An Examination of the Factors Associated with Bank Switching in the U.K. Small Firm Sector

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ABSTRACT. Previous research has consistently shown that a large number of firms are sufficiently dissatisfied with their bank relationship to have considered switching to an alternative bank. In practice, however, the number of firms which actually switch banks is relatively low. This paper examines empirical evidence from a postal survey of small firms in order to investigate this paradox. Binomial and multinomial logistic regression is used to identify the characteristics which discriminate between a group of firms considering switching banks and two other groups, namely those which had switched banks in the previous three years and those which had not switched banks and were not considering doing so. The paper tests the hypothesis that some small firms may be "informationally captured", in that they are tied into their current bank relationship due to difficulties in conveying accurate information about their performance. The results provide some evidence in support of the hypothesis in that rapidly changing information, particularly changing technology, was a characteristic associated with firms which were considering switching but had not switched. However, there was no significant evidence to support the hypothesis that superior performing firms are more likely to be "informationally captured"; growth and perceived business success were both associated with firms which switched banks. There was strong evidence that the main drivers of the decision to switch or consider switching banks were difficulties obtaining finance and dissatisfaction with the service provided. The results also showed that firms which were considering switching banks tended to use more alternative (non-banking) sources of finance. It is concluded that some firms will resolve difficulties obtaining finance by switching banks, whereas others will use alternative sources of finance depending on the balance between the benefits of switching, such as increased finance, and switching costs including information provision.

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Introduction

The recent U.K. Review of Banking Services (Cruickshank, 2000) highlighted the low number of SMEs which switched banks and suggested this was due to the lack of competitiveness in the provision of banking services to smaller firms. Various surveys have consistently reported that the number of firms considering switching banks is much higher than the number which actually switch (BZW, 1994; Binks and Ennew, 1994; FSB, 1998; Bank of England, 1999). For example, the Federation of Small Businesses (FSB, 1998) reported that 4% of small businesses had actually switched banks in the previous year compared to 34% which had considered switching. This paper investigates the paradox of the relatively large number of firms with an apparent desire to switch banks, but the small number who actually do so.

Although it is accepted that the importance of debt finance to small firms means that bank relationships play an important role in the development and growth of firms (Binks and Ennew, 1997; Bank of England, 2000), relatively little research has been devoted to understanding the

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motivations to switch or remain with a particular bank. Ongena and Smith (2001) argue that shorter bank relationships are more prevalent among smaller, profitable, highly leveraged firms. However, their sample was not representative of small firms as it consisted of listed Norwegian firms (average turnover $100 m), many of which were characterised by multiple bank relationships.

Much of the literature on small firms is anecdotal or impressionistic and is based on the commonly held assumption that inertia, not loyalty, is responsible for firms remaining with the same bank (CB, 1996). Previous research on bank switching (see e.g. Ennew and Binks, 1996) has examined the differences between firms which were content with their bank relationship and those which had recently considered switching banks. We extend extant research by focusing on the differences between firms which were considering switching banks and those which had actually switched, in order to examine the reasons for the discrepancy between the number of firms which express dissatisfaction with their bank and the number which actually switch banks.

Ennew and Binks (1996) suggest that firms may continue in a banking relationship despite maintaining a negative attitude towards the bank. In this context, Sharpe (1990) hypothesises that information asymmetry plays a key role in restraining firms from switching banks. He posits that some firms may be "informationally captured" in that they are tied into the relationship because the bank has inside information on the firm, built up over the length of the relationship, which the firm has difficulty imparting to outsiders (e.g. other banks). Sharpe (1990) argues that this is more likely to be the case for superior performing firms. In discussing Sharpe's hypothesis, Holland (1994) also argues that smaller firms are more likely to be informationally captured since they tend to have a relationship with only one bank. However, to date, these hypotheses do not appear to have been tested empirically.

A further concern is that the high level of reported dissatisfaction with banking relationships (Ennew and Binks, 1996; Binks and Ennew, 1998), coupled with the possibility that firms may be trapped (informationally captured) in sub-optimal relationships, may be indicative of credit rationing. Should this prove to be the case, it would have important implications for the financing, and subsequent growth, of small firms. Whilst the debate regarding the existence of credit rationing is unresolved (see e.g. Stiglitz and Weiss, 1981; De Meza and Webb, 1987; Cressy, 1996), it is generally agreed that credit rationing is more likely to occur where information asymmetries are highest and that small firms in particular are more likely to suffer from informational opacity (Berger and Udell, 1998).

