the loan officer's knowledge and interest in the business of the credit applicant as well as the loan officer's possibility to affect the credit applicant and ability to assess the risks associated with the credit applicant. The negotiation results in the credit agreement.

4.2 Relationships in the credit evaluation process

Relationship lending means that banks over time acquire information through contact with the firm, its owner and the local community surrounding the firm (Berger & Udell, 2002). The bank can use this information in its decision about the availability of credit and the terms of the loan. These relationship-based transactions develop trust and legitimacy between the loan officer and the credit applicant via the exchange of information. Relationships are according to Berger & Udell (2002) one of the most efficient tools for reducing information problems in small firm financing.

The relationship in the credit evaluation process is of importance for several actors, the most focal ones being the credit applicant and the bank (Butler & Durkin, 1998). From the bank's perspective, it can obtain knowledge about firms through the relationships and gathering of information about firms and their owners. A result of this is that the bank knows more about the credit applicant, and can improve its appeal for firms and the ability to retain the firms as customers. Word-to-word promotion among the business community and networks can create comparative advantages for the bank and put it in a stronger position for selling other financial services. From the credit applicant's perspective, he is more assured of attaining financial support when needed if he has a close and strong relationship with the bank.

Many authors argue that the primary reason for the relationship being of importance in the credit evaluation process is that information is costly to collect in terms of both money and time for both the credit applicant and the loan officer (Hedelin & Sjöberg, 1993; Butler & Durkin, 1998). With the provision of better and more accurate information, banks are able to estimate risk more accurately and thus use the prospects of the credit applicant more consistently in the credit evaluation process (Berger & Udell, 1993). The problem comes down to communication and information between the parties involved in the process. The costs of gathering information about a credit applicant can be very high if the bank and the credit applicant interact only once, by having a lasting relationship with continuous transactions that cost can be reduced. Every time a firm receives renewed credit from the bank it gives a signal that the firm has the ability to meet the requirements and conditions of the bank and thus the monitoring costs for the bank are lowered each time (Elsas & Krahnen, 1998).

Fama (1985) examines if the relationship with the bank increases the value of the firm. He finds that bank customers were willing to pay in order to maintain a relationship with their bank. Fama (1985) argues that banks are inside lenders, and as insiders they have access to information about the credit applicant that is not available to any outsiders. The information can be historical data about previous loans and deposits of the firm, income statements and balance sheets, as well as familiarity with the plans and projects of the firm and the capabilities of the firm manager. Access to this kind of historical information gives the bank a comparative cost advantage in collecting new information. The historical information is also useful when the bank is evaluating the loans and making risk assessments.

4.2.1 Three-dimensional credit evaluation

There are according to Kling *et al* (2003) several arguments for taking qualitative factors such as knowledge, competence, entrepreneurial qualities and personal characteristics into consideration in the assessment of small firms. The author stress that these characteristics must be assessed and evaluated in connection with the situational context and the business situation in particular. The problems with evaluating these qualitative factors and applying them in a consistent system are that they often are very complex and are dependent on the subjective perceptions of the loan officer.

The model of three dimensional credit evaluations that is illustrated in figure 3 is a useful tool for evaluating and understanding the relationship between the credit applicant, loan officer and business situation (Kling *et al*, 2003). The model can provide an overall picture of the factors that might affect the credit evaluation process and create an understanding for how the relationships between the actors affect each other. When applying three-dimensional credit evaluation the fitting between the credit applicant, the loan officer and business situation is analyzed. The model talks about fitting of business, assessment and communication.

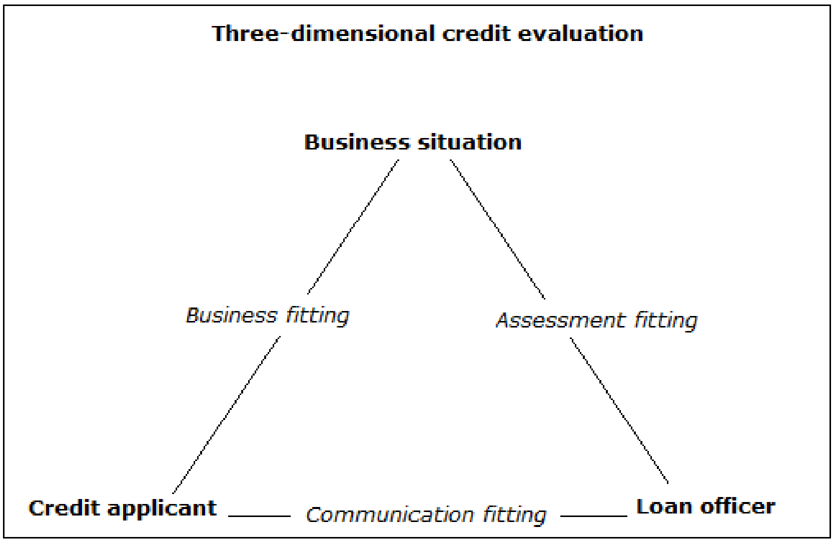

Figure 3. Three-dimensional credit evaluation. Own preparation from Kling et al, 2003, p.74.

Business fitting means that the credit applicant and business situation are matching, this is analyzed by assessing the level of matching between them (ibid). The personal characteristics and handling of information of the credit applicant is matched with his business plan and the potential market for that particular business. It is important that the loan officers has an understanding for the fitting between the credit applicant and business situation, especially when it concerns small businesses where the entrepreneur often is the key factor for the entire business and development of the firm.

Assessment fitting concerns how well the loan officer is matching with the business situation (ibid). From this aspect, the understanding, experience and risk attitude of the loan officer has an important role for the matching. Other factors of importance are how the loan officer collects and assesses information, which can vary depending on how important the credit evaluation is. It is common that the loan officer uses internal and external networks in order to get an understanding for the business situation and thereby increase the fitting of the assessment. The most important part in many cases of three-dimensional credit evaluation is the communication matching that concerns the relationship between the loan officer and the credit applicant (Kling *et al*, 2003). This matching can be difficult to evaluate since it is a question of personal fitting between the actors, a factor that is difficult to assess and define.

4.3 Actors in the relationship

Credit evaluation is not only about assessing and evaluating financial statements and key figures (Andersson, 2003). In many cases, credit evaluation is just as much about handling and understanding individuals, which requires that the loan officer has knowledge, competence and experience enough to make accurate evaluations and decisions.

4.3.1 The loan officer

The experience of the loan officer can affect the credit evaluation process (Hedelin & Sjöberg, 1993). A strong factor influencing the evaluation and decision-making of a loan officer is his ability to handle and analyze the situation (Kling *et al*, 2003). There is no "one best way" for how to make a credit evaluation since every individual has different methods and preferences of how to gather information and make decisions. The course of action is often a result of the specific situation of every single case.

Relatively little research has been done about the way in which a loan officers handles information in a credit evaluation process (Andersson, 2003). Previous studies shows that inexperienced loan officers tend to scrutinize information in a chronological order and search for information that strengthens and confirms his expectations. More experienced loan officers scrutinizes that provided information in a more critical and consistent manner and is looking for ambiguous information based on previous experiences.

The loan officer is the person who has the greatest access to information about the firm, the firm owner and the situational context in which the firm operates (Lehmann & Neuberger, 2001). This kind of soft information cannot be quantified and can be difficult to transmit and communicate through the bank organisation. The loan officer is the person who has personal contact with the firm owner and other key persons around the firm. The loan officer is often well familiar with the local business conditions, market situation, and has contact with other local firms and entrepreneurs that can provide relevant information about the capabilities and potentials of the firm and the firm owner.

4.3.2 The credit applicant

According to Hedelin & Sjöberg (1993) it can be difficult for the loan officer to evaluate the credit applicant, which can be a problem since the characteristics of the credit applicant is of importance for whether the business will be successful or not. The characteristics of the credit applicant have a strong influence in the relationship to the loan officer. According to Andersson (2003) characteristics such as entrepreneurial and managerial skills and sense of responsibility is of greatest importance. Another important characteristic of the credit applicant is that he has a good understanding for his business and has the ability to see both opportunities and risks in his business. Realistic goals and strategies are important in order for the credit applicant to establish a sense of trustworthiness in the eyes of the loan officer.

The bank usually requires that the credit applicant has produced a well-made business plan of the business and the investment (Broomé *et al*, 1998). A business plan is a documentation of the ideas and goals of the investment in specific and the business in general. In many cases small businesses chose to use a business advisor or consultant for the preparation of a business plan, since they often lack the expertise required (Butler & Durkin, 1998). It is very important though that the credit applicant has an understanding of his business plan so that he can present it to the loan officer in a credible way. It is also important to adapt the business plan to the situational context since the market conditions are constantly changing so the content of the business plan must be adapted to the current situation.

There are according to Hedelin & Sjöberg (1993) three aspects implying that the credit applicant will be successful in implementing the business plan, these aspects include; motivation to perform, motivation to succeed and control and ability to handle risks. Other factors such as education, competence and experience are crucial. Exaggerated positivism and friendliness in the first personal contact can have a negative impact on the loan officer's perception about the credit applicant.

It is important to keep in mind when evaluating the characteristics of the credit applicant that it is always a subjective assessment (Hedelin & Sjöberg, 1993). This evaluation is affected by the loan officer's previous experiences and can never be generalized. Another aspect that must be taken into consideration is that research shows that it is unrealistic to select a certain characteristic as the most desirable for being a successful entrepreneur as the characteristics demanded always must be adapted to the specific situation.

4.4 Factors influencing the lending relationship

Several studies have according to Lehmann & Neuberger (2001) tried to find the determining factors of a successful long-term business relationship. Some of the factors identified as playing key roles include trust, confidence and satisfaction (Ganesan, 1994; Perrien & Ricard, 1995).

4.4.1 Trust

A business relationship is according to Luhmann (1988) based on the parties historical and present knowledge about each other. Salmond (1994) calls trust "*a bridge between the partners past experience and anticipated future*".

