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A Model of trust between Branch Managers and Loan Officers of Indian Banks

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Abstract

The lending climate for banks in India is very different from those in western countries. Banks in India undertake many additional risks when they lend to customers . Also, there are a number of impediments for banks in India for recovering their loans. Some of these impediments have been put in place due to the government policies. Others have been created due to lack of proper legal protection to banks. The instrument based quantitative methods have limitations in evaluating the lending risk for banks in India because instrument based methods use variables which cannot be accurately described and measured by banks. A social risk evaluation is therefore more appropriate for risk evaluation and reduction by banks in India. This study focuses on one specific aspect of lending relationship - the relationship between branch manager and loan officer of bank branches in India. A social risk evaluation approach is used to describe this relationship. A model based on trust theory is developed which help in understanding and reducing the lending risk by Indian banks. Trust factors that help in determining this relationship are identified and the suitability of each factor is discussed.

Key words: Banking, Trust, Lending, Indian bank,

Introduction

Banks undertake risk when they grant a loan - the risk that the borrower may not honour their debt commitments according to the terms and conditions specified in the loan contracts. The probability of default on the loan to the borrower depends on the quality of risk evaluation by the bank. To deal with risk, banks have created several methods of risk evaluation. The two main approaches to credit risk evaluation by banks are-the instrumental or quantitative approach and the qualitative approach. The quantitative approach relies on formal rules and variables that help in assessing the clients' solvency and the probability of default of a loan. Borrower's characteristics such as age, income, activity, previous borrowing record are related to the probability of default. The problem with instrumental approach is that the variables used to construct quantitative models are based on the information that could be subjective. The second problem is that quantitative methods are based on accounting data and information. In a business situation the entrepreneurs use many other inputs such as past experience, training, goodwill and relationships which contribute to business profits. Additional risk is created for banks when the state intervenes in the regulation of credit activities by banks. The example of lending to Small Scale Industries (SSI) in India is considered below to illustrate this intervention by the state. According to a study by the Federation of Indian Chamber of Commerce and Industry (FICCI, 2004) SSI units in India face the following problems in obtaining credit from banks.

1. *Delay in loan sanction and disbursement*

   The paperwork and formalities required is a big impediment in the obtaining credit. Banks need to address this issue. According to the FICCI(2004), 20% of SSIs found that obtaining credit from banks is extremely difficult and 59% of SSIs find it moderately difficult. Only 21% of SSIs find it easy to obtain credit from the banks.

2. *Lack of transparency in sharing information*

   It is observed that 50% of SSIs whose credit applications were rejected by the banks were not provided reasons for the rejection of the application. Information relating to the credit appraisal of SSIs done by banks is kept confidential. An appropriate feedback from banks to the applicants of rejected applications about performance, rating parameters and reasons for not granting loans will help the small businesses in obtaining credit facilities better.

3. *Inadequate discretionary powers with banks*

Powers delegated to branch managers responsible for sanctioning loans to SSIs are observed inadequate. Most decisions are not taken at the branch level and approval takes a lot of time. A greater devolution of authority to branch managers would help in SSIs obtaining decisions on credit applications faster. As the branch managers are generally overworked with responsibilities, loan officers in the specified branches should be made responsible for the loans to SSI units. These loan officers will speed up the process of loans under the discretionary limits delegated to branch managers.

4. *Collateral security arrangements*

There are no formal guidelines from the Reserve Bank of India to the banks in regard to the collateral security to be insisted upon by the banks when they want to advance a loan to SSI unit. Different banks have different policies in this regard. Some banks insist on collateral free limit for the loan up to Rs 5 lacs whereas others insist on a collateral free limit of Rs 15 lacs. In many cases SSI units with good track record of loan repayment have to pledge a collateral security.

5. *Inadequate publicity given to various schemes and facilities provided by banks for SSI units.*

Information on various schemes in place such as collateral free and composite loan schemes is not available to majority of the SSI units. Nearly 70% of the SSI units feel that the banks are not giving adequate publicity to various schemes to SSI units. As such SSI units are not able to take advantage of the same. The management of the SSI units have demanded that information on all loan schemes pertaining to the sector be made available to them and the banks should interact regularly with customers by way of mailers and brochures and keep them updated.