A prime objective of this paper, therefore, is to investigate empirically whether there are specific characteristics which distinguish small firms which switch banks from those which only consider switching and in particular test whether there is any evidence of the "informational capture" of smaller firms in the banking relationship. The paper also examines whether firms which remain in a banking relationship show any evidence of credit rationing. The following section gives an overview of the literature. This is followed by a description of the data and method used to empirically test our hypotheses, together with a discussion of the motivation for the variables collected for the study. Three groups of firms are examined in testing our hypotheses; firms which are currently considering switching banks, those which have recently switched banks and those which have been with their current bank for more than three years and who indicated that they had no intention of switching. The paper concludes with a discussion of the salient points to emerge from the analysis.

Literature overview

It is generally accepted that there is an asymmetry of information between small firms and financiers (Berger and Udell, 1998). Indeed, it has been suggested that information asymmetries are a major imperfection in the provision of finance to small firms (Keasey and Watson, 1993). Furthermore, small firms with a longer bank and/or creditor relationship have been shown to have an increased availability of bank or trade credit, which, it is assumed, arises from a reduction in information asymmetries (Berger and Udell, 1995; Petersen and Rajan, 1994). This reduction in information asymmetry is the major advantage of relationship lending and has been

shown to lead to lower interest rates, lower collateral requirements and increased availability of finance (Berger and Udell, 1995; Elsas and Krahnen, 1998; Harhoff and Korting, 1998).

However, Sharpe (1990) argues that the increased flows of information created by longer banking relationships lead to an asymmetry of information between the firm's current bank and other banks. This is particularly relevant to small firms, which often conduct all their depositing, lending and transactions business with one institution and in the process provide their bank with a continuing history of the business (Fama, 1985; Harhoff and Korting, 1998). A bank which possesses inside information about a firm is in a powerful position in comparison to other banks (Fama, 1985; Cosimano and McDonald, 1998). Not only is the bank able to assess the risks relating to its customer (firm) more accurately than other banks, but the availability of an ongoing history reduces the incremental costs of risk assessment.

From the firm's point of view, the switching costs incurred in moving to an alternative bank will be higher due to difficulties in conveying accurate information about their performance and establishing a track record with a new or prospective banker (Sharpe, 1990). Sharpe argues that superior performing firms will be informationally captured because their current bank will offer the best deal relative to their competitors due to the firm's difficulties in conveying enough information about their superior performance to other banks.[1] Switching costs will be especially high for those firms where information is less easily obtainable, rapidly changing or more difficult to convey, for example where the pace of innovation is rapid, technology is changing or firms are growing rapidly (Storey, 1994).

It might also be expected that relatively small firms will face particularly high switching costs. As well as the difficulties in conveying an accurate picture of their performance, the time required to search out and evaluate potential new banks, together with the administrative effort involved in switching, is expected to represent a proportionally higher cost to smaller firms. The underlying reason is inherent in the structure of small firms where owner-managers tend to take personal responsibility for all areas of their business (Storey, 1994). This leads to many and varied demands on their time and may result in the adoption of a "fire fighting" approach to management (Howorth, 1999) where bank switching may only be undertaken if it resolves an immediate problem. Furthermore, it is likely that the process of switching will be more time consuming in smaller firms due to a relatively low level of administrative skills and less efficient financial management systems (Nayak and Greenfield, 1994; Howorth, 1999). It is hypothesised, therefore, that, ceteris paribus, smaller firms will be less likely to switch banks.

Any decision to switch banks will depend on the balance between the perceived benefits and costs of switching. Where firms are dissatisfied with their current bank, this will increase the potential benefits of switching as firms will expect to select a new bank which will satisfy their particular requirements. However, it is not only dissatisfied firms which may be motivated to switch banks. Some banks may target (cherry pick) particular types of firms based on the attractiveness of their risk profile, or the potential profitability of their accounts. Such groups of firms will be encouraged to switch by offers of services targeted at their specific requirements (Ennew and Binks, 1996).

In any event, the low level of bank switching (relative to those considering switching) which is observed in practice would suggest that many firms expect the costs of switching to outweigh the benefits. Furthermore, it has been highlighted that many firms perceive little differentiation between banks (Binks and Ennew, 1994), which would clearly reduce the benefits to be gained from switching. It has also been suggested that some firms require a "trigger" event to motivate them to seek an alternative bank (CB, 1996). It is expected that as well as highlighting the possibility of bank switching, trigger events will change the balance between the costs and benefits of switching. Examples of triggers include an offer from an alternative bank which changes the perceived level of differentiation between banks, a loan being denied, a dispute over charges, and local branch closure (Ennew and Binks, 1996).

In this context, difficulty in obtaining finance (including denial of loans or unacceptable terms) has been identified as a motivator to bank

switching (CB, 1996). However, it is not clear to what extent problems in obtaining finance are resolved by firms switching to an alternative bank. Whereas for some firms the solution to difficulties obtaining finance may be switching banks, other firms, particularly those facing higher perceived switching costs, might choose to resolve such difficulties by seeking alternative (non-bank) sources of finance.[2] However, if firms are trapped within sub-optimal bank relationships, and they are unable to obtain alternative sources of finance, they could face credit constraints. Clearly, it is important therefore to examine whether there is any evidence that firms which find it difficult to switch banks are in any way credit rationed, particularly if, as Sharpe (1990) suggests, it is superior performing firms which are more likely to be informationally captured.

