Emerging Markets Review 9 (2008) 206–219

Contents lists available at ScienceDirect

Emerging Markets Review

journal homepage: www.elsevier.com/locate/emr

Syndicated loans in emerging markets

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A R T I C L E I N F O

Article history:
Received 5 April 2007
Received in revised form 3 March 2008
Accepted 17 April 2008
Available online 25 April 2008

JEL Codes:
G21
C25

Keywords:
Bank
Loan
Syndication
Emerging markets
Logit regression

A B S T R A C T

There has been a considerable expansion of the volume of syndicated loans in emerging markets in the recent years. We provide the first analysis of the determinants of the decision of banks to syndicate a loan on a sample of loan facilities from 50 emerging countries. We show the significant role of loan characteristics and of financial development, banking regulation, and legal institutions, in the decision to syndicate a loan. We support the efforts of authorities to increase banking competition and efficiency, and to implement binding banking regulation on capital requirement to promote the expansion of syndicated loans.

1. Introduction

In recent years the volume of syndicated loans in emerging markets has considerably grown from 9343 billion dollars in 1992 to 251,019 billion USD in 2004.[2] Today, syndicated loans represent an important source of external finance in emerging markets, corresponding in 2004, to more than 10% of the private credit of financial institutions in Malaysia, and more than 18% in Mexico.[3]

A syndicated loan is a loan for which at least two banks jointly grant funds to a borrower. In a nutshell, a lead bank establishes a relationship with the borrower and negotiates the terms of the loan agreement. This bank then finds participant banks which grant a share of the loan, receiving fees for this activity. There is

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2 These figures are based on computations from the authors on the Dealscan database. They are presented in Table 1.
3 These figures are based on computations from the authors, with figures on syndicated loans from the Dealscan database and with figures for the private credit by financial institutions provided by Beck et al. (2000).

1566-0141/$ – see front matter
doi:10.1016/j.ememar.2008.04.001

consequently one single loan agreement in which each member bank of the syndicate owns a separate claim on the debtor.

Banks can have several motivations to syndicate loans. First, syndication allows the diversification of loan portfolios. Second, it avoids excessive single-name exposure which can be prohibited by banking regulation, by still preserving the commercial relationship with the borrower. Third, it generates fee income for the lead bank, which can then diversify its income sources. Fourth, it allows banks suffering from a lack of origination capabilities in certain types of transactions to fund loans.

These motivations should however be put into perspective with the potential agency problems generated by syndicated loans. Indeed there exists an adverse selection problem as the lead bank, owning information unavailable to the participants, may syndicate loans with the less favorable information. Furthermore a moral hazard problem arises from the fact that all participating banks have fewer incentives for monitoring than one bank granting the full loan (Pennacchi, 1988).

Some potential benefits also exist for the borrowers. Indeed, according to Allen (1990) and Altunbas and Gadanecz (2004), syndicated loans are less costly than issued bonds in terms of origination fees, and than a series of bilateral loan agreements in terms of spread. Furthermore, in comparison to bonds, syndicated loans can be arranged more quickly and more discreetly than bonds.

The benefits of syndicated loans for banks and borrowers show that their expansion is important for economic development on emerging markets. On the one hand, this expansion contributes to enhance the sources of external finance and consequently favors investment in emerging countries. Because of the low development of financial markets in these countries, bonds are a limited alternative to bank loans for firms requesting large loans. Additionally, syndicated loans allow circumvention of bank's lending limits. Moreover, if syndicated loans reduce the cost of borrowed funds, they also contribute to favor the financing of companies. On the other hand, the expansion of syndicated loans increases the diversification possibilities for banks in terms of risk and income, which decreases the likelihood of bank failures. As a consequence, the expansion of syndicated loans contributes to financial stability, which is a fundamental issue for emerging economies.

Consequently, the expansion of syndicated loans contributes to the economic development of emerging countries, by encouraging financial development, which has been shown to favor growth (e.g. Levine, 2005 for a survey) and by reducing financial instability.

It is therefore of utmost interest to identify the determinants of a bank's decision to syndicate a loan. Indeed, these determinants provide policy-oriented advice for the authorities in favor of the expansion of syndicated loans, and therefore in favor of financial development and stability. These determinants also help explain the recent expansion of syndicated loans in emerging markets.

Former empirical literature on syndicated loans is relatively scarce, in spite of their recent boom following the generalized use of databases on syndicated loans. Most studies however focus on another issue: identifying the size and composition determinants of loan syndicates, all on developed economies. Nonetheless, three studies can be partly related to ours. Dennis and Mullineaux (2000) study the determinants of the decision to syndicate a loan with a sample of US loans. They support the positive role of several factors in this decision, with notably those related to the transparency of the borrower and the maturity of the loan. Furthermore two papers investigate syndicated loans issues for emerging markets. While Nini (2004) examines the participation of local bank in loan syndicates, Altunbas and Gadanecz (2004) study the determinants of loan pricing for syndicated loans.

Our paper is therefore the first research identifying the factors that comprise a bank's decision to syndicate a loan in emerging markets. With this goal, we will test the role of several loan characteristics along the lines of Dennis and Mullineaux (2000). However, we will investigate the role of country-level variables for legal environment, financial development and banking regulation, thereby extending their analysis. Indeed, there is substantial evidence that institutional framework plays a role in bank behavior (e.g. Qian and Strahan, 2007), which suggests the potential role of these country-level variables.

The rest of the article is structured as follows. Section 2 presents some features for the loan syndication process and the syndicated market in emerging economies. Section 3 discusses the tested determinants of the decision to syndicate the loan. Section 4 presents data and variables, and Section 5 displays the results. Section 6 provides our conclusion.