The relationship between the bank and the credit applicant is based on a mutual dependence (Bruns, 2003). The bank is in need of clients to loan money to, and the firms need banks in order to finance investments. Therefore, both parties must actively engage in increasing the trust of the counterpart. Trust in a banking relationship is according to Bruns (2003) signified by expectations that neither of the parties will act against the interest of the other. The bank expects the client to repay his loans and the pay the agreed interest rate. The firm expects to attain financing and fair credit conditions. According to Bruns (2003), trust in the banking relationship also means that there are expectations from both parties that the relationship will be of lasting character and a platform for future co-operations.

There must always be some level of trust in order for a credit contract to be signed (Bruns, 2003). There is a risk that one party will betray the agreement and act opportunistically taking advantage of the trust of the counterpart for his own benefit (Lehmann & Neuberger, 2001). The nature of the relationship between the bank and the firm influences the quality and quantity of information available to the bank. In close relationships, the bank understands the operating environment and situation of the firm. The bank can interpret and understand the signals it receives concerning managerial capabilities, qualities and business prospects.

According to Bruns (2003) both the bank and the client perceives the trust in the relationship as important, but they have different of expectations the relationship. The bank finds that trust in the relationship is important in order to attain information and decrease the information asymmetry. For the bank, the relationship is important in order to establish trust for the firm manager's capabilities and intentions of the investments. For the firm, the relationship and trust for the bank is about obtaining the best conditions and financing for the investment.

4.4.2 Communication and information

The different characteristics and experiences of banks and small businesses contribute to the perception that it is difficult for banks and small firms to develop a good relationship (Butler & Durkin, 1998). The differences may lead to difficulties for the bank and the credit applicant to understand each other and the environment in which they operate. There is a gap between the two parties and their expectations of each other, which can be perceived as unrealistic by both the bank and the credit applicant. Banks expect their clients to provide financial information such as historical records, forecasts and security. The small firm applying for credit is also looking for support, advice and empathy from the bank. Butler & Durkin (1998) concludes that if the banks and clients lack deeper understanding for each other's characteristics, objectives and constraints it will be unrealistic to have mutual expectations and may result in a problematic business relationship. According to Binks & Ennew (1997) there is often a problem of lack in communication and cooperation between banks and their clients. The result of that lack is that the parties are operating in mutual ignorance of each other and misunderstanding about why and what kind of information is required and how that information is used.

According to Binks & Ennew (1997) the flow of information between the loan officer and the credit applicant implies that both parties will have a better understanding for each other. This information and mutual understanding can decrease monitoring costs. The bank can only meet customer needs if the firm manager provides appropriate and timely information. Information is according to Binks and Ennew (1997) the key factor for making accurate assessments of risk and allocate finance efficiently to small firms. The banks are likely to require less security the better informed they are about the firm.

For customers requiring a relationship with the bank the personal contact and communication is important (Binks & Ennew, 1997). According to Binks & Ennew (1997) face-to-face communication allows parties to understand and sympathize with each other and is therefore increasing the incentives of creating trust. Relationships as a method of collecting information that is not available from financial statements may be more appropriate for some kinds of businesses than others and in certain situations (Elyasani & Goldberg, 2004). Large firms are usually more transparent than small firms are so the relationship in a credit evaluation process is important for obtaining information about small firms.

4.4.3 Information asymmetry

Small firms are especially vulnerable to moral hazard and adverse selection problems because they are often opaque in terms of information (Berger & Udell, 2002). The information gap between internal and external stakeholders tends to be larger for small companies than for larger companies, making financing to small firms particularly challenging. There is always a risk of information asymmetry in the relationship between a loan officer and a credit applicant, since the credit applicant knows more about the capabilities of the firm, (Bruns, 2003). The information asymmetry can make the loan officer more restrictive in his evaluation of the firm and make him spend a lot of resources assessing the firm in order to decrease the uncertainty regarding the true skills and capabilities of the firm and its owner.

Adverse selection problems occur when the credit applicant acts opportunistically and deliberately hides information that he knows is valuable and of relevance for the credit evaluation (Berger & Udell, 2002). Another common problem of the type of moral hazard is when the bank cannot ensure that the funds will not be used elsewhere than what the credit applicant claims. A good business relationship between the credit applicant and loan officer can decrease the risk of moral hazard problems but there will always be a risk for one of the parties in the relation to act opportunistically. Firms using multiple sources of finance can make the bank more restrictive to allow credit (Cole, 1998). A firm with several sources of finance raises suspicions that the firm has been denied credit elsewhere and has learned how to hide its undesirable characteristics. Another aspect for banks being more restrictive toward a firm with multiple sources is that the information the bank has spent resources on gathering is not exclusive and private to that bank.

The degree of asymmetric information may according to Cole (1998) vary with the organizational structure of the firm. A problem of adverse selection may occur if a small firm is denied credit since the bank cannot readily verify that the firm has the skills and capabilities it claims to have or that the investment is of satisfying quality (Berger & Udell, 2002). When loan officers are given more authority within the organisational structure of the bank this can lead to agency problems. The loan officer has the responsibility to act on behalf of the bank when evaluating a potential customer. An agency problem between the loan officer and the bank may occur if it is in the interest of the loan officer to admit credit to a firm, or hide a deteriorating borrower's conditions due to personal reasons. This problem may depend on the size and organizational structure of the bank. In small banks the problem can be solved by having the manager of the bank making or reviewing most of the credit decisions. Agency problems between the bank and the loan officer can also be solved by reducing the number of different managerial layers in the organisational structure of the bank. Small banks are organized in a structure with few managerial layers that according to Berger & Udell (2002) can reduce the information asymmetry between bank management and shareholders, and between firms and loan officers, as well as between loan officers and the bank.

4.4.4 Resources and network

Loan officers use different parts of their personal network when evaluating and assessing firms and business investments (Hedelin & Sjöberg, 1992). This information-collecting can according to the authors be seen as a model of five layers (figure 4).

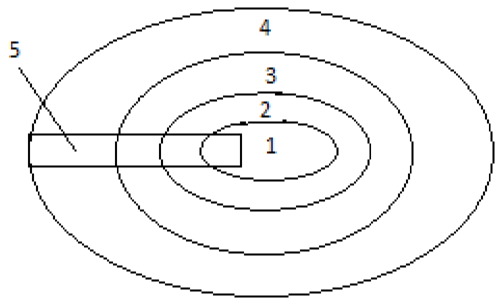

Figure 4. The loan officer's network. Own preparation from Hedelin & Sjöberg, 1992

Hedelin & Sjöberg (1992) describes the levels of the network model as following:

1. The relationship between the bank and the firm
2. Internal network consisting of the loan officer, firm and the closest commercial actors including the accountant
3. Local network, the loan officers aggregated contacts in the local community
4. The contextual network, gives the loan officer access to social and commercial general information
5. Bank organisation, stretches over all levels of the network and includes all the relations the loan officer has within the bank

The first level is central to the loan officer since it gives the loan officer an opportunity to collect information about the credit applicant based on his own perceptions and experience without being influenced by the interpretation of an external third party, like an accountant (Hedelin & Sjöberg, 1992). The information collection can be both firm specific but also based on the social and personal characteristics of the firm owner. It is important for the loan officer to find a system where he knows how to ask the right questions to obtain the desired "right" information and avoid problems with information asymmetry. The relationship between the loan officer and the firm is important since it creates mutual understanding and legitimacy for the credit applicant and his business situation. Another aspect of this reasoning is that the credit applicant trusts that the loan officer understands him and has his and his company's best in mind. In order for this to be possible, the loan officer must have established legitimacy so that the firm owner does not feel the need to search among other banks to find the best rates and conditions for a loan.

Level two consists of the loan officer, the firm and an external third party, usually being a business advisor or accountant (Ibid). The firm can use a third party in order to compile information for the bank in a professional and efficient way. It is important that all parties have a good understanding about the information. The firm must have a deep understanding of the information he presents to the loan officer in order for the loan officer to feel trust for the feasibility and reliability of the investment.

The third level of the loan officer's network of contacts is the local network consisting of social and commercial information about the reputation of the firm and firm owner (Ibid). Banks have always found it important to have knowledge about the local community. The local context have become of less importance in connection with the centralization of the organizational structure of many banks. The local knowledge is still an important factor for banks with a more decentralized organisational structure, especially in smaller communities in a more rural geographical setting (Silver, 2003). Many bank offices in these settings have office boards consisting of local actors working as ambassadors for the bank collecting information about the local business situation and firms. The loan officers then use this information as a base for their credit evaluations. Participating in social gatherings is an important activity for the bank since it creates and maintains important business contacts. It is also an important source for gathering background- and contextual information that could be difficult to observe and transmit otherwise, and is therefore an efficient method for avoiding information asymmetry problems.

The fourth level is the contextual network (Hedelin & Sjöberg, 1992). This gives the loan officer an opportunity to obtain information about the contextual situation of the firm. This information is based on the experience of the loan officer. An experienced and competent loan officer is able to see what information is of most relevance and so make rational decisions. Loan officers can also use the contextual network in order to broaden the information collection about different business sectors. In some sectors, it can be difficult to understand what the relevant information to focus on is, without having knowledge and experience about that particular sector (Hedelin & Sjöberg, 1993).

The fifth level is the banking organisation (Hedelin & Sjöberg, 1992). How the banking organisation is structured affects how relationships are formed between different parties. Banks with a more centralized organisation structure are more depending on the internal policies and hierarchy. A decentralized organisational structure implies more focus on the local bank offices. In decentralized organisations, each bank office has more authority to control the usage of resources and decision-making. According to Berger & Udell (2002) successful lending relationships require an organisational structure of the bank where more authority is given to the loan officers, which are the ones who has the access to the soft information about the customers. Small banks can be closer, both geographically and hierarchically to potential clients. The closeness can help the transmission of soft information about the firm, its owner and the local community.

4.4.5 Length of the relationship

Several authors (Petersen & Rajan, 1994; Berger & Udell, 1995; Elsas & Krahnen, 1998; Harhoff & Körting, 1998) examine what effect the length of the relationship between the client and the loan officer has on different aspects of the relationship. The findings differ between the studies. Some authors find that the length of the relationship has no effect on the quality of the relationship, while some find that it does have an effect. One aspect all these authors agree upon is that length of the relationship affects the bank's supply of information about the client. A business relationship that has been on going for a longer period gives the bank more time to gather information about a client and monitor the client's behaviour (Cole, 1998). Thus, the problem of asymmetric information between the firm and the bank can be mitigated and greater trust between the parties is established. If the bank learns about a firm's quality over time it can lead to improved lending terms because there are evidence of previous successful projects and investments in the firm (Lehmann & Neuberger, 2001).