Data, method and variables

The data are derived from a postal questionnaire survey of the managing directors of U.K. small firms, completed in 1996. Two random samples were utilised. The first sample was an industry stratified random sample of 1,970 small firms from the *One Source* database of 130,000 small companies. The second comprised a random sample of 400 members of the Forum of Private Businesses, which has been shown to be broadly representative of small businesses in the U.K. (Binks and Ennew, 1997). The sample frame was selected from a broad range of industry sectors throughout the U.K. in manufacturing, services, distribution and construction. Sampling criteria were based on the U.K. Companies Act definition of a small firm (updated with effect from 1990) – that is, firms with under £2.8 million turnover. The survey generated 491 usable responses, representing a response rate of 21%. Chi-square and Student's *t*-tests were employed to test for non-response bias. There were no significant differences at the 5% level of significance or lower in respect of size, region and industry (see Peel et al., 2000, for fuller details of the survey and significance testing).

Based on respondents' responses to the survey instrument, firms were classified into three groups: (i) those which had not switched banks and were not currently considering switching; (ii) firms which had switched banks in the preceding three years; and (iii) firms which stated they were currently considering switching banks. Of the 491 small firms providing data, 9% ($n = 45$) indicated that they had changed bank in the preceding three years; 18% ($n = 89$) intimated that they were currently considering changing their bank; and 72% ($n = 357$) stated they had not changed their bank in the preceding three years, nor were they currently considering changing their banks. Consistent with previous research (Binks and Ennew, 1996; BZW, 1994), the number of firms which were currently considering switching is substantially higher than those which have switched.

The questionnaire elicited detailed information from which the experimental variables relating to "informational capture" and credit rationing were formulated, together with a range of control variables. Univariate significance tests between sub-group means were conducted using parametric and non-parametric tests on the continuous and non-continuous variables respectively. Logistic regression was used to identify, in a multivariate context, the key variables which differentiate between firms in each of the three groups. Table I provides a full description of the explanatory variables employed in the empirical analysis.

In testing the informational capture hypothesis, we examine whether characteristics which make information more difficult to assess are associated with firms which are considering switching banks but do not do so. In line with the above discussion, it is hypothesised that information will be more difficult to assess where circumstances change rapidly and/or informational flows are more complex. In this context, it is hypothesised that information will be more difficult to convey where firms face frequently changing technology. The variable (TECHSTAB) is used to proxy this in the form of a five point ordinal scale with respondents indicating how stable (ranging from 1 = very unstable to 5 = very stable) they considered technology was in the market for their primary product/service. TECHSTAB is therefore expected to be negatively associated with those firms which are considering switching relative to those which have switched.

Furthermore, where firms are relatively innovative, and therefore more likely to be introducing

TABLE I
Variable definitions

Variable	Definition	Measurement
Information capture		
TECHSTAB	Stability of technology	Ordinal: 1 = very unstable to 5 = very stable
NEWPROD	Frequency introduce new products/services	Ordinal: 1 = very frequently to 5 = never
SUCCESS	Success relative to U.K. competitors	Ordinal: 1 = not at all successful to 5 = very successful
YOUNG	Firm aged less than 5 years	Binary: 1 = Yes; 0 = No
SALESLG	Sales for last financial year	Natural log (£)
GROW	Importance of growth in sales	Ordinal: 1 = not at all important to 5 = very important
Credit rationing		
DIFFDD	Experienced difficulty obtaining finance from bank for day-to-day operations in past 3 years	Binary: 1 = Yes; 0 = No
USEHPL	Leasing or hire purchase is used as a source of external finance	Binary: 1 = Yes; 0 = No
PAYVL	Pay trade creditors late more than occasionally	Binary: 1 = Yes; 0 = No
Control variables		
CHSUP	Would consider changing suppliers for better terms	Ordinal: 1 = never to 5 = always
BKEFF	How efficient bank is in meeting financial and trading requirements	Ordinal: 1 = very inefficient to 5 = very efficient
MAN	Manufacturing dummy	1 = manufacturing; 0 = else
SERV	Services dummy	1 = services; 0 = else
CON	Construction dummy	1 = construction; 0 = else
DIST	Distribution dummy	1 = distribution; 0 = else

new products, information is likely to be changing rapidly and the probability of corporate success will be more difficult to assess (e.g. risk will be perceived to be higher in consequence of the higher variance of returns). Respondents were therefore requested to indicate on a five point ordinal scale, ranging from 1 = very frequently to 5 = never, the frequency with which they introduced new products. In line with the previous discussion, it is expected that this variable (NEWPROD) will also be negatively associated with those firms which are considering switching banks relative to those which have switched.