6. *Operational issues*

A number of operational issues have been suggested in regard to the loan operation of the bank branches. Some of these issues are:

a. The frequency of the compounding in relation to the interest charged has been increased from quarterly to monthly. This has the effect of increasing financial burden on these businesses. The processing fee is charged by the banks even on limits not sanctioned. The same needs to be paid with the application.

Most of the bank branches do not have FOREX facilities. This proves to be a burden to the SSI exporters as they receive payment in foreign currency.

b. In computing maximum permissible bank finance, banks give a lot of weight to stocks. This methodology adversely affects those SSI units which keep minimum stocks through efficient inventory management. These units may have higher outstanding amount of accounts receivable.

c. It is suggested that the time taken for collection of cheques deposited with the banks takes considerable time. It takes on the average a week for clearance of local cheque and nearly 10 days for the realisation of interstate cheques. The SSI units want that if the delay in collection of cheques takes more than 3 days then banks should pay interest to the client on the amount outstanding for the time taken in excess of 3 days.

From the representation of FICCI to the Government of India, it is observed that expectation of industry in India in regard to the credit dispensation is very different from those in western countries. Industry organisations expect the regulator and the central bank to intervene in various lending situations which are considered to be in the domain of the lender in western countries or are considered as a part of negotiations between lender and borrower.

In order to deal with many problems outlined by FICCI and in order to develop a focused policy, the Government of India has examined the issue of delivery of credit to SSI sector in India. A number of committees and study groups set up by the Government of India have recommended various policy initiatives for delivery of speedy credit to SSI sector. Based on these recommendations, the Reserve Bank of India (2005) has adopted certain policy guidelines in delivery of credit to SSI sector. Each of these policy initiatives has implication for the credit risk of the lending bank. Some of these initiatives help in reducing the credit risk for the bank whereas other initiatives increase the credit risk for the lending bank. A discussion on the policies adopted and their implication for lending banks, is given below.

1. *Credit to small scale industry is ensured as part of the priority sector lending banks are required to compulsorily ensure that defined percentage (40%) of overall lending is made to priority sector. The SSI sector is included as one of the groups in the priority sector. 40% of 40% or 16% of total lending is assigned to SSI sector.*

By specifying the quantum of credit that a bank has to lend to SSI units, the Government has diluted the norms the bank could use in assessing the quality of credit. The bank working or achieving within these norms will face an increase in its credit risk because the borrowers with low credit rating will also be financed by the bank.

2. *Earmarking of credit to sub-sector within overall lending to small scale industries. For example, credit to tiny sector within SSI sector.*

Earmarking of credit to sub-sectors within overall SSI sector also has the potential of allowing borrowers with poor credit rating to obtain loans from the bank. This again has the potential of increasing credit risk for the bank.

3. *Small Industries Development Bank (SIDBI) was set up to refinance term loans provided by Scheduled Banks and State Financial Corporations to SSI units.*

Refinance of term loans helps bank in obtaining certain percentage of loan granted to SSI borrowers, back from SIDBI. The bank can reinvest this money in other loans and thereby increase its income. As the ultimate responsibility of recovering the credit remain with the bank, (and not SIDBI) there is no risk reduction of bank through the refinance facility. The risk for banks increases because SIDBI's refinance support has many conditions. This support also creates a moral hazard problem for banks and customers.

4. *Loan limits for composite loans and working capital (for example, collateral free loan up to Rs. 10 lacs.*[*]

By providing collateral free loans up to Rs.10 lacs to specified borrowers, the bank increases its credit risk as the bank may not able to recover all or part of the loan in case of default.