Cole (1998) finds in his study that it is more likely that a bank will allow credit to a client to which it already has a relation. This can be explained by the fact that relationships generate valuable information about the firm's financial prospects and historical information that is important for creating trust that the client can fulfil its commitments. Elyasiani and Goldberg (2004) find that the longer the relationship the more important the relationship becomes, and the greater is the flow of information between the parties. Studies of how the length of the relationship affects the availability of credit come to different conclusions, just as studies on how the length of the relationships affects the conditions of the loan. The older literature shows that banks are more likely to allow credit the longer the business relationship they have had with the client (Petersen & Rajan, (1994); Berger & Udell (1995)). Degryse & Van Cayseele (2000), who found that the longer the relationship the quality might deteriorate, draws the opposite conclusion. According to Cole (1998) does a relationship longer than one year have no effect on the availability of credit.

4.5 Summary of the literature review

The results of the literature review show that credit arrangements often have a long-term perspective and that the credit applicant and the loan officer often have different objectives for the credit arrangement (Svedin, 1992). The credit applicant wants to secure finance at the lowest possible cost and have a reliable partner with expertise knowledge. The bank wants clients that can generate good economic returns and profitability with a high security. There are several arguments for considering qualitative factors when evaluating small firms (Kling *et al* 2003). Many authors argue that the primary reason for the lending relationship being of importance is that it simplifies the collecting information about the credit applicant (Hedelin & Sjöberg, 1993; Butler & Durkin, 1998). The problems with evaluating qualitative factors and applying them in a consistent system are that they are often dependent on subjective perceptions.

The model of three-dimensional credit evaluation describes the fitting between the credit applicant, the loan officer and business situation (Kling *et al*, 2003). The model can be a tool for understanding the connection between the parties. A factor influencing the evaluation is the loan officer's ability to handle and analyze the information. The loan officer is the person who has the greatest access to information about the firm, the firm owner and the situational context in which the firm operates (Lehmann & Neuberger, 2001). Relatively little research has been done about the way in which a loan officers handles information in a credit evaluation process (Andersson, 2003). The characteristics of the credit applicant, such as entrepreneurial and managerial skills have a strong influence on the relationship (Andersson, 2003). Another important characteristic is that the credit applicant has a good understanding for his business and has the ability to see both opportunities and risks. It is important to keep in mind that the evaluation is always a subjective assessment, affected by the loan officer's previous experiences (Hedelin & Sjöberg, 1993).

Some of the factors identified as playing key roles in the relationship between the bank and the credit applicant include trust, information and communication and that the relationship is based on a mutual dependence (Hedelin & Sjöberg, 1993; Bruns, 2003). Trust in a banking relationship is signified by expectations that neither of the parties will act against the interest of the other. The bank finds that trust in the relationship is important in order to attain information, which leads to a better understanding of each other and decrease the information asymmetry and transaction costs (Binks & Ennew 1997). The significance of length of the relationship differs between studies (Petersen & Rajan, 1994; Berger & Udell, 1995; Elsas & Krahnen, 1998; Harhöff & Körting, 1998). One aspect all these authors agree upon is that a business relationship that has been on going for a longer period of time gives the bank more time to gather information about a client and monitor the client's behaviour (Cole, 1998).

The results of the literature review do not give an answer to how these factors are linked together and affects the establishment of a relationship. Literature does not include the Swedish agricultural sector and how loan officers establish an understanding of the personal characteristics of a farmer applying for credit.

5. Empirical study

This chapter presents the empirical material of the study. The chapter begins with a description of the Handelsbanken farm and forestry division and is followed by the result of the case study consisting of interviews with 16 loan officers at Handelsbanken.

5.1 Case background

Handelsbanken was founded in Stockholm year 1871 (www, Handelsbanken, 2012). The primary purpose was to focus on the local financial market. Handelsbanken quickly gained a strong position, and today Handelsbanken is one of the leading banks in the Nordic countries with almost 11 000 employees at 720 offices in 22 different countries.

Handelsbanken offers its customers a comprehensive range of financial services. The bank has a decentralized organizational structure with 461 local offices throughout Sweden (figure 5). The local offices are almost autonomous and all decisions about clients are made at the local office. This organizational structure is unique for Handelsbanken, and differentiates it from other banks in Sweden. The local connection and presence shall make Handelsbanken the number one local bank. In 2010 Handelsbanken was the only bank present with a local office at 40 local locations throughout Sweden (pers. comm., Åttingsberg, 2012). Handelsbanken aims at having close, long-term relationships and gaining the trust of the clients by being close to the clients and making all decisions as close to the client as possible (www, Handelsbanken, 2012). Handelsbanken believes that close customer relations leads to more satisfied clients and better results.

Figure 5. Organizational structure of Handelsbanken. Own preparation from www, Handelsbanken, 2012.

Handelsbanken initiated a large investment in the farm- and forestry division in 2007 (pers. comm., Åttingsberg, 2012). One reason for this is the increasing demand for farm land and forestry properties. Handelsbanken is the third largest bank offering finance to the agriculture sector. Since 2010 the bank has intensified their focus on agriculture market segment. Handelsbanken offers comprehensive financial solution for both the farm business and the private person. Today Handelsbanken's farm and forestry division has over 100 000 clients. The farm and forestry division of Handelsbanken aims at having a local profile and are offering training to the employees in order to be able to offer special competence to the farm and forestry clients. The bank is establishing networks of contacts around the local office in order to develop co-operations with other organizations within the agricultural sector.

5.2 Case study of Handelsbanken's farm and forestry division

Interviews with 16 loan officers working at Handelsbanken have been conducted in order to answer the aim of the study. The loan officers were asked open-ended questions about how they evaluate a credit application and how they establish a relationship to the clients.

5.2.1 Relationships in the credit evaluation process

In order to investigate the loan officers' perceptions of the relationship in the credit evaluation process the following questions were asked.

- How do you evaluate a credit application?
- Do you find the relationship with the client being of importance?
- What are the benefits of having a good relationship with a client?

How do you evaluate a credit application?

The result of the case study shows a tendency of two prevailing types of approaches for evaluating a credit application (table 2). All of the loan officers mention the same components in a credit application as being of importance for the evaluation. It is the order in which the loan officers consider these components important when they evaluate a credit application that differs. The results show that none of the loan officers participating in the case study bases their evaluation of the personal characteristics of a credit applicant on a standardized template.

Approach	Number of loan officers	Order in which the factors are considered
Approach 1	12 of 16	Personal character, business plan. Ability to repay, security
Approach 2	4 of 16 loan	Ability to repay, security, personal character, business plan

Table 2. How the loan officers approach a credit evaluation

Twelve of the 16 loan officers found that the person behind the application is the factor that it is most important to get a perception about, followed by the business plan, the applicants' ability to repay and security. One loan officer that uses this approach explains that he begins a credit evaluation process by trying to get an idea about who the applicant is as a person and business man (pers. comm., Loan officer 10, 2012). Another loan officers explains that it is important to get a perception of what the investment entails and who the entrepreneur and person behind the credit application really is in an early stage of the process in order to be able to build a good, long-term relationship (pers. comm., Loan officer 5, 2012).

"The chemistry is an important factor early in the process since farming is a lifestyle and that is something the loan officer must understand".

(pers. comm., Loan officer 1, 2012)

One of the loan officers using this approach explained that in small firms, such as farm businesses the person behind the application is usually the key factor for the firm, and it is therefore important that this person have the right character in order to run a company (pers. comm., Loan officer 9, 2012).

Four of the 16 loan officers begin the credit evaluation process by assessing the applicants' ability to repay. Followed by security, personal character and business plan. One loan officer explains that the most important factor is that there is a reasonable chance for the bank to get its money back, and therefore he requires that the client can present security for the loan (pers. comm., Loan officer 9, 2012). According to this loan officer, the personal character of the applicant is of relevance, primarily in order to increase the flow of information.

Do you find the relationship with the client being of importance?

All of the loan officers participating in the case study found the personal relationship with the client as important in the credit evaluation process. Four of the 16 loan officers said that 50 per cent of the credit decision depends on the "gut" he gets about the credit applicant and the relationship that is established. One of the loan officers said that financial statements and figures can always be improved and presented in a way to make it look better, and are relatively easy for the loan officer to see through (pers. comm., Loan officer 15.2012).

"A good relationship is based on the capabilities of a good entrepreneur, which in turn often shows good financial results."

(pers. comm., Loan officer 15, 2012)

What are the benefits of having a business relationship with a client?

All of the loan officers participating in the case study explain that trust is the main factor for establishing and remaining a good business relationship (table 3). All of the loan officers also explain that trust is one of the main benefits of a good relationship.

Table 3. The loan officers' perception of the benefits with a good relationship to the clients

Benefits of a relationship	Number of answers
Trust	16
Flow of information	16
Decision-making process	7
Condition of credit	5
Marketing	4

The loan officers explain that trust is a benefit since it helps to make the credit evaluation process more efficient as the processing and handling of information is facilitated. Trust is also a benefit in terms of security for the bank, as the bank has more trust in a client with a good ability to repay the loan.

All of the loan officers participating in the case study believe that a good relationship increases the flow of information between the bank and the client. The loan officers explain that credit applicants' are more willing to share information about themselves and their business if there is a good relationship established between the loan officer and the credit applicant. One of the loan officers explains that the most important factor influencing the relationship is that the client is open and honest about the information and does not try to disguise any factors of importance that may affect the credit decision (pers. comm., Loan officer 11, 2012). Seven of the loan officers state that the decision-making process becomes more efficient when there is a good flow of information and communication and when both parties understand each other.

“Efficient decision-making is important in order to lower transactions costs in the credit evaluation process.”