As discussed above, Sharpe (1990) hypothesised that superior performing firms are more likely to be informationally captured. Although he was unspecific in defining superior performance, it might be expected that it would be the unquantifiable aspects of performance which firms would have most difficulty in imparting to prospective banks. In consequence, respondents were asked to rate their firm's success relative to their competitors on an ordinal scale of 1 to 5, with 1 indicating not at all successful and 5 equalling very successful. In accord with Sharpe's (1990) hypothesis, we would expect a positive association between this variable (SUCCESS) and firms which are considering switching, relative to those which switched.

A further implication of informational capture is that younger firms may be more willing to switch banks because they will not be subject to the same degree of informational asymmetry as older firms in consequence of them not having established a track record with their current bank. In most circumstances, young firms face greater information asymmetries (Berger and Udell, 1998). However, in the particular context of bank switching, and extending Sharpe's (1990) hypothesis of informational capture, younger firms are hypothesised to face lower switching costs because their shorter banking relationship has less potential to provide their current bank with an informational advantage over new banks.

Furthermore, young firms might be expected to shop around for banking services as they reach the end of special introductory terms (e.g. low or no transactions charges) offered to new firms by most banks (Cruickshank, 2000) and therefore, they are more likely to switch banks at that time. However, it should be noted that this argument applies to young firms and is not expected to transfer to a general (continuous) relationship with the age of a firm. In consequence, a binary variable (YOUNG) is employed which is coded 1 if a firm indicated that it was less than 5 years old and zero otherwise. In line with the above discussion, this variable is expected to be positively associated with firms which have switched banks.

As noted above, Holland (1994) argued that smaller firms are more likely to be informationally captured for reasons of informational asymmetries, time and administrative constraints (Howorth, 1999; Nayak and Greenfield, 1994) and because they are more likely to be in single bank relationships. In the analysis which follows the natural logarithm of sales (SALESLG) is used as a measure of firm size and is expected to be negatively associated with firms which are considering switching. In addition, smaller firms may be less attractive to banks because their accounts are likely to be less profitable. This may be particularly the case where customers exhibit little or no growth prospects. Furthermore, where growth is an important objective of firms, they are less likely to be able to satisfy their financial requirements from alternative (non-bank) sources and therefore, any difficulties in obtaining finance from their current bank may have to be resolved by switching. It is also probable that such firms will be seeking finance more frequently, which could lead to an increased awareness of the benefits of switching banks. Respondents were therefore requested to indicate how important sales growth was to their firm on a five point ordinal scale ranging from 1 = not important to 5 = very important. In line with the preceding arguments, this variable (GROW) is expected to be positively related to bank switching.

With respect to credit rationing, three variables are employed in the analysis. A refusal or, other difficulties obtaining finance may lead to dissatisfaction in the banking relationship and hence, to an increased likelihood of a firm considering switching its bank in the hope of obtaining additional finance and/or an improved banking relationship. A dichotomous variable (DIFFDD) indicates whether respondents had experienced any difficulties in financing their operations in the previous three years (1 = Yes, 0 = No). A positive association is expected with both firms which have switched banks and firms which are considering switching banks in comparison to firms which are in neither category. It could also be argued that the information capture variables (above) may be at least partly proxying for firm-specific risk which itself may be positively associated with difficulty in obtaining finance and hence, may result in increased dissatisfaction with the banking relationship. It is therefore important to control for firms' difficulties in obtaining finance in order to test for the incremental effects of the information capture variables on the bank switching decision.

As discussed above, whereas some firms may resolve difficulties obtaining finance by switching banks, others may seek alternative non-bank sources of finance. Therefore, a measure of the extent to which firms are suffering from financial constraints is their use of alternative sources of finance. Undercapitalised firms have been shown to "juggle" cash flow items to finance their operations (Howorth, 1999). Indeed, it is assumed that firms which make the greatest use of late payments to creditors do so because they have reached the limit of the finance available to them from institutional sources (Wilson et al., 1997; Petersen and Rajan, 1994). Respondents were therefore requested to indicate the frequency with which they paid their suppliers late on a five point ordinal scale ranging from 1 = never to 5 = frequently. A dummy variable (PAYVL) was coded 1 for respondents who scored 3 or more and 0 otherwise, thus identifying respondents who paid late more than occasionally. Another alternative source of finance which, because it is asset-backed, is relatively easy to obtain is hire purchase and/or leasing. Respondents were requested to indicate whether or not they used hire purchase or leasing – with the variable (USEHPL) coded 1 for firms which use hire purchase or leasing and 0 otherwise. A positive association between these two variables (PAYVL and USEHPL) and firms which are considering switching would support the hypothesis that firms which are considering

switching use more alternative sources of finance than firms which actually switch.