5. *Launch of Credit Guarantee Fund to cover loans up to Rs. 25 lacs.*

The Credit Guarantee Fund was established to refund a part of defaulted loan to the bank against fees by the bank. The Credit Guarantee Fund serves as insurance against default by SSI units. In case of default the bank can recover a part of the loan from Credit Guarantee Fund subject to a limit of Rs 25 lacs per borrower. To the extent that the bank obtains its amount in default from CGF, the credit risk of the bank is reduced. But the provision of Guarantee Fund also induces a moral hazard problem. The availability of CG Fund reduces the incentive for the bank to assess and monitor its loans properly. Similarly, the borrowers are also inclined to undertake risky business activities because they rely on Credit Guarantee

[*] 1Lac = 100,000.
1 Crore = 10,000,000.

Fund to pay for the amount in default. As such the combined impact of availability of CG Fund on risk is difficult to quantify.

6. *Launch of Credit linked subsidy scheme to provide subsidy against loans taken for specific purposes such as technological upgrade.*

The subsidy is provided to the borrower by the Government for specified purpose. The subsidy is used to repay a part of the loan amount and is paid directly to the bank. This help is reducing the credit risk of the bank. Availability of subsidy can also result in reducing the quality of credit assessment, which in turn can increase the risk for the bank.

7. *Opening of specialised SSI branches*

The purpose of opening specialised SSI branches is to provide speedy credit to SSI units. These branches are provided with specialised staff such as engineers who are in a position to evaluate loan applications from SSI units at the branch level itself. These branches also have access to data and other inputs for assessing loan applications as well as monitoring the borrowers. The provision of specialised staff helps in reducing the credit risk for the bank. On the other hand, SSI branches receive lending targets from the Head Office of the bank and the Government in regard to loan levels (number of applications disbursed and rupee amount of the credit). In order to achieve the credit the branches may be forced to dilute their assessment criteria. If the assessment criteria are diluted, this may lead to risky loans, increase in bad debts and increase the credit risk for the bank.

8. *Initiation of adequate powers at regional and branch levels. Sensitisation of branch managers towards working of the SSI sector*

Initiation of adequate powers at the regional and branch level lead to speedy credit decisions by regional managers and branch managers. This helps in reducing the time and cost of lending, specially the cost of assessing the loan applications and monitoring the borrowers.

Sensitisation of branch managers, in political parlance means putting pressures on the branch managers to conform to the government policies, external administrative and political pressures from government agencies, local politicians and administration. These kinds of pressures lead to the dilution of credit norms and consequently increase the credit risk for the bank.

9. *A cluster based approach to SSI sector.*

The purpose was to make available appropriate information for risk management and monitoring of lending institution

The cluster based approach to lending involves identifying specific clusters of SSI units and providing loans to SSI units in these areas. The clusters are located in areas where the population of SSI units engaged in specific type of activity is large such as hosiery manufacturing in Ludhiana or woollen garments in Amritsar. The advantage of cluster based financing is that specific information about particular units are available easily and other inputs for manufacturing is also available in those clusters. This helps the lending bank in managing their credit risk by having access to information. The bank is also able to reduce its monitoring cost of borrowers because borrowers are located within particulars clusters, which makes monitoring easy for the bank.

10. *The SSIs linked as supplies and service providers to large industries are usually successful ventures in India and need more attention.*

When SSI units are linked to large units as suppliers, service providers, they provide input to large industries by way of raw material etc. The large units provide selling opportunities to SSI units. The disadvantage to SSI units in this arrangement is that SSI units have very limited power against large units when they enter into contractual arrangements with large units. If the large customers of SSI units do not pay in time, there is very little that SSI units can do to force large units to honour the contractual terms. All the same linking with large units help in reducing the costs of SSI units. Some large units also provide help to ancillary SSI units in modernisation/technological upgrading/market information etc. For a lending bank, this kind of relationship between a large unit and SSI unit is helpful in reducing the credit risk for the bank when they advance money to SSI unit. Banks can stipulate terms and conditions of loan agreements with SSI units which can facilitate easy recovery of bank loan given to SSI units.

11. *The Credit Information Bureau of India Limited (CIBIL) was established in 2001 to serve as an effective mechanism for exchange of information between banks and financial institutions.*

CIBIL is not involved in developing database on all SSI units. CIBIL provides information which is already available with the banks. Lending bank has still to rely on the branch manager and loan officer for obtaining information which would lead to a credit decision. CIBIL's working does not help the lending bank to reduce its credit risk to a large extent.