(pers. comm., Loan officer 3, 2012)

Five of the 16 loan officers mean that the relationship can have an effect on the conditions of the credit, since the conditions in some situations are negotiable. The loan officers explain that the credit conditions are primarily decided by a rating system depending on the strength of the firm’s capital. Some loan officers meant that the relationship had a larger effect on the pricing of the credit before, but explains that today it is centrally controlled via the classification system of the bank. One of the loan officers explains that when a good relationship to the client is established, the bank can be more willing to take a higher risk (pers. comm., Loan officer 13, 2012). According to another of the loan officers, a client is likely to get better conditions of the loan and lower requirements of presenting security if the relationship with the bank is based on mutual trust (pers. comm., Loan officer 11, 2012). It is according to all of the loan officers a requirement that the financial statements of a client are in order and in accordance with regulations and policies of the bank in order for credit to be allowed.

Four of the loan officers mention the relationship as being of importance for the bank from a marketing perspective. The personal relationship with the client is important in order for the bank to keep its clients and to attract new clients. There is according to the loan officers a fierce competition within most segments and the bank must niche its profile and offer a product the client desires in order to attract the best clients.

“From a product perspective almost all of the banks have the same services to offer, therefore the relationship between the loan officer and the client plays an important role in order for the bank to attract the best clients, and for these clients to remain with the bank. The loan officer plays a key role since he builds the personal relationship through trust, knowledge and understanding for the needs of the client.”

(pers. comm., Loan officer 7, 2012)

According to the one of the loan officers there is a risk that the business relationship becomes too dependent on one specific loan officer (pers. comm., Loan officer 3, 2012). The loan officer explains that if that particular loan officer leaves the office it can be costly for the bank. The value created by the relationship can be difficult to maintain, communicate and transmit.

“I have a very close relationship with my clients, which is extremely important when working with farm- and forestry clients. But if I would die there is no one else who knows what I am doing”.

(pers. comm., Loan officer 13, 2012)

5.2.2 The primary actors influencing the relationship

The actors that are identified as having a primary influence on the relationship include the loan officer and the credit applicant. In order to investigate how the different actors in the credit process influence the relationship the following questions were asked:

- What significance does your background and experience of farming/forestry have for the relationship with the client?
- What personal characteristics of the client do you consider as important for the credit evaluation?

5.2.2.1 Characteristics of the loan officer

What significance does your background and experience of farming/forestry have for the relationship with the client?

Twelve of the 16 loan officers have some kind of experience of farming and/or forestry; they find it being a great advantage in order for them to understand the client and his situation (table 4). The loan officers stress that they can evaluate the client in a more credible way since they know what the client is talking about and understand the business behind the figures.

Table 4. The value of the background of the loan officers

Background in farming/forestry 12 of 16 loan officers	No background in farming/forestry 4 of 16 loan officers
Understand the client & his situation	No preconceptions
Assess the client & his situation	Humble attitude
Reduce asymmetric information	Sees it as any business
Social interaction & same language	
Appreciated by clients	

The loan officers with a background in farming/forestry mean that their experience is of importance for assessing the characteristics and capabilities of the client, since credit evaluation, according to them, is about getting the right "gut feeling" for the client.

"Assessing the personal factors of a client is a craft."

(pers. comm., Loan officer 7, 2012)

One loan officer explains that experience and knowledge are important factors in order to assess whether the client has understanding and knowledge about his business and if he has a realistic perception of the objective of the business (pers. comm., Loan officer 15, 2012). According to another loan officer the background and understanding about farming can also reduce problems with asymmetric information since the loan officer is able to ask the "right" questions, read between the lines, and discover weaknesses of the business plan (pers. comm., Loan officer 4, 2012). One loan officer finds that clients appreciate an experienced loan officer and that this often contributes to a stronger relationship (pers. comm., Loan officer 13, 2012).

”I am genuinely interested in farming, and because of my background I can question and understand the situation of the client.”

(pers. comm., Loan officer 2, 2012)

According to the loan officers they perceive that the farmers appreciate when they speak the same language and that this contributes to a social interaction and legitimacy for the loan officers (pers. comm., Loan officer 16, 2012). This is something the loan officer experience especially with the older generation of farmers. Eight of the 16 loan officers stress that financing to the agriculture sector is often different compared to financing in other sectors. One loan officer explains that farmers often live in their business, since the home of the farmer and his family is often included in the business (pers. comm., Loan officer 10, 2012). Another loan officer mentions that the agriculture segment can be different since there is often a long and strong culture and tradition within the companies (pers. comm., Loan officer 15, 2012).

Four of the 16 loan officers do not come from a background of farming or forestry. They explain that they have procured knowledge and experience internally within the Handelsbanken farm and forestry division, which offers training to all their employees. One of these loan officers explains that he finds farm- and forestry clients being just as any client, and he does not see background experience from the sector as a prerequisite in order to establish a good relationship to the clients or making a good credit evaluation (pers. comm., Loan officer 6, 2012).

Another loan officer without a background in farming/forestry stresses that it is necessary to have a basic understanding about every sector he works toward (pers. comm., Loan officer 7, 2012). This loan officer believes that the most important factor for establishing a good relationship is to be open towards the client and be straight and honest with the fact that they are not experts within that particular business sector. It is also important to consult colleagues within the bank or use ones network of contacts in issues outside of the individual loan officer’s area of competence. One loan officer stress that the bank cannot be experts within all business sectors, the primary activity of the bank is to sell financial services (pers. comm., Loan officer 9, 2012). Those loan officers that does not have a background in agriculture or forestry meant that it could have a negative impact on the relationship if the loan officer acts like too much of an expert.

”A know-all attitude of the loan officer can be deterring for the client, they do not except you to be an LRF-advisor.”

(pers. comm., Loan officer 7, 2012)

One of the loan officers finds that the most important quality of a loan officer in order to establish a good relationship with the client is to have a genuine interest in people and business and try to satisfy the clients’ needs in the best possible way by having an open and honest dialogue (pers. comm., Loan officer 7, 2012).

”When there is a larger investment I usually put on my wellies, bring an experienced advisor and visit the farm. This gives me a better understanding about what the farmer is doing, but most importantly, it shows the client that I want to understand his business, even though I am not a farm expert. This is a great basis for establishing a mutual trust and the effort is perceived as added value by the client.”

(pers. comm., Loan officer 7, 2012)

5.2.2.2 Characteristics of the credit applicant

What personal characteristics of the client do you consider important for the credit evaluation?

All of the loan officers participating in the case study mentioned the farmers’ understanding of his business and investment as the most important factor for creating legitimacy and credibility in the relationship between the loan officer and client (table 5). It is according to all of the loan officers important that the client understands the risks associated with the business and is able to explain his choices and investments. Four of the 16 loan officers stress that the client must see himself as an entrepreneur. Eleven of the 16 loan officers stress that the credit applicant should be able to analyze and control his business and present realistic and feasible strategies and objectives. Another important aspect according to two of the loan officers is that the client has a good network of contacts to consult for issues outside of the farmer’s area of competence.

A characteristic three of the loan officers find being of particular importance in the agricultural sector is that the farmer is really committed to what he is doing and has a genuine interest in farming since farming often means hard work and low profitability under uncertain conditions. Eight of the 16 loan officers explain that it is important that the client give a solid impression. The client must furthermore be able to take criticism and advice, and handle rejections in order to maintain a good relationship for future investments. One loan officer explained that even if it is positive that a client is enthusiastic and optimistic it should not be exaggerated and the business plan must be based on realistic expectations (pers. comm., Loan officer 9, 2012).

Table 5. Personal characteristics of the clients the loan officers find important

Important characteristics	Number of answers
Understanding for business & investment	16
Realistic & feasible strategies & objectives	11
Solid impression	8
Entrepreneurial capabilities	4
Genuine interest	3
Good network	2

There are according to the loan officers more pressure on the farmers today to have competence within other areas besides farming in order to be successful. One loan officer mentions that it is important for the farmer to have a basic economic understanding in order to be able to analyze and optimize the production (pers. comm., Loan officer 16, 2012). Several loan officers talk about a generational shift among farmers. The loan officers mean that the older generation of farmers see themself as practical, and often lack the business and economical understanding. The younger generation of farmers on the other hand often sees the objective of their farm business from a strategic and profit generating perspective.

“Today, the most important aspect is that the farmer is a good business man. That is the first thing I try to get a feeling about. It is secondary whether he is a good farmer, as long as he is a good entrepreneur”

(pers. comm., Loan officer 15, 2012)

5.2.3 Factors influencing the relationship

The main factors that were identified as influencing the relationship are trust, the flow of information and communication, information asymmetry, the resources and the length of the relationship. In order to investigate how the different factors in the credit process influence the relationship the following questions were asked.

- What factors are important in order for trust to be established between you and the client?
- What information do you expect the credit applicant to present in order for trust to be established?
- Do you expect the client to keep you updated with information?
- How is the relationship maintained?
- How do you perceive the problem of asymmetric information?
- What kind of resources do you have access to for evaluating a credit application?
- How does the length of the relationship affect the quality of the relationship?
- Do the important factors in terms of establishing a relationship differ if it is a new or existing client?

5.2.3.1 Trust

What factors are important in order for trust to be established between you and the client?

According to the result of the case study, a number of factors contribute to the establishing of trust in the relationship (table 6).

Table 6. Important factors for establishing trust

Important factors for establishing trust	
Mutual understanding	16
Open & Honest	14
Meet the expectations of the bank	7
Professionalism	7

All of the 16 loan officers find that trust is established through a mutual understanding of each other’s character, capabilities and situation. One of the loan officers explain that there must always be an open dialogue in the relationship, it is about giving and taking for both the parties (pers. comm., Loan officer 14, 2012). A second loan officer explains that chemistry between the parties is the most important factor for establishing trust. It is according to him difficult to verbally express how trust is established, but mutual understanding is definitely important (pers. comm., Loan officer 3, 2012). Seven of the loan officers stress that trust is established by a businesslike and professional appearance and behavior of the client. According to one of the loan officers, it is important to trust the client both as a business man as well as to trust the client as a person (pers. comm., Loan officer 15, 2012). If the person is trustworthy, he is often the same in a business context as well, according to the loan officer.

Fourteen of the 16 loan officers mean that it is the way the client presents information that establishes trust and legitimacy. One loan officer explains that if the client is open and honest and voluntarily presents financial statements, business plan and strategies it gives a trustworthy impression rather than if the loan officer has to drag everything out of the client (pers. comm., Loan officer 15, 2012). The content of the information is of importance as well as the way the client presents information, which should correspond to the content of the information. One of the loan officers explains that it is important to be observant and able to see through figures since there are many clients that are very skilled in presenting and selling their idea but not as skilled when it comes to implementing and performing it (pers. comm., Loan officer 7, 2012).