Following Ennew and Binks (1996), who examined the factors associated with small firms who were considering switching their bank relative to those who were not considering switching, we include a range of variables to control for other factors which may impact on the switching decision. Firstly, it is hypothesised that some firms might generally be more willing than others to switch suppliers, including suppliers of finance, because they place a relatively high value on the benefits (in terms of improved terms or lower charges), or a lower value on the costs or disruption involved in switching. In accord with this, a variable (CHSUP) is included in the analysis which attempts to proxy for the firms' propensity to switch banks, and which is measured by respondents indicating on a five point ordinal scale ranging from 1 = never to 5 = always, their willingness to switch suppliers if better terms were available. It is expected that CHSUP will be positively associated with the decision to switch banks.

A major influence on a firm's motivation to switch banks is their satisfaction with the service offered to them by their current bank (Ennew and Binks, 1996). Respondents were therefore requested to indicate on a five point scale their opinion of the efficiency of their bank, ranging from 1 = very inefficient to 5 = very efficient. This variable (BKEFF) is included in the analysis to control for the influence of dissatisfaction with a current banker on a firm's desire to switch banks and is expected to be negatively associated with firms who are considering switching banks, relative to both the other two groups – that is those who have switched (where it is hypothesised they are more likely to be satisfied with their current bank following the switch) and those who have not switched and are not considering switching.

Finally, respondents were also requested to indicate in which industrial sector they classified their firm's primary product or service. From these responses, four industry dummies were created (MAN, SERV, CON, DIST) which identified (where 1 = the specific industry group and 0 otherwise) firms in manufacturing, services, construction and distribution industries respectively. Three of these (MAN, SERV, CON) were included in the analysis to control for any industry specific effects.

Empirical results

Table II provides summary statistics on the explanatory variables together with the results of statistical significance tests across the three subsamples. It shows that the variables which are most closely linked with the switching decision exhibit the highest significant differences between the three groups. In particular, and in line with expectations, firms which had switched banks show a higher propensity to switch suppliers (CHSUP). Furthermore, there are significant differences between the groups with regard to the two variables which might be expected to act as triggers to a firm considering switching, namely difficulties in obtaining finance (DIFFDD) and the perceived efficiency of the firm's current bank (BKEFF). On average, firms which were considering switching rated the efficiency of their current bank (BKEFF) significantly lower than either of the other two groups. In addition, a significantly higher proportion of firms which had switched banks, together with firms currently considering switching, indicated that they had experienced difficulty obtaining finance for their day-to-day operations (DIFFDD) relative to firms which had not switched and were not considering switching.

In examining the use of alternative sources of finance, hire purchase and trade credit (USEHPL, PAYVL), the table illustrates that a significantly higher proportion of firms which were considering switching used the alternative sources in comparison to the other groups. This is again consistent with prior expectations and may indicate that firms which had switched banks resolved their difficulties in obtaining finance by switching banks, whereas those which were considering switching are more likely to use alternative sources of finance as a solution to the financing problem.

Table II also reveals that firms which were considering switching are characterised by a lower mean score on the variables measuring the stability of technology (TECHSTAB) and the frequency with which new products are introduced (NEWPROD) indicating that their technology is less stable and that they introduce new products more frequently than the other groups. However,

TABLE II
Summary statistics (means)

Variables	No change	Changed bank	Considering change	All firms
TECHSTAB	3.15 (n = 329)	2.98 (n = 44)	2.79 (n = 84)	3.07†† (n = 457)
NEWPROD	3.08 (n = 344)	2.98 (n = 44)	2.85 (n = 86)	3.03 (n = 474)
SUCCESS	3.43 (n = 343)	3.52 (n = 44)	3.23 (n = 87)	3.40 (n = 474)
YOUNG[a]	15.1% (n = 357)	26.7% (n = 45)	9.0% (n = 89)	15.1%** (n = 491)
SALES (£000)	545.976 (n = 350)	750.975 (n = 45)	445.592 (n = 85)	547.418 (n = 480)
GROW	4.23 (n = 345)	4.43 (n = 44)	4.27 (n = 88)	4.26 (n = 477)
DIFFDD[a]	16.1% (n = 353)	48.9% (n = 45)	53.4% (n = 88)	25.9%** (n = 486)
USEHPL[a]	53.9% (n = 356)	51.1% (n = 45)	67.0% (n = 88)	56.0%* (n = 489)
PAYVL[a]	53.5% (n = 357)	60.0% (n = 45)	69.7% (n = 89)	57.0%** (n = 491)
CHSUP	1.98 (n = 349)	2.63 (n = 43)	2.27 (n = 83)	2.09††† (n = 475)
BKEFF	3.32 (n = 355)	3.27 (n = 44)	2.22 (n = 87)	3.12††† (n = 486)
MAN[a]	45.7% (n = 357)	22.2% (n = 45)	46.1% (n = 89)	43.6%*** (n = 491)
SERV[a]	26.6% (n = 357)	26.7% (n = 45)	36.0% (n = 89)	28.3% (n = 491)
CON[a]	16.0% (n = 357)	24.4% (n = 45)	9.0% (n = 89)	15.5%* (n = 491)
DIST[a]	11.8% (n = 357)	26.7% (n = 45)	9.0% (n = 89)	12.6%*** (n = 491)