From the above we can see that some of the policy initiatives of Government of India help in reducing the credit risk for the banks whereas others help in increasing the credit risk for the banks. The increase in credit risk is evidenced by the large number of non-performing assets of the banks in India, specifically in the public sector. The reduced profitability of public sector banks as compared to private sector banks and foreign owned banks in India can also be explained due to the increased credit risk of public sector banks which are forced to follow the government credit norms.

The net increase in credit risk is evidenced by the large number of non-performing assets of the banks in India, particularly in public sector banks. The reduced profitability of public sector banks as compared to private sector banks and foreign owned banks in India can also be explained due to the increased credit risk for public sector banks, arising from the government credit norms.

The lenders in India do not have the same level of legal protection as the lenders in the western countries. The financial law is not very developed. In addition, the enforcement of financial contracts through the legal system is very time-consuming, costly and cumbersome. According to the study by the World Bank Group (2006), ease of contract enforcing is critical to encourage business relationships, generate confidence in business transactions and in the event of default, enforcing threat points in contracts. According to this study, India rates poorly on the all the indices of investor protection through the legal system. The banks in India face additional risk due to lack of legal protection in enforcing contracts, as compared to western banks.

In emerging economies like India, many additional variables which play a significant part in the risk evaluation process for banks as compared to western banks. The effect of these variables cannot be easily quantified and modelled. A bank trying to use a quantitative instrumental method of risk evaluation will need to define, quantify and measure these variables to a great degree of accuracy. The accuracy of the bank's risk evaluation process will depend on the quality and reliability of this risk measurement. Therefore the quantitative instrumental based methods of risk evaluation have limited use for banks in emerging economies such as India.

Ferrary (2003) has analysed the decision making of granting credit in banks using a social risk evaluation process. Using the example of French social networks, Ferrary (2003) argued that banks can reduce their credit risk by participating in these networks. Banks through social networks can improve the quality of risk evaluation by developing personal relationships and trust with the borrowers. Ferrary (2003) examined the trust relationship between loan officer (financial counsellor) and the borrower. In addition to a loan officer, the branch manager of the bank branch also plays a crucial role in managing the credit function at the branch level which includes taking credit decision and risk evaluation. The relationship between a branch manager and a loan officer therefore determine the quality of risk evaluation that a bank will achieve in its credit assessment, evaluation and risk management. This paper focuses on the relationship between a branch manager and a loan officer of bank branches in India. The purpose of the paper is to study the role played by both of them in lending relationship and to identify the factors that help in developing trust between them.

Nature of relationship between a branch manager and a loan officer

Branch managers of a bank branch are the leaders and chief executives at the local level. They are responsible for the profitable operations of the branch. Branch Managers approve loan requests within their delegated authority. This approval is done based on the evaluation of loan applications by loan officers. Sometimes a branch manager may delegate their lending authority to a loan officer for temporary period. When a branch manager delegates this authority to a loan officer he or she may take a considerable risk. If the loan officer does not use the delegated authority in accordance with the bank's policies and procedures, branch managers may be held accountable for any mistakes committed by loan officers. When loan officers assume the authority of branch managers on delegation, they also undertake a risk. If the loans are not approved according to the bank's policies and procedures, branch managers may refuse to confirm the actions of loan officers. In such an event, the loan officers may be held personally accountable for any lapse of judgment. Neither the branch managers will delegate their authority to loan officers nor the loan officers, will assume their delegated authority unless there is a trust between the branch manager and the loan officer. Trust between the two becomes a very important part of the relationship.