Another of the loan officers adds that it is very important that the client meets the expectations of the bank; otherwise, the trust can quickly disappear (pers. comm., Loan officer 10, 2012). The same applies for the loan officer; in order for the trust to be mutual, the loan officer must keep his promises to the client, within the rules and regulations of the bank.

”Trust is something that often takes a long time to establish, but it can also be lost quickly unless it is based on mutual understanding by the loan officer and the client.”

(pers. comm., Loan officer 10, 2012)

5.2.3.2 Communication and information

What information do you expect the credit applicant to present in order for trust be established?

All of the loan officers stress that it is a prerequisite for the credit applicant to be able to present financial information about the business and investment, ability to repay the loan, placement, pension plans and financial statements (table 7). Ten of the 16 loan officers answered that in order for them to trust the client, the client must be able to present realistic and thoroughly analyzed information about his business and the business sector in which he operates. According to four of the 16 loan officers, they want the client to present a formal business plan without any embellished figures. One loan officer believes that it is not necessary for the applicant to have a formal business plan, but it gives the client an impression of being serious and professional if he does present a plan (pers. comm., loan officer 7, 2012). Four of the 16 loan officers find it important that the client is open and honest about information in order for them to feel trust.

Table 7. Type of information the loan officers demand

Type of information	Number of answers
Financial information	16
Thoroughly analyzed information	10
Formal Business plan	4
Open & honest	4

According to all of the loan officers the most important factor for establishing trust is that the client has a good understanding about the information he presents and that he can provide additional information in short notice if needed. It is up to the client to provide the bank with sufficient information of good quality.

”In order for information to be credible the client must have a good understanding about the information he presents.”

(pers. comm., Loan officer 8, 2012)

One loan officers explains that it can be a divergence between the farmer and loan officer regarding what kind of information is of relevance, since farmers are often more practical and the loan officer more of a theoretician (pers. comm., loan officer 9, 2012).

Do you expect the client to keep you updated with information?

Six of the 16 loan officers expect the clients to keep them updated with information (table 8). One loan officer explains that information updates and check points is something the parties agree on when they set up the contract (pers. comm., Loan officer 15, 2012). Eight of the 16 loan officers expect the client to keep the bank updated only about larger occurrences. Two of the 16 loan officers do not expect the client to keep them updated with information, but if the client does it anyways, it can strengthen the relation and increase the trust.

Table 8. The loan officers’ expectations about being updated with information

Do you expect the client to keep you updated with information?	Number of answers
Yes	6
No	2
Sometimes	8

All of the loan officers mean that it should be in the interest of both the client and the bank to maintain the relationship, since both the bank and the client benefits from having a good business relationship with each other. One of the loan officers explains that it is the bank that carries the primary responsibility for the relationship in most situations (pers. comm., Loan officer 9, 2012). If the client informs and alerts the bank about major events in time it gives the bank a better chance to be able to help the client. One loan officer explains that there is a difference between new and existing clients, since existing clients generally are more open and confident about informing the bank about hardships and difficulties and trust the bank more (pers. comm., Loan officer 7, 2012).

How is the relationship maintained?

All of the loan officers participating in the case study mean that there must be a continuous flow of communication and information in order for the relationship and trust to remain (table 9). Ten of the 16 loan officers find visits to the farm as a good way of maintaining the relationship with farm and forestry clients. Four of the loan officers mention client events as a good activity in order to maintain the relationship.

Table 9. Activities for maintaining the relationship

Activity	Number of answers
Continuous contact	16
Visits to farm	10
Yearly follow-ups	7
Client events	4

Visiting the client's farm is according to one of the loan officers advantageous due to two reasons. The first reason is that the loan officer shows his interest in the farmer and his business, and the farmer gets to show what he has accomplished and in a more detailed way give the loan officer a perception of what the business and investment entails (pers. comm., Loan officer 9, 2012). The second reason is that when visiting the farm the loan officer has a great opportunity to inspect the status of the farm and what the daily business looks like. According to the loan officer it is important to get an impression of the state of the property since it is often the property that is the security of the loan. Those loan officers that did not have farm visits included in their routine for evaluating a credit application, mentioned time as a limiting factor. The size and importance of the client and the investments are also determinants for whether time and resources are spent on visiting the farm.

Seven of the 16 loan officers find that it is reasonable to have meetings and feedback with the client once a year, if no major investments or events have occurred, in order to maintain the relationship. Another activity in order to strengthen the relationship is client meetings, when the loan officers meet with their clients under more informal circumstances.

”Client meetings are often very relaxed events and thus they are excellent opportunities to mingle and socialize with clients and other actors of the local community. This can have a very strengthening effect on both new and existing relations.”

(pers. comm., Loan officer 8, 2012

According to the loan officers the method most suitable for maintaining the relationship is depending on each individual situation, and the importance and size of the client. According to one of the loan officers, the clients also have different expectations on how and to what extent the relationship should be maintained, and it is up to the loan officer to meet these expectations (pers. comm., Loan officer 13, 2012).

5.2.3.3 Information asymmetry

How do you perceive the problem of asymmetric information?

According to the result of the case study, six of the loan officers perceived there being no problems with asymmetric information, since they find clients within the farming and forestry segment as being honest, open and willing to share information (Table 10).

Table 10. Loan officers perceptions about problems with asymmetric information

Perceptions about information asymmetry	Number of loan officers
No problems	6
Different views on information	5
Deliberately hides information	5

According to the result of the case study five of the 16 loan officers perceive that it is a larger problem if the loan officer and the client have different perceptions and experiences' regarding what information is of importance. According to one loan officer, the parties can see value in different things, and it is not unusual that the loan officer sees assets on the farm which the farmer has never considered being of value or importance (pers. comm., Loan officer 8, 2012). These kinds of assets can according to the loan officer be, for example, buildings. It is according to the loan officer often vice versa as well, the farmer believes that animal stables or outbuildings are adding to the value of the property, but the bank finds them being of no value.

One of the loan officers explains that farmers can have a tendency of wanting to make investments that does not directly add to the value of the business (pers. comm., Loan officer 16, 2012). It is for example not unusual that a farmer wants to borrow for investing in a new machine if his friend or neighbour has recently bought a new one. The loan officer explains that the farmer may lack understanding of whether the investment increases the value of the business. It is according to the loan officer of great importance that the client has an understanding for his business and what creates value in the business, as well as that the loan officer understands the situation of the client in order to decrease and avoid problems of information asymmetry.

Five of the 16 loan officers state that it can sometimes be a problem with clients deliberately trying to hide information. One loan officer explains that the bank has a large network of contacts and resources in order to reveal if the client tries to hide information (pers. comm., Loan officer 6, 2012). The same loan officer means that the bank secrecy can sometimes limit the loan officer from accessing all information about the client. Another loan officer explains that most clients understand that it is almost never beneficial for the client to try to act opportunistically toward the bank (pers. comm., Loan officer 12, 2012). A third loan officer finds that the risk of information asymmetry declines if a relationship based on trust and legitimacy is established (pers. comm., Loan officer 7, 2012). It is according to the same loan officer important to ask the right questions in order to reveal asymmetric information.

"You must ask such questions that reveals if there are any weaknesses of the client and his business, at the same time as you cannot be too obtrusive. If you are successful doing this the risk of asymmetric information is usually very low."

(pers. comm., Loan officer 3, 2012)

5.2.3.4 Resources and network

What kind of resources do you have access to for evaluating a credit application?

All of the loan officers find that they have the authority and accessibility to the resources needed when making a credit evaluation. There are several resources, both internal and external they can use if their own authority or competence is insufficient, and together these constitute an important network of resources. These include capabilities such as material resources like valuation systems and templates but also human resources with special competences, knowledge and experience. This vast spread of available capabilities is something the loan officers find being of great value since it makes it possible to offer the client information quickly and efficiently in the credit evaluation process. Time is a resource that was mentioned as being a constrain by 7 of 16 the loan officers.

The loan officers explained that they can contact the regional offices for review and authorization for large credits that exceeds their personal credit limit or the credit limit of the office. The loan officers can also consult the regional offices for advice regarding issues requiring expertise competence within agriculture and forestry. Handelsbanken has co-operations with different actors like LRF Konsult and Södra in order to be able to offer comprehensive solutions for the clients. Several of the loan officers mention the value of external actors. One of the loan officers talks about local boards consisting of farmers acting as advisors for the loan officers (pers. comm., Loan officer 2, 2012).

The knowledge and familiarity of the local community is something that is an important part of building trust and legitimacy in the relationship.

(pers. comm., Loan officer 2, 2012)

Another loan officer finds it important to actively take part in activities outside the ordinary operations of the bank, such as farm auctions and local events (pers. comm., Loan officer 5, 2012). Thus, the loan officers keep themselves updated at the same time as they can expand their local network.

5.2.3.5 Length of the relationship

How does the length of the relationship affect the quality of the relationship?

According to the results of the case study 14 of the 16 loan officers found that the length of the relationship has a meaning. It differs though what that meaning is (table 11).

Table 11. How the length of the relationship affects the quality of the relationship and trust

Factors affected by the length of the relationship	Number of loan officers
Trust increases	9
Increase available information	5
No effect	2
Declining importance after a while	2

Five of the 16 loan officers find that a longer relationship increases the amount of information available. Therefore, the quality of the relationship increases with time, as the processing of information about the client becomes more efficient and decisions can be made quicker. Nine of the sixteen loan officers mention the importance of the length of the relationship in terms of establishing a trusting relationship. The loan officers explain that trust and legitimacy is built up during a long period. Three of the 16 loan officers participating in the case study state that it takes at least a year to establish a good business relationship with a client. One loan officer explains that one year is the time it takes to get to know the client and his business and how the client handles difficulties (pers. comm., Loan officer 2, 2012). Two of the 16 loan officers experience that the importance of the relationship has a declining benefit after a couple of years. One of these loan officers explains that in the beginning of the business relationship the benefits and importance of the relationship increases quickly, to eventually reach a stable level and then decline after one or two years (pers. comm., loan officer 3, 2012).