[a] indicates a binary variable where the mean describes the proportion (%) of the sample with a value of 1.
***, **, * indicates three sample Chi-square test is significant at 1%, 5%, 10% level respectively.
†††, †† indicates three sample Kruskal Wallis test is significant at 1% and 5% level respectively.

although these findings are consistent with prior expectations, the differences are only significant in the case of TECHSTAB. In contrast to Sharpe's (1990) hypothesis, the table shows that firms which were considering switching indicated that they were less successful (SUCCESS) than their counterparts in the other two groups. However, as hypothesised, Table II reveals that firms which were considering switching were significantly less likely to be young firms (YOUNG) and, on average, were smaller in terms of turnover but not significantly so. The growth objective (GROW) received relatively high mean scores in all cases with no significant differences between the three groups. In terms of industrial classification, the table shows that, on a univariate basis, firms which switched banks were more heavily represented in the construction (CON) and distribution (DIST) sectors and less in manufacturing (MAN).

Table III presents the results of multivariate logistic regression analysis for the firms which had switched banks in the previous three years, relative to those which were currently considering switching (dependent variable coded 0 and 1

TABLE III
Logistic Regression:[a] Switched Banks v. Considering Switching

Variable	Coefficient	Wald value
TECHSTAB	–0.582	4.03**
NEWPROD	–0.382	1.46
SUCCESS	–0.126	0.12
YOUNG	–1.295	2.68*
SALESLG	–0.322	1.25
GROW	–0.406	1.08
DIFFDD	0.084	0.017
USEHPL	1.815	7.00***
PAYVL	0.451	0.49
CHSUP	–0.572	4.11**
BKEFF	–1.556	15.11***
MAN	1.280	1.93
SERV	0.916	0.97
CON	–0.693	0.35
Constant	13.45	7.98***
% correctly classified	83.78%	
Model Chi-square	63.34 (p = 0.0000)	

[a] Dependent variable is coded 0 = switched, 1 = considering switch.
***, **, * denotes significance at 1%, 5% and 10% levels respectively (two-tailed tests).

respectively). Overall, the estimated model appears well determined (model chi-square = 63.3, p = 0.000; 83.8% of observations correctly classified).[3] All the variables which proxy for information capture attract the hypothesised signs except the variable measuring firms' perceptions of their success (SUCCESS), which is negative but statistically insignificant. This finding is contrary to Sharpe's (1990) hypothesis that informationally captured firms are more likely to be superior performers. There is, however, some evidence in support of the informational capture hypothesis. TECHSTAB is negative and significant indicating that the degree of technological stability discriminates between firms which were considering switching banks (less stable) and those which had switched (more stable). Table III also reveals that, consistent with prior expectations, young firms (YOUNG) are significantly more likely to switch banks. The remaining information capture variables (NEWPROD, SALESLG, GROW), although exhibiting the hypothesised signs, are statistically insignificant.

In respect of the financing (credit rationing) variables, Table III shows that firms which were considering switching appear to be making more use of alternative sources of finance relative to firms which have switched. Consistent with prior expectations, variables indicating the use of alternative sources of finance (USEHPL; PAYVL) attract positive signs, although only USEHPL is statistically significant. It was hypothesised that firms which were considering switching and firms which had switched would be more likely to have experienced difficulty obtaining finance (DIFFDD) than firms which had not switched and were not considering switching. Consistent with this, the table shows that difficulty obtaining finance (DIFFDD) is not statistically significant in discriminating between firms which were considering switching and those which had switched.

The variable which proxies respondents' willingness to switch suppliers (CHSUP) is negative and significant indicating that, as expected, firms which switched banks exhibit an increased propensity for switching suppliers generally. Also in accord with prior expectations, firms which were considering switching banks were significantly more dissatisfied with the efficiency of their bank (BKEFF).

In line with previous research, Table IV presents the results for a logistic regression model for firms which had not switched and were not considering switching banks, relative to those which were currently considering switching (dependent variable coded 0 and 1 respectively). As anticipated, it reveals that the two key variables (in terms of statistical significance) are those (DIFFDD, BKEFF) which focus on banking relationships. Firms which were considering switching were significantly more likely to consider their bank was inefficient (BKEFF) and to have experienced difficulty obtaining finance from their bank (DIFFDD).

