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Are current syndicated loan alliances related to past alliances?

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Abstract

The odds of a current syndicate relationship between two lenders depend upon their previous alliances. The odds are significantly higher [lower] and strongest for a current lead–participant relationship with a continuation [reversal] of their previous roles. To illustrate, the odds are nearly four times higher when two lenders have allied in the previous 5 years. The strength of lead–participant syndicate relationships between two lenders with same-ordered roles is most sensitive to the lead bank's reputation and informationally opaque participants tend to have stronger relationships with lead banks. Lenders exhibit home bias in their syndicate alliances since ongoing relationships are stronger with domestic counterparts.

JEL classification: F30; G20; G21; N20

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1. Introduction

The syndicated loan market is an important source of financing for large and medium-sized companies based on global transactions totaling three trillions dollars (Loan Pricing

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Corporation). This market is becoming more transactional in nature, with qualities typically associated with public capital markets, such as the availability of loan ratings and participation by non-banks.[1] However, this trend away from the traditional bilateral lender–borrower relationship does not diminish the importance of lender–lender relationships. The sustainability of the syndicated loan market relies on a complex network of international ties between financial institutions.

While most inter-bank relationships are not observable to outsiders, loan syndicates represent visible manifestations of bank interactions that can be studied. The expanding literature on syndicated loans ranges from syndicate composition to agency problems, but little is known about the underlying relationships behind this activity. Except for a paper by Sufi (2007) whose development appears to coincide with our paper, most of the research concerning the dynamics of alliances in general is theoretical and hypothesizes (logically) that banks repeat syndicate alliances with other financial institutions.

Given this deficiency, the purpose of this paper is twofold: first, to examine the impact of past syndicate alliance relationships on future alliances based on activity over the 1987–2004 period; and second, to examine the factors influencing the importance, or weight, of an alliance between two lenders, such as the significance of home bias, legal system and religion.

This paper contributes to the syndicated loans literature by providing additional evidence regarding the nature of ongoing relationships between syndicate members. The evidence presented herein differs from and, in some ways, improves on the similar case made by Sufi (2007) who contends that previous relationships between the lead arranger and potential participants do affect future alliances between the lenders. Dealing with the full spectrum of internationally domiciled (including US) borrowers as opposed to US-only non-financial firms (as in Sufi) allows us to examine what role domesticity, legal systems, state of country development, regional (multi-country) lender diversification, etc. play in the ongoing relationships between syndicate members. In that vein, we find that the strength of the relationship between two lenders is positively related to the reputation of the lead bank and increases when the two lenders are from the same country. Specifically, the weight of the relation increases by 20.6% for every 1% increase in the lead's market share and by 1.7% when both the lead and the participant are from the same country. The latter finding concurs with the literature on home bias which reports that investors, for example, are more likely to overweight in domestic securities. The strength of the relationship is also negatively related to the informativeness of the participant in the syndicated loan market.

This paper also finds that syndicate lender participation is just as strongly determined by previous lead–participant (same-role-ordered) relationships as by borrower–participant relationships, whereas Sufi concludes that the former relationships are relatively less influential. In our view, this discrepancy may arise from differences in the geographical range of the samples or in the measurements of the variables. To be specific, Sufi's conclusions more likely apply to loans advanced to borrowers within the same country (particularly those made to the US borrowers selected in his study) than to loans advanced to borrowers from different countries (selected in our study). Furthermore, Sufi bases his conclusions

[1] Yago and McCarthy (2004) examine the characteristics and developments of the primary and secondary syndicated loan markets in the US. Jones et al. (2005) provide an excellent review of trends in this market.