"It is better for the client to switch loan officer after a while since he'll need someone that can see things from a different perspective and has new ideas".

(pers. comm., Loan officer 3, 2012)

Another loan officer thinks that the quality of the relationship just gets better the longer the relationship lasts, the loan officer and client trust each other more and more as time passes (pers. comm., Loan officer 16, 2012). According to another loan officer, the correlation between the quality of the relationship and the length of the relationship is depending on how the relationship is maintained and how the loan officer perceives that the client is living up to the expectations (pers. comm., Loan officer 5, 2012).

Do the important factors in terms of establishing a relationship differ if it is a new or existing client?

The case study showed that it differs between which characteristics that are of greatest importance if it is a new or already established client (table 12). As the loan officers explained, a new client has no previous history with the bank, and it is therefore more difficult to evaluate a credit application and the person behind it, since the loan officer must start to assess all information about the client from scratch.

Table 12. The important factors for establishing a relationship for new and existing clients

New clients	Existing clients
Appearance &first impression	Knows about characteristics & capabilities
Trustworthy & professional	Expectations
Open & honest	Financial capabilities
	Open & honest

The appearance of the client and the first impression is according to the majority of the loan officers important. One loan officer explains that the personal characteristics of the client plays a significant role, since the way in which he presents himself and the investment is more crucial than if the client is already known by the bank (pers. comm., Loan officer 1, 2012). One of the loan officers explains that they are often a little sceptical towards new clients, especially if the client has already been denied credit from another bank (pers. comm., Loan officer 3, 2012). It is according to the loan officer extra important that the client give a trustworthy and professional impression in these situations. With an already established client, the loan officer already has an impression about his capabilities and characteristics and knows how he behaves in different situations. According to one of the loan officers, the previous results of an existing client can lead to expectations which becomes difficult for the client to live up to (pers. comm., Loan officer 9, 2012). One loan officer finds the financial capabilities being of greater importance for existing clients, while another believes that it is the personal characteristics that are most important, since the loan officer trusts the clients and does not scrutinize the financial statements as carefully (pers. comm., Loan officer 3; Loan officer 13, 2012).

Two of the 16 loan officers mean that there is no difference of what characteristics are of importance for establishing trust in the relationship if the client is new or already known by the bank. The important factor is according to these loan officers that the client is open and honest. Being open and honest about information is something that continuously must be maintained in order to ensure that the trust and a good relationship remains (pers. comm., Loan officer 4, 2012).

6 Analysis

In this chapter, the importance of relationships in the credit evaluation process of farm and forestry businesses, the primary actors and factors that are influencing the relationship is analysed.

6.1 The importance of relationships in the credit evaluation process of farm and forestry businesses

The results of the case study showed that all of the loan officers find the relationship as being of great importance. This result is co-aligned with literature on the subject showing that the relationship is of great importance in the credit evaluation of small businesses (Berger & Udell, 2002). According to literature, the relationship is of particular importance for small businesses since there is not as much transparent information available about small firms as there is about incorporated businesses (Kling *et* al, 2003). Another reason is that the firm owner/business manager is the key person and that the success of the business is entirely dependent on the capabilities of this one person (Bruns, 2003). According to the case study one person or a family usually manages a farm or forestry businesses. This makes farm and forestry businesses vulnerable for the conditions and situation of that person. Farm businesses are dependent on the specific farmer, and the operations and activities on a farm cannot be postponed due to illness or other incidents affecting the farmer. A diary producer must milk his cows every day regardless, whereas the owner of a shop can close it for one day if necessary. This is something the loan officer must have a knowledge and understanding about. The information about the farmer and his situation cannot only be found in the financial statements; therefore the establishment of a good business relationship is important. The primary purpose of the relationship is to create an understanding for the client's situation and a sense of trust between the loan officer and the farmer.

According to the case study the loan officers find it difficult to quantify the significance of the relationship in comparison to financial factors. A relationship is according to Morgan & Hunt (1994) primarily based on trust and satisfaction; these are soft factors, which are difficult to measure. A relationship is based on the mutual dependence and need for each other, and it is the secondary effects of the relationship that the loan officers highlighted rather than the relationship itself. The benefits of a relationship are according to the loan officers that the flow of information increases. More information leads to better knowledge about the business and the capabilities of the farmer. If the loan officer finds this information satisfying it creates trust for the farmer, and eases the decision-making process.

An additional benefit of the relationship is according to the case study that the client can become more willing to open up and share information with the loan officer. An increased flow of information contributes according to Binks & Ennew (1997) to decreased information asymmetry between the parties. The relationship between the loan officer and the client decreases the gap between the parties access to different information, but in order for the information asymmetry to really decrease the loan officer and the client must understand the information they share. It is according to the case study crucial that the farmer understands his business plan and objectives in order for the loan officer to trust the farmer and establish a good business relationship. It is as important that the loan officer understands the situation of the farmer and the meaning of the business plan and objectives the farmer presents.

A good business relationship is according to the case study important in order to make the credit evaluation process more effective. The loan officers found that a credit evaluation process becomes smoother if the client is willing to share information and is being open and honest about information. An efficient credit evaluation process can lead to the lowering of transaction costs in the credit evaluation.

Theory describes three types of transaction costs; contact costs, contract costs and monitoring costs (Hultkrantz & Nilsson, 2004). Contact costs occur when the parties are getting to know each other, and can according to the case study thus be reduced if the loan officer has a good understanding for the client and the business since he does not need to spend as much resources on learning about the business and the market. Contract costs occur when the parties are negotiating the contract. A good relationship, which according to the case study is established when the loan officer trust the client’s capabilities, can lead to lower contract costs since both parties feel secure that they are acting in the best interest of each other. In a good relationship where the loan officer trusts the client to fulfil his commitment in terms of repaying the loan and interest rates and where the client knows that the loan officer is giving the client the best possible conditions according to the circumstances, the resources needed to negotiating the contract can decline according to the case study. Monitoring costs occur when the parties control and monitor the other in order to be sure that he fulfils his part of the contract. Having a relationship based on trust can according to the case study, as well as the literature review, decrease the need of monitoring. Instead, the resources can be spent on entertaining the relationship in order to strengthen the benefits of it.

According to Berger & Udell (1995) the relationship has a small effect on the condition of the credit. This co-aligns with the perception of the loan officers of Handelsbanken. The credit conditions are in most banks today decided by a rating-system. The small possibilities to affect the conditions of the credit can be both an advantage as well as a disadvantage for the relationship. The advantage of a fixed rating-system can be that the credit evaluation is fair and that all clients are treated equally. If the credit conditions were negotiable to a greater extent, the client’s ability to negotiate would be more significant, there would be a risk of higher transaction costs and an increase of information asymmetry. The advantage of negotiable credit conditions could be that the relationship becomes of greater importance, since it becomes more important for the parties to make a good impression and gain the trust of the counterpart. Negotiable conditions of credit could make the relationship more vulnerable and the risk of opportunistic behaviour could increase.

The result of the case study showed that a client could be willing to pay a higher price for the credit if the client feels that he is understood by, and has a good relation to his loan officer. According to the case study, the loan officers are often expected to function as an advisor, and the relationship and the loan officers’ treatment of the clients can therefore be very valuable. Farmers rarely use other sources of external finance than bank loans, so the loan officer is of great importance for the farmer. The loan officers of Handelsbanken find the relationship to the clients as an important benefit in order to differentiate and attract clients. The personal relationship is a marketing factor for both new and existing clients. A relationship between two parties is according to Gadde & Håkansson (1998) something unique that cannot be imitated since it is dependent of the specific situational context and individual perceptions. This is an added value as most banks offer more or less the same services, products and credit conditions. The personal relationship and closeness to the clients can according to the case study be a mean to attract the best clients to the bank. Handelsbanken's vision is to be the number one choice of local banks.

A risk associated with a strong personal relationship is according to the case study that if it becomes too individual specific it is difficult to maintain, communicate and transmit the value of the relationship to someone else within the bank if the specific loan officer would leave the bank. In order to lower this risk it is important to keep records on important information about the clients, so that the information will not be lost without that specific loan officer. Another aspect of why it is important to keep records is that the client should be able to get assistance quickly even if "his" loan officer is not available at the time. It is important to make the relationship associated with the bank, and not only with the loan officer in order for the relationship to be important for the organization of the bank.

6.2. Characteristics of the primary actors that influence the relationship

According to theory, a relationship is affected by the different characteristics of the parties involved (Gadde & Håkansson, 1998). Together these characteristics create the basis for the relationship. How the actors influence the relationship depends on the complexity of the actors involved. According to Hedelin & Sjöberg (1993) the actors that primarily influence the relationship are the credit applicant and the loan officer. These are strongly influenced by the situational context and market conditions. The case study showed that the actors understanding of each other, the business and the situational context is an important factor for establishing a relationship based on mutual trust. The understanding and evaluation of the relationship between the credit applicant, loan officer and business situation is in the literature described in the model of three-dimensional credit evaluation (Kling *et al*, 2003).

6.2.1. Characteristics of the loan officer

According to the case study many of the loan officers find that "chemistry" is an important factor for establishing a relationship to the client. According to the model of three-dimensional credit evaluation, the relationship between the loan officer and client is dependent on the communicative fitting between the actors (Kling *et al*, 2003). This communicative fitting can be difficult to define and measure. The model of three-dimensional credit evaluation describes that it is important that the loan officer is matching with the client as well with the business situation. The loan officer must understand the characteristics of the client. The result of the case study showed that two different approaches for evaluating a credit application can be distinguished. Twelve of the 16 loan officers starts the credit evaluation process by trying to get a perception about the personal characteristics of the credit applicant and the credit applicants' matching of his business plan. Four of the 16 loan officers start the credit evaluation process by investigating the credit applicant's ability to repay the loan. These loan officers admit that the relationship is of importance but they also mean that credit cannot be allowed to someone based only on their personal characteristics and capabilities. The loan officer must see to that the process is profitable; both for the client and the bank in order to build a stable relationship that can be viable in the long-term perspective.