In addition, relative to those firms which had not switched and were not considering switching, those which were currently considering switching were characterised by significantly less technological stability (TECHSTAB) and were significantly more likely to use hire purchase and leasing (USEHPL). These results suggest that, on average, firms which are considering switching banks are characterised by a relatively less stable technological environment. Although the previous finding that switching firms operate in more stable

technological environments than their counterparts which are considering switching is consistent with the information capture hypothesis, it is difficult to offer an explanation why those firms which have not switched are more likely to operate in a more stable technological environment than those considering switching. However, this variable (TECHSTAB) may proxy for firm-specific factors (such as a higher demand for finance and/or other banking services) which are associated with an uncertain operating environment and hence, may be associated with a higher propensity to be dissatisfied with the current banking relationship.

This interpretation is at least partly consistent with the fact that Table IV shows that, relative to those firms not considering switching, those that were doing so were more likely to use alternative financing in the form of hire purchase/leasing (USEHPL). It should also be noted that, consistent with Ennew and Binks (1996), there is no significant evidence that sales growth (GROW), age (YOUNG), perceived success (SUCCESS) or firm size (SALESLOG) are significant discriminators between the two groups. Overall this model exhibits a high goodness of fit measure – largely in consequence of the banking relationship variables (DIFFDD and BKEFF) – and an overall classification accuracy of 84.8% (chi-square = 122.5; $p = 0.000$).

TABLE IV
Logistic regression:[a] No Change v. Considering Switching

Variable	Coefficient	Wald value
TECHSTAB	–0.331	4.90**
NEWPROD	–0.219	1.35
SUCCESS	0.081	0.13
YOUNG	–0.662	1.51
SALESLG	0.072	0.20
GROW	–0.046	0.066
DIFFDD	1.588	18.12***
USEHPL	0.897	5.55**
PAYVL	0.145	0.14
CHSUP	0.108	0.43
BKEFF	–1.228	34.31***
MAN	0.436	0.48
SERV	0.964	2.17
CON	–0.091	0.01
Constant	0.745	0.10
% correctly classified	84.76%	
Model Chi-square	122.49 ($p = 0.0000$)	

[a] Dependent variable is coded 0 = no change, 1 = considering switch.
***, ** denotes significance at 1% and 5% levels respectively (two-tailed tests).

Finally, to increase the degrees of statistical freedom and to test the sensitivity of the results when a different estimator is utilised, Table V presents the results of multinomial logit analysis where the three groups are analysed simultaneously (see Maddala, 1983). In interpreting the model, separate coefficients are generated for two of the three outcomes (switched bank and not switched bank) which are assessed against the third outcome (considering switching).

In general, the signs[4] on the multinomial model variable coefficients, together with their significance levels, are consistent with the binomial logit models. Table V shows that the multinomial logit model exhibits the same pattern of significant explanatory variables as the preceding binomial logit models and is again well determined (chi-square = 178.1, $p = 0.000$, overall classification accuracy = 77.4 %). Hence YOUNG, USEHPL, CHSUP, and BKEFF are all statistically significant discriminators between firms which had switched banks and those considering switching, and their coefficients attract the same signs (influence) and interpretation as the binomial logit model reported in Table III. However, although Table V shows that TECHSTAB exhibits its expected sign, it is not statistically significant whereas NEWPROD is now statistically significant and attracts its hypothesised sign – that is, firms which switched introduced new products less frequently than those which were considering switching. In addition, Table V reveals that, relative to those firms which were considering switching, those which switched were significantly more likely to operate in the manufacturing and services sectors rather than construction and distribution sectors.

The table also shows an identical pattern of significant variables (TECHSTAB, DIFFDD, USEHPL, BKEFF) to those in the equivalent binomial logit model (Table IV) in respect of those firms which were considering and those not considering switching banks. The signs on the coefficients of these variables are also consistent with the associated logit coefficients in the binomial logit models. Overall, therefore, the multinomial

TABLE V
Multinomial logistic regression model

Variable	No change v. considering change		Changed v. considering change	
	Coefficient	Wald value	Coefficient	Wald value
TECHSTAB	0.390	6.94***	0.084	0.17
NEWPROD	0.292	2.47	0.460	3.13*
SUCCESS	–0.091	0.68	0.190	0.38
YOUNG	0.749	2.04	1.312	4.19**
SALESLG	–0.024	0.02	0.186	0.73
GROW	0.065	0.13	0.304	1.38
DIFFDD	–1.621	19.23***	0.650	1.44
USEHPL	–0.851	5.25**	–1.149	5.27**
PAYVL	–0.215	0.33	–0.792	2.37
CHSUP	–0.068	0.19	0.431	4.68**
BKEFF	1.223	36.43***	1.415	24.92***
MAN	–0.265	0.66	–1.668	5.07**
SERV	–0.770	1.49	–1.829	5.67**
CON	0.084	0.01	–0.758	0.74
Constant	–1.981	0.68	–9.455	8.10***
% correctly classified	77.4%			
Model Chi-Square	178.14 (p = 0.000)			

***, **, * denotes significance at 1%, 5% and 10% levels respectively (two-tailed tests).

results support the binomial ones and the associated hypotheses tested.