The agency theory (Jensen and Macklin, 1976) has been used in finance literature to describe economic relationships. The agency theory has limitations in describing the relationship between the branch manager and the loan officers of a bank branch because this relationship has different dimensions from a simple principal-agent relation. One, the branch manager is a superior officer whereas the loan officer is a subordinate officer. Therefore the relationship between a branch manager and a loan officer has elements of superior subordinate relationship. Both the branch manager and the loan officer operate in a risky environment. Sometimes they may act independently, while at other times the branch manager may delegate authority to the loan officer. When a branch manager delegates his or her authority to a loan officer, the relationship between the two will involve issues relating to the delegation of authority (principal–agent relationship). Both the branch manager and the loan officer are accountable to the Head Office of the bank and senior management, for their decisions. Both work as agents of the bank, which is a common principal. The bank is a hierarchical organisation and both these functionaries interact with other employees of the bank in a group while performing their individual responsibilities towards the bank. Therefore, the relationship between the branch manager and the loan officer is more complex than a principal agent relationship as observed in the finance literature. The nature of their relationship, however, puts them in a risky situation when trust becomes important.

Trust in Banking

Most of the literature on lending relationships that includes trust focuses on lending relationship between a bank and its borrowing customer. The first study by Lehman et. al (2001) in this regard provides an empirical analysis of bank lending to small and medium-sized firms in Germany. This study provides evidence that loan rates do not depend on the duration of the lending relationship. The availability and terms of loans are not only influenced by firm characteristics and credit risk variables but also by social interaction between a loan officer and a firm manager. This social interaction may indicate mutual trust as advantageous to both the borrower and the bank. These findings represent facts about the German banking system. Further the variables used in this study were not able to capture the social dimension of the lending relationship. There are other studies on lending relationships which focus on trust between various players in a lending situation but deal with other elements of this relationship. For example, Mayer’s study (1988) suggests that countries like

Germany, with a bank based financial system have experienced higher economic growth than countries with more advanced and competitive financial markets. Close ties between the banks and the corporate sector enhance the availability and reduce the costs of loans to the firm. Petersen and Rajan (1994) showed that the bilateral credit relationship between a bank and its customer is considered as enduring when both parties have dealt with each other for some time and expect to continue to do so in future. The bank-borrower transactions are not standardized. The signing of a loan contract does not represent an end of relationship between the bank and the borrower. Many events could occur which can alter the bank's cost of providing the credit as well as the borrower's willingness to repay the loan. The end of relationships by the borrower can convey a negative signal about bank's quality to outside parties. Sjorgen (1994) has provided a theoretical framework to study the merits of lending relationship using neo-institutional theory. Their study provides a framework for change of perspective from neoclassical interest in the quantitative, strictly economic aspect of the capital market to those of a qualitative, organisational and social nature of the relationships. The U.S. study of Petersen and Rajan (1994) on relationship lending, focuses on effects of various transaction variables on the duration of firm's relationship with the bank or banks increases. Burghoff's (2000) German study on relationship lending of banks suggest that German banks are more concerned about the behaviour of the borrowing firm's insiders in making their credit assessment about the firm as compared to its investment program.

The studies of Lehman et. al (2001), Mayer (1988) and Burghoff (2000) suggest that the continuing relationship between the bank and the borrowing customer is beneficial to the bank and the customer alike and that the quantitative variables used by banks in their credit evaluation process are not enough in credit risk management. Banks have to look into social interaction between the bank and the borrower in order to reduce the credit risk for banks.

Ferrary (2003) has analysed the decision making process of granting credits in bank and raised questions about the nature and role of trust in economic situations. From the analysis of actual practice of loans granted in banks in France they conclude that the creation of trust relationship is not about the altruism of the economic agents but that trust relationships correspond to a certain kind of optimisation. The bank‘s counsellor grants credit because establishing friendly relationships with client allows the bank to gather information to reduce moral hazard that such a decision would otherwise represent to the creditor. Trade based on trust relationships do not exclude the economic rationality of the contractors but presupposes

another kind of economic rationality. This rationality is based on a different temporality and different social space. The financial counsellor does not want to make a one-time profitable transaction with an individual but instead seeks to create a profitable long-term relationship with a social group. Ferrary (2003) has used the notion of social capital, social networks and trust to define this framework for analysing lending activities. By analysing the process involved in the financing of Parisian Breweries in 1980s, Ferrary (2003) tried to show that information gathered through social networks allows better risk evaluation than an instrumental evaluation used by banks. Ferray's conclusion may be summarised as follows:

1. *Scientific methods of risk evaluation and institutional devices intended to warn of risks of the borrowers' failure are insufficient to efficiently reduce the risks taken by bankers in their lending activities. The incompleteness of contracts induced by weaknesses of the instrumental methods of risk evaluation and the limits of the institutional protection devices used by lenders can be solved by the quality of social bonds between the financial counsellors and the borrowers. The greater the density of the interpersonal relationships the greater the access to information, which is inaccessible in the framework of strict professional relationships. Trades are facilitated by a relationship of trust when information held by each contractor through informal relations reduces the moral risk that is inherent in trades and creates positive expectation about the transaction by the actors.*
2. *To reduce the inherent uncertainty in the risk evaluation and to compensate for the limits of instrumental methods and institutional devices, financial counsellors use a social risk evaluation. This evaluation, correspond to the acquisition of information through informal relationship based on trust. To be efficient in their job, financial counsellor must accumulate social capital by exceedingly strictly professional relationships with borrowers. They must develop friendly and informal relationships with their clients and other economic actors. The quality of the social risk evaluation and the reduction of information asymmetry depend on the quality of social capital held by the financial evaluator, notably the extent of his integration in social network which underpin the economic activity he evaluates.*
3. *Banks are aware of the limits of the instrumental methods of risk evaluation and the efficiency of the social evaluation. Consequently they have modified their management practices and their work organisation to allow their financial*

counsellors to accumulate social capital and to integrate social networks. (Ferrary, 2003, p.674-675)

Ferrary (2003) sets certain conditions of trust bond in a trade relationship for banks as follows:

1. *The geographical proximity of the contractor. Geographical proximity is the first condition that is needed to establish an interpersonal bond of trust because such proximity improves the quality of the interpersonal relationship. The risk evaluation is a mix of accounting information, subtler information gathered and subjective understanding of that information. The importance of physical proximity for establishing a trust bond with small businesses gives a competitive advantage to banks that are close to borrowers.*
2. *The need for long-lasting relationship. A long lasting exchange relationship reduces the costs of access to information because it allows mutual apprenticeship between contractors. It is the regularity of the relationship that produces information. The financial counsellor and the entrepreneur have a mutual interest in creating a reservoir of relationship and shared knowledge. The more the borrower gives the information to prove his honesty, the more the banker gives him the best financial conditions. The length of time over which the trust relationship has been pursued, is important for establishing a trust relationship because time is necessary to allow for information sharing between contractors.*
3. *The need to modify the nature of professional relationship. The nature of the relationship also has to evolve to create an intuiti personae between contractors. The best financial counsellor strengthen their professional relationship by informal and friendly exchange. Beyond the technical competence, the financial counsellor is required to have exceptional relational qualities. Without intuiti personae, the ambience of trust which is absolutely essential for a good development of the activity cannot be established (Ferrary, 2003, p.684-686) .*

Ferrary (2003) questions the wisdom of using the conventional economical rationality and scientific methods of risk evaluation based on quantitative risk evaluation models. He advocates the utility of trust based relationship in reducing the uncertainty in risk evaluation by banks. He argues that the trust relationship is also a form of economic rationality, not altruism. Banks and borrowers are able to reduce their cost of operation by having a trusting

relationship. The use of trust has helped banks in France reduce their credit risk in lending. Ferrary's paper is however based on the lending relationship between a bank's financial advisor and their customers. The present study differs from the study of Ferrary in that the present study focuses on trust relationship between a branch manager and a loan officer of bank branches, which is another important relationship in the lending decision by banks. Ferrary's study recognises that banks operate in a risky environment when they lend money and recognise external risk as a part of bank's operations. Ferrary has however not proposed any model of trust relationships in the banking context nor has he identified any trust characteristics that are required by actors in a trusting relationship in a banking environment. His study focuses on the trust relationship between a financial advisor and a customer which is only one dimension of the relationship. This study focuses on the other important dimension of trust relationship – the relationship between a branch manager and a loan officer – which is more important from the perspective of the bank because these actors in the lending relationship have a continuous input into the credit management of the bank and consequently play a much more important role in credit risk management as compared to customers. Ferrary's study is also a limited study in the context of the French banks.

