MIC 2020
Management International Conference
Online Conference • 12–13 November 2020

Banking Concentration and Stability: the Effect on Borrower Discouragement for European SMEs

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Abstract. A deeper transformation of the European banking system has become an urgent priority in order to limit the effects of a new financial crisis. Policymakers are promoting more concentrated and stable banking systems. However, changes in the structure of the banking systems might have a deeper effect on small and medium-sized firms (SMEs) since, compared to large companies, SMEs are more dependent of bank financing. Besides being rationed, SMEs can suffer financial constraints if they are discouraged from applying the financing they need. Using multilevel methodology applied to a sample of 20,207 SMEs across 28 European countries we uncover the existence of an interesting interplay between the concentration and the stability of the banking system when explaining the existence of financial constraints. The multilevel methodology enables us to consider that financing decisions taken on by the same individuals at different occasions will tend to be more highly correlated than two measurements from different individuals. The LR tests provided in the result section confirm that the two-level model used in this paper offers a significantly better fit to the data than the single-level model. Results obtained with a mixed effects logistic regression show that the effect of banking concentration on discouraged borrowers depends on the stability of the banking system. The slope with which the likelihood of being discouraged increases following higher levels in banking concentration is much steeper for those SMEs operating in less stable banking system. Therefore, as the European banking system conquers higher levels of concentration, big differences in SMEs access to finance will start to emerge, and the situation of SMEs operating in less stable banking system will deteriorate. Moreover, we also find that micro firms are the ones that would suffer the most due to this process towards a more concentrated banking system. Our results show that micro firms are, compared to medium-sized firms, more affected by increases in the concentration of the banking system. These firms constitute a large percentage of European economic sector, with a key contribution to job creation, GDP growth, and innovation. We have to conclude that policy makers should take our results into account when thinking about the direction that the European banking system is going to take in the coming years. The current developing trend towards a more concentrated banking system should be taken with caution in order to preserve the core contribution that SMEs make to the European economy.

Keywords: SMEs, discouraged borrowers, financial constraints, banking system