These two different approaches may stem from the loan officer's experiences in terms of both experience from credit evaluation and experience from farming/forestry. The experience of the loan officer is an important factor for the credit evaluation and the ability of the loan officer to accurately assess the situation. A loan officer that is inexperienced in the profession might not feel confident in trusting his own "gut feeling" and instincts, and will therefore rely more on financial information about the client. According to literature an experienced loan officer tends to look for information in the credit application that is ambiguous and contradicting to what impression the loan officer gets from the credit applicant (Andersson, 2003).

A loan officer with no experience from farming/forestry might not have the same understanding and feeling for the specific situations of agriculture or capabilities of the credit applicant. According to the case study other advantages of having background experience from farming/forestry is that the loan officer might get a better matching with the business situation. The loan officers perceive the collection and evaluation of information as being simplified with background experience. The loan officers also stress that background experience is positive in order to understand if the business plan and objective of the farmer are feasible. Farmers are constantly exposed to choices and uncertain factors such as volatile prices, uneven cash flows and markets for both input- and output goods. Many farmers are dependent on subsidies and grants in order to reach profitability in their business. If the loan officer has insight and understanding about this it is thus easier for him to understand and assess whether the client has the potential to run a successful business. This means that by having experience from the sector the loan officer and credit applicant are more likely to speak the same language. That factor is important for establishing a good relationship. If the loan officer and credit applicant speaks the same language the information asymmetry is likely to be reduced as the loan officer often attains more information and also understands that information, and can read between the lines and perceive things that are not directly outspoken.

The result of the case study showed that loan officers can procure knowledge about farming and forestry internally within the bank. Handelsbanken offers training internally to all of their loan officers. Those loan officers that did not have background experience from farming/forestry did not perceive that they have worse prerequisites for making a good credit evaluation and establishing a trusting relationship with their clients. They perceived it as advantageous not to have any preconceptions, and that they can use the large network of competences that is available within Handelsbanken, both internally and externally. The difference is that the loan officers without background experience tend to perceive farm/forestry businesses like any other profit maximizing business.

It is difficult to assess how the experience of a loan officer affects the credit evaluation since the importance of experiences and the perceptions of the loan officers are subjective and cannot be compared. According to literature, there is no characteristic that makes the perfect loan officer, nor is there One Right Way to evaluate a credit application (Kling *et al*, 2003). The relationship is affected by the clients' expectations on the loan officer and his knowledge and competence about agriculture. Some credit applicants may just be interested in securing finance, whereas others perceive the role of the bank more as business advisors.

6.2.2. Characteristics of the credit applicant

According to the case study, farmers must have a genuine interest for farming/forestry since this business is often hard work and low profits. The client must also have a business perspective on his farming in order to succeed in the tough market climate of today. As mentioned above the character of the credit applicant is extremely important for the establishment of a relationship. According to the three-dimensional model, credit evaluation process the business fitting is about the matching between the credit applicant and the loan officer (Kling *et al*, 2003). The business assessment regards the loan officer's understanding about how well the credit applicant understands the business situation and how his investment fits in that situation. The credit applicant must be able to motivate his choices and understand the risks associated with these.

Four of the 16 loan officers participating in the case study stressed that it is important that the credit applicant has entrepreneurial capabilities. According to literature, entrepreneurial capabilities are based on motivation to perform, motivation to succeed, and ability to control and handle risks (Hedelin & Sjöberg, 1993). All these factors are mentioned in the case study where the loan officers explain that a competent businessman is more likely to have realistic plans for his business and thereby convince the loan officer that the investment is feasible.

It is important to figure out whether the farmer is just a good entrepreneur or if he also possess' good capabilities of being the manager of a business. If there is staff employed in the farm business, which is becoming more common as farm businesses grow larger and larger, it is important that the client understands what it inclines having employees and running a company at that scale. This often requires a greater extent of business competence of the farmer but it also requires social skills in order to be a good manager. Farm businesses are usually small firms and the farmer is the key person of the business and solely responsible for its success. That entails a lot of responsibility and pressure on one single individual. It is therefore according to several loan officers participating in the case study, important that the farmer gives the impression of being healthy, fresh and in a good condition, as well as being able to act business like. In order to find out if the person behind the figures really is a good entrepreneur with the right capabilities to run a business it takes a good relationship and trust between the loan officer and the client. The financial statements and the relationship both need to be good and works in symbiosis.

6.3. Factors influencing the relationship

The primary factors influencing the establishment and the quality of a relationship are according to theory, literature and the case study trust, information, communication, the actors' resources and network and the length of the relationship. These factors can have a strengthening effect on the relationship, such as trust and communication, whereas factors such as asymmetric information can have a deteriorating effect on the relationship.

6.3.1. Trust

The results of the case study showed that mutual understanding is the most important factor in order for the loan officer to trust the credit applicant. The second most important factor according to the case study is that the credit applicant is open and honest about information. The loan officers of Handelsbanken explain that they feel trust for the credit applicant if the credit applicant can show that he knows what his investment entails and gives the impression of having the right entrepreneurial capabilities, in combination with sound financial information. The credit applicant must give a good impression of being a professional and reliable person. According to Blomqvist (1997) trust in a business perspective is two-dimensional. Trust needs to be established for both the entrepreneurial capabilities of the client, as well as for the personal characteristics. It is impossible to collect totally comprehensive information about the credit applicant, so trust is established if the loan officer comes to a point where he chooses to believe in the good intentions of the credit applicant based on the information he has access to. The loan officer must weigh the costs of collecting additional information against the potential benefits of understanding the client.

A factor that can add to a quick establishment of trust is according to the case study that the client meets, or exceeds the expectations of the bank. According to theory, strong relationships are based on trust and satisfaction (Morgan & Hunt, 1994). If the loan officers' expectations are met or exceeded the satisfaction of the loan officer increases according to the case study, which adds to the trust in the relationship. For the trust to be remained in the relationship and continue to add value to the relationship, it needs to be continuously maintained. Establishing trust in a relationship is according to Blomqvist (1997) an extensive process. According to the case study the trust can easily be lost if one of the parties does not live up to the expectations of the counterpart.

6.3.2. Communication and information

The type of information the credit applicant presents to the loan officer is according to the case study of importance for the establishment of a good relationship. Literature stresses the importance of how that information is presented in order for a good relationship to be established (Butler & Durkin, 1998). The results of the case study showed that comprehensive financial information is a prerequisite. The majority of the loan officers stressed the importance of this information being thoroughly analyzed and understood by the credit applicant. Financial information is often produced by the credit applicant in collaboration with a third external party, such as a financial advisor. Most of the loan officers do not expect the information to be presented in the form of a formal business plan. If the information is presented in a professional way, it gives a good impression and can affect the satisfaction of the loan officer, and thus the establishment of trust for the credit applicant.

The most important aspect though, is that the credit applicant presents the right kind of information and has a good understanding for the information even if he hasn't compiled it himself. According to theory it is difficult for the sender of information to communicate the message to the receiver if the sender lacks understanding of the information (Dahlkwist, 2004). The communication between the parties is facilitated if the parties speak the same language. The receiver of information must decode the information from the sender. The result of the case study showed that problems of decoding and understanding information can occur since the vocabulary in the agriculture sector can be difficult to understand for a loan officer without knowledge about the vocabulary. Without the same language the asymmetric information between the parties is likely to increase.

In order for the relationship between the loan officer and the client to remain it must be continuously maintained. The kind of maintenance of the relationship depends on the expectations that the loan officer and the client has of the relationship. According to theory the more complex the relationship is the more interaction it takes (Gadde & Håkansson, 1998; Ljung *et al*, 1998). The result of the case study showed that some of the loan officers expect the clients to keep them updated. Many of the loan officers found it sufficient to have yearly follow-ups with the clients unless any major events or incidents occur. Some of the loan officers believe that it is up to both parties to communicate and maintain the relationship. The dependence in a relationship is according to theory about one part's need to maintain the relationship in order for him to reach his objectives (Gadde & Håkansson, 1998). Both the bank and the client are dependent on the maintenance of the relationship in order for the relationship to be viable in a long-term perspective and continue to generate benefits.

According to the case study an important and efficient activity in order to establish and maintain the relationship is visits to the clients farm/forest. The benefits of visits are that the client is given the opportunity to show his achievements and present his business. This is advantageous for the loan officer to see in order to get an impression of the situation of the business. Another benefit is that the parties get the opportunity to meet in the home environment of the farmer. According to the case study, many loan officers of Handelsbanken perceive that farmers often open up more when they are in their home environment. In this situation, the personal characteristics of the farmer are often presented in a more honest way. A visit at the farm is a good way for getting an impression about the condition of the farm. If the buildings and yard is well-kept it gives the loan officer a more positive feeling about the ability of the farmer and can therefore affect the credit evaluation process. According to Dahlkwist (2004), communication is not only about verbal messages. The message of information can be enhanced and explained by sensory inputs, such as vision and hearing. It can have a positive effect of the relationship since meeting in the natural environment of the farmer gives the loan officer a better impression of his professionalism.

6.3.3. Information asymmetry

The risk for opportunistic behaviour is according to the case study perceived as low. When the loan officers establish a close relationship to their clients the risk for problems due to information asymmetry and opportunistic behaviour decrease. According to the case study, clients in the farm/forestry division are open and honest. A reason for the clients in farming segment being honest can be that they work and live in the same place, the farm. Because of this they have most of their assets and security in one place, which makes the potential loss too big to risk the good relationship to the bank by trying to act opportunistically.

Information asymmetry does not only occur because of opportunistic behaviour. According to the case study a common source to problems with asymmetric information is that the loan officers and client have different abilities to understand and interpret information. A reason for this is that the loan officer often has a more theoretical perspective and view on the investment and the risks associated with it, whereas the farmer often is more practical on his view of the investment. A close relationship that is based on communication and mutual understanding can decrease the information asymmetry between the parties. To combine farm visits with meetings in the bank office can create a relationship based on mutual understanding for both the practical and theoretical perspectives of the situation. Mutual understanding is also based on the competences of both the loan officer and the client. If the loan officer is able to understand the situation of the farmer and see beyond figures and presented information he has better possibilities to reduce problems of asymmetric information. The same applies to the clients' understanding of what the conditions of a profitable business are, and his entrepreneurial skills.