The Present Model

The theoretical model of Mayer et. al (1995) is modified to develop the present model of trust between a branch manager and a loan officer of bank branches. This model is described in Figure 1. The key concepts of the model are as follows.

1. A branch Manager and a loan officer develop a trusting relationship due to credit risk caused by the external environment. The parties involved have propensity to trust and develop trust due to the risky situation they are involved in.
2. Trust is based on a number of key factors – similarity, benevolence, behavioural integrity, behavioural consistency, communication, ability and culture. Culture is identified as an important aspect of trust in Indian context.
3. The risk caused by external environment leads to development of trust and trust leads to risk taking in relationship. The higher the trust in a relationship the more is the assumption of perceived risk.

Risk

The first key concept of the model is the assumption of risk. Shemwell, Cronin and Bullard (1994) have found that the trusting relationship helps in reducing the level of perceived risk in a relationship. The definition of risk developed by Sitkin and Pablo (1992) is used here. According to them risk is the extent to which there is uncertainty about whether potentially significant or disappointing outcomes of a decision will be realised. In their opinion, risk exists due to outcome uncertainty, outcome expectation and outcome potential. It is however necessary to differentiate between the risk due to external environment to which actors in a trusting relationship are exposed compared to risk arising due to a trust relationship. In a lending situation, both branch manager and loan officer are exposed to risk from external parties when they loan to customers. This risk from external parties occurs irrespective of whether there is a trusting relationship between branch manager and loan officer. The previous models of trust do not incorporate this element of risk, which is specific only to lending situation. The present model on trust considers this financial risk as an important part of the trust model.

Trust factors

In order to develop trust, the trustee and the trusted need to have certain characteristics. These characteristics have an impact on the trustworthiness of an individual. The following trust factors have been included in the present model - similarity, ability, benevolence, behavioural integrity, behavioural consistency, communication, and culture. The relevance of each of these factors for the development of trust between a branch manager and a loan officer is discussed below.

Similarity

Creed and Miles (1996) and McAllister (1995) have discussed the impact of similarity on willingness to trust. Individuals are more willing to trust other individuals who exhibit similar characteristics to their own. A branch manager of a bank will be more willing to trust a loan officer whom he or she perceives to have similar characteristics as his or her own. Lehmann et. al (2001) suggest that in the initial stages of a relationship individuals prefer to assume similarity because operating from the position of a trust is far easier than from the position of distrust in the initial stages of a relationship. Starting with initial distrust could make the

development of trust very difficult later on as individuals may gain bias. Similarity can exist in a number of ways such as similarity of race, religion, culture, language or personal characteristics as an approach to work.

Ability

The ability or competence is one of the essential characteristic for the development of trust in a risky situation as that of lending in a banking environment. Since lending involves taking risk, the assumption of risk without the competence of trusted person can increase the risk. Mayer et. al (1995, p. 717) define ability as *"the group of skills and characteristics that enable a party to have influence within some specific domain."* Skills related to the job performance, is an essential component of the ability. Wintoro (2000) has studied the importance of ability on trust developed in financial markets. Some authors have used the term competence instead of ability although both would take into consideration the skills required in job performance (Butler, 1991: Rosen and Jerdee, 1977).

The characteristic of ability in subordinates has been studied in different contexts. For example, Butler and Cantrell (1984) in their study involving undergraduate management students, investigated five determinants of dyadic trust, one of which included competence, by asking respondents to rate the level of trusts they would have in a variety of hypothetical bosses and subordinates. Butler and Cantrell conducted two experiments. The first experiment explored whether a respondent would trust a hypothetical boss and the second experiment utilising similar methodology dealt with trust in hypothetical subordinates. Across both the experiments it was found that the competence of subordinates was a determining factor of the level of trust that would be placed in an individual. The competence was found to be the most important factor in determining the trust. But laboratory experiments would not present the same level of risk as the actual job situation.