Conclusion

The purpose of this paper has been to extend extant research by focusing on those factors which might explain why so few small firms switch banks in comparison to the high proportion which express an intent to do so. Following new hypothesis development in relation to information capture and credit rationing, the evidence presented in this paper suggests that, although dissatisfaction with the service provided or the finance available appear to be key factors associated with a firm considering switching banks, other influences (including information capture) appear to affect their ability or willingness to actually make the switch.

This study also found that firms which had switched banks displayed an increased propensity to switch suppliers generally, which might indicate that such firms face (or perceive) lower switching costs than other firms and/or are, *cet par*, more predisposed (exhibit less inertia) to change the suppliers of services. Furthermore, and in accord with Sharpe's (1990) hypothesis, relative to those firms which had switched banks, those which were considering switching appeared to face higher switching costs due to difficulties in conveying accurate information about their activities. These firms could therefore be described as "informationally captured".

In this context, firms will only be informationally captured when the costs of switching banks, including the costs of conveying an accurate picture of their performance to prospective bankers, outweigh the benefits. If the balance between the costs and benefits of switching banks change so that benefits outweigh costs, previously informationally captured firms are likely to switch banks. For firms which are considering switching because they are dissatisfied with the finance available from their bank, this could occur when alternative sources of finance are exhausted. The paper provided some new evidence in support of this proposition, in that firms which were considering switching banks made greater use of alternative sources of finance, in comparison to the other groups of firms.

It follows that some firms will resolve difficulties obtaining finance by switching banks,

whereas others will use alternative sources of finance depending on the balance for individual firms between the benefits of switching such as increased finance, and the costs of switching, including information provision. However, and contrary to Sharpe's (1990) hypothesis, there was no evidence that superior performing firms were more likely to be informationally captured.[5] Measures of success and growth were found to be statistically insignificant in respect of the switching decision. Clearly, successful and growing firms are likely to be seeking finance more frequently, and will therefore be more alert to the possibility of switching banks. They are also more likely to be the subjects of "cherry picking" by prospective banks, particularly where their success/growth is easily quantifiable. In consequence, they may perceive greater benefits from switching relative to the costs, albeit including a high informational cost of switching.

This research has highlighted that the increased provision and availability of information relating to small businesses is likely to result in benefits for the firms as well as finance providers, by reducing switching costs[6] and by enabling small firms to take advantage of optimal financing. Further research could examine these issues in more detail. In particular, interview research could investigate the motivations for switching or remaining with a bank more comprehensively. Longitudinal research could also examine the dynamics of bank switching by determining at what point firms which are considering switching actually make the switch.

Notes

[1] Sharpe (1990) is unspecific in defining "superior performance". Clearly, aspects of performance that are more difficult to observe are more likely to lead to informational capture. Firms in this study were therefore asked to provide their own rating of success relative to competitors.

[2] There is evidence that trade creditors and factors have advantages over banks in lending to informationally opaque companies because information is provided through a detailed trading history and a large number of transactions (Carey, Post and Sharpe, 1998; Mian and Smith, 1992; Wilson and Summers, 2000).

[3] Independent variables were tested for multicollinearity using bivariate correlations of all variables. These tests appeared satisfactory in that the maximum correlation coefficient between any pair of variables was 0.35 (for TECHSTAB and BKEFF).

[4] It should be noticed that the signs on both sets of coefficients in the multinomial model reported in Table V reverse sign relative to their counterparts in the binomial logit models reported in Tables III and IV. This results purely from the different specification of the dependent variables in binary logit models relative to the trichotomous coding for the multinomial model.

[5] As noted by a referee to this paper, Sharpe's hypothesis is not unambiguously rejected, since our study uses a subjective measure of performance which may be subject to small business owner's hubris. Further studies could examine this issue in more detail by including objective performance measures (e.g. from annual accounting data).

[6] In Italy, for example, small firms are much more likely to have multiple bankers and also switch banks more frequently (Holland, 1994; Berger and Udell, 1998). Ongena and Smith (2001) provide evidence on Norwegian firms and suggest that switching is more likely with multiple bankers, and profitable, smaller firms. Hence, greater competition amongst banks and lower bank concentration levels may reduce switching (particularly search) costs (Scott and Dunkelberg, 1999). Comparative studies would clearly throw more light on these issues.

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