There is always a risk that the client tries to act opportunistically and hide information, but with the resources and strong position that the bank possesses it is according to the loan officers unlikely that the bank would not discover the deceitful behaviour. If the client would be exposed trying to act opportunistically it would seriously damage the relationship. If the bank communicates trust and legitimacy through the relationship the incentives for the client to act opportunistically decreases.

6.3.4. The resources and network

It takes, according to literature, resources to be able to establish a business relationship (Hedelin & Sjöberg, 1992). Literature explains that loan officers can use different parts of their network when evaluating a credit application. The network model consists of five levels, where the first levels describing the relationship between the credit applicant and the loan officer have been analyzed in the sections above (6.2.1 & 6.2.2). There are according to the network model other actors influencing the relationship, something that was also seen in the case study. The model describes that the local network, the contextual network and the banking organization influences the relationship.

According to the case study, the loan officer's network within the local community is an important tool in order to get a perception about the credit applicant. Several of the loan officers participating in the case study describes how their local offices uses influential actors in the local community as representatives for the bank and how they engage in local activities. The local network and the ambassadors can be used for collecting information about credit applicants and potential clients. The local network is of particular importance for banks with a decentralized organizational structure, such as Handelsbanken, since it gives each loan officer the possibility to get a strong position in the local community which can strengthen the relationship to the clients. According to the literature, a decentralized structure of the bank gives the loan officers more freedom and authority which can have a positive effect on the relationship to the clients, because of the more personal treatment and local connection (Hedelin & Sjöberg, 1992).

Handelsbanken has an organizational structure that aims at being close to the client. In order to achieve this Handelsbanken has many local offices, which are almost autonomous entities. The case study shows that the organizational structure of Handelsbanken facilitates the close relationship to the clients, since the local offices possess the authority and resources to make decisions. According to literature a successful banking relationship requires an organizational structure of the bank that allows the loan officers to use soft information in their evaluation of credit applications, and gives the loan officer authority to make own decisions (Berger & Udell, 2002).

The contextual network of Handelsbanken consists of both internal and external actors that can provide competence and resources about the business sector. In Handelsbanken the regional offices of farming- and forestry, as well the divisional office can contribute with expertise competence. External actors include the co-operations with, among others, LRF Konsult and Södra, which loan officers can consult but also use in order to offer complete business solutions to the clients. According to the case study the loan officers can easily contact the different actors within the contextual network for assistance when their own competence is insufficient. According to Hedelin & Sjöberg (1992) a well-working network can help organizations achieve their goals, and the legitimacy of the bank can be enhanced by a good network since it signals to the clients that the bank is making efforts to give the client the best solutions.

6.3.5. Length of the relationship

The result of the case study showed that the length of the relationship has no particular effect on the quality of the relationship. Literature comes to different conclusions about the importance of the length of the relationship. A point that co-aligns in literature and the case study is that the availability of historical information about the client and the length of the relationship have a positive correlation (Cole, 1998). According to the case study, the trust in the relationship increase when information is already available about how the parties act and behave in different situations. The transaction costs of every application for renewed credit decreases with an existing client where historical information is available.

According to literature it is difficult to say how long time it takes to establish a relationship (Elyasiani & Goldberg, 2004). The result of the case study co-aligns, but some of the loan officers mentioned that it is during the first year that the basis for the relationship is established and that it is during this period that the benefits of having the relationship are the greatest. According to both literature and case study there can be a negative correlation between the quality of the relationship and the length of it. This is since the parties' preconceptions and impressions about each other are already set and it can be difficult to find new perspectives and visions in the relationship when the relationship has been ongoing during a couple of years. According to the case study the presentation of information and the impression of the personal characteristics of the client are of greatest importance when the relationship is under construction. With time the maintenance of the relationship and that the client lives up to the expectations are the most important factors for the relationship to keep its quality.

7. Conclusions

This chapter presents the conclusions of the study, drawn from the purpose of the study which is to investigate how loan officers establish an understanding of applicants' personal character in the loan application process, and how that understanding together with the personal relationship that is formed between the loan officer and the credit applicant affects the credit evaluation.

Why is a relationship of importance when evaluating a credit application from a farm or forestry business?

The conclusions of this study is that the relationship is of importance when evaluating a credit application from a farm or forestry business since the relationship creates benefits for both the bank, the loan officer and the business that cannot be obtained from financial information solely. These benefits include trust, which means that the loan officer and the client have established mutual understanding for each other. Another benefit is an increase of the available information about the firm. This is important since farm and forestry businesses are often small, and information opaque. A third benefit is that the decision-making process can become more efficient and the transaction costs for collecting information and monitoring the client can decrease. These three benefits reduce agency problems in the relationship as trust is established and the client is willing to share information and is open and honest about the information he shares. A fourth benefit is that a strong and close relationship to the client is a marketing argument for the bank. It is important though that the relationship does not become to individual specific, since the bank might lose the values of the relationship if the loan officer leaves the bank.

How does the character of the loan officer and the credit applicant influence the relationship?

The primary actors that influence the relationship are the loan officer and the credit applicant. The loan officer must have good communicative fitting to the client, and understand the client and his business situation. Experience from credit evaluation and farming/forestry can help the loan officer to achieve this understanding. Being a good loan officer is about being interested in the clients and their business which are subjective perceptions. The most important characteristic of the credit applicant is that he understands his investment and business, has good entrepreneurial capabilities and has a genuine interest for his business. The credit applicant must be able to communicate feasible and realistic objectives for his business, and understand the risks associated with these.

What factors affect the relationship and how do these factors influence the relationship?

The primary factors that influence the relationship are trust, information, communication, resources and the length of the relationship. Trust affects the legitimacy of the relationship. In a relationship based on trust the actors feel confident about what to expect from each other. Good communication in the relationship increases the available information about the business and capabilities of the farmer. The maintenance of the relationship, as well as the length of the relationship affect the availability of information and can add to the quality of the relationship. The resources and the network around the credit applicant and the loan officer can have an important influence on the relationship since it helps both the credit applicant and the loan officer to get to know each other and increase the flow of information between them. A good flow of information helps reducing asymmetric information, which in the case of credit evaluation to farm and forestry businesses is often about different perceptions of what kind of information is of importance. The organizational structure of the bank has an important role for the credit applicant and loan officer's interaction with each other. A decentralized organizational structure allows for the actors to work close together which leads to the establishment of a strong relationship.

From this the conclusion can be drawn that the loan officers establish an understanding of applicants' personal character in the loan application process by being interested in the credit applicant and his business. This creates legitimacy for the loan officer and he receives the credit applicants' approval, which creates trust in the relationship. A relationship built on trust leads to improved communication between the loan officer and the credit applicant. The good communication can increase the flow of information, which leads to the establishment of a mutual understanding. This understanding between the parties decreases the problems of information asymmetry in the credit evaluation process, which makes the process more efficient and viable in a long-term perspective.

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Personal messages

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Appendix 1: Letter to loan officers

Uppsala, 11 March 2012

Hello,

We are three students writing our Master thesis in agronomy-economics programme at the Swedish University of agricultural sciences. We write our thesis in co-operation with the Handelsbanken farm and forestry division. The aim of the thesis is to investigate how loan officers establish an understanding of applicants' personal character in the loan application process, and how that understanding together with the personal relationship that is formed between the loan officer and the credit applicant affects the credit evaluation.

Our hopes are that the thesis will provide deeper understanding for how the personal relationship between the credit applicant and the loan officer affects the credit evaluation process. We have chosen this area since there can be difficulties for the bank associated with the assessment of whether the information the farmer provides gives a true picture of the capabilities of the farmer.

According to literature the personal relationship is of particular importance in the credit evaluation process of farm and forestry businesses. This can be explained by the fact that farm and forestry businesses are often operated in the form of a sole proprietorship and managed within the family. Therefore we believe that it is important that a loan officer working with farm and forestry clients has knowledge and understanding about the sector.

The aim of the study is to investigate how trust and legitimacy is established between a loan officer and credit applicant, and what significance this relationship has for farm and forestry businesses. In order to answer this aim we will interview loan officers at the Handelsbanken farm and forestry division

A sample of loan officers has in cooperation with staff at the central farm and forestry division of Handelsbanken been chosen and we hope that you are willing to participate in the study. The telephone interviews are expected to take 30 minutes. The interview guide is attached in this letter in order for you to be able to look at them before the interview. You do not need to fill in the answers before the interviews.

Please confirm your participation by suggesting two dates between the 15th – 30th of March that would be suitable for us to call you.

Thank You for participating!
Best regards,

Sofia Eriksson	Tina Olsson	Rebecca Servin
070-88 30 998	070-29 92 076	073-50 53 117
soer0002@stud.slu.se	tiol0001@stud.slu.se	rese0001@stud.slu.se

Appendix 2: Interview guide

Questionnaire, farm and forestry division Handelsbanken

Characteristics of the bank office

Where is the bank office located?

How many employees are there at the bank office?

How many of you work with the farm and forestry segment?

What kind of resourcesdo you have access to for evaluating a credit application?

Characteristics of the loan officer

Age

Experience in credit evaluation

Experience in credit evaluation to farm and forestry

Background/education in agriculture

The credit evaluation process

What is the first thing you look at/ask for when starting a credit evaluation?

How do you evaluate a credit application?

Do you follow a template/routine?
If yes, does it take the soft factors, such as personal characteristics/ entrepreneurial skills into consideration?

What personal characteristics of the credit applicant do you consider as important for the credit evaluation?

What information do you expect the client to present?

How do find out if the client has an understanding for his business plan and investment, and the risk associated with this?

How do you perceive the problems of information asymmetry?

Uppsala, 11 March 2012

The significance of relationships in the credit evaluation process

What factors do you think affect the relationship?

What factors are important in order for trust to be established between you and the client?

How much significance does the personal relationship have in comparison to the financial information?

Do you find the personal relationship being of importance?

What are the benefits of having a good relationship with a client?

Does the personal relationship affect the conditions of the credit?

Do the important factors in terms of establishing a relationship differ if it is a new or exisitng client?

Is there a difference in what factors are of importance whether the credit application concerns a farm business or a forestry business?

What significance does your background and experience of farming/ forestry have for the relationship with the client?

How does the length of the relationship affect the quality of the relationship?

How is the relationship maintained?

Do you expect the client to keep you updated with information?

Thank You for participating!