Wintoro (2000) has examined the characteristics that help in development of trust by studying the extent to which the Indonesian trustees of Pensions Funds would be willing to trust the Investment Fund Managers. The ability in this context was defined to be the effort of Indonesian Fund Managers in improving the performance or maintaining the performance of the Fund. He concluded that the ability of the investment manager is important to the trustee because the reason for the trustee to hire a fund manager is to receive benefits from the relationship in the form of return on investment and transfer of knowledge. These benefits could be realised if the investment manager has a great degree of ability in active investment management. The ability was further expressed by the trustor (Indonesian Pension Fund

Trustees) as being the expertise, reputation, performance, knowledge and experience. Their investigations were limited by the fact that the ability could only be measured by the performance record of the investment managers, investment qualifications, the number of years of investment experience of the investment managers, the information used to support his or her decision, and recommendations of other trustees. Wintoro's findings were the confirmation of other studies of Swan, Trawick and Silva (1985), Moorman, Deshpande and Zaltman (1993) and Stewart (1998).

In the context of the branch manager-loan officer relationship, ability would mean knowledge and competence on how the loan function is performed. A loan officer would be required to have knowledge about the various policies and procedures of the bank, analytical techniques, legal knowledge, knowledge about people, place, customers etc. In the context of branch manager, it would also include ability to take decisions, resolve conflicts and handle unforeseen situations.

Benevolence

Mayer et. al (1995) has defined the benevolence as the extent to which a trusted is believed to want to do good to the trustee. Benevolence is the good in addition to the profit motive that needs to be done or that the trusted is inclined to do. It suggests that the trusted has some specific attachment to the trustee. A person who is viewed as benevolent is seen as more trustworthy than others. There is a positive intent attached to the benevolence. According to Mayer et. al (1995) benevolence is an integral part of trust. McAllister (1995) has decomposed the act of benevolence into three actions – being considerate and sensitive to the needs of others including employees, protecting the interest of others and not exploiting the interest of others. A manager is likely to be considered benevolent when they do not exploit their subordinates to further their own interest, protect their subordinates and remain considerate and sensitive to the needs of their subordinates. According to Velez (2000) when managers engage in these actions, they are perceived to be loyal and benevolent. Benevolence from this perspective highlights both confident expectations and willingness to take risk. In his study of Indonesian Fund managers, Wintoro (2000) found benevolence as synonymous to concern for returns on investments, concern for providing good investment services, the willingness to transfer knowledge, concern for cost of transactions paid by the Pension fund trustee and avoiding the possibility of using the information for personal gains. The trustee could only measure the benevolence of investment managers based on the number and quality of investment services provide the investment team of the investment

manager and other trustee's recommendations. For the purpose of this study, the definition of benevolence provided by Velez (2000) in regard to the action of managers in protecting the interest of subordinates, not exploiting the subordinates to further their own interest and remaining considerate and sensitive to the need of their subordinate is more appropriate and will be used here because the relationship between the branch manager and loan officer is also a subordinate-supervisor relationship unlike an investment manager-pension fund trustee relationship, which has elements of principal-agent relationship only.

Behavioural Integrity

The behavioural integrity is defined as the extent to which the manager act consistently with what he or she says and adheres to the agreements. Behavioural integrity has been identified as a category of behaviour that influence employees' perception of managerial trustworthiness. Mayer et al (1995) suggest that issues as the consistencies of the past action, credible communication about trustees from other parties, belief that the trustee has a strong sense of justice and the extent to which the parties' actions are congruent with his or her words are part of behavioural (p.719). The studies by Gabaro (1978), Butler and Cantrel (1984) and Shaw (1997) have concluded that a person gains trust from others by explaining honestly and acting with integrity. A person who is consistently incompetent and dishonest will not be trusted. Wintoro (2000) in his study has concluded that integrity of an investment manager is important for the trustee of small pension funds because the aim of the trustees is to hire an investment manager to whom a mandate can be given with confidence to manage the trustee' investment policy. Only an investment manager with high sense of integrity can accomplish the mandate. Behavioral integrity is considered here as important trust factor .

Behavioural consistency

According to Velez (2000) behavioural consistency is defined as the reliability or predictability of another's behaviour and aligns perfectly trust based on knowledge. Once a supervisor or subordinate has developed initial trust, the next level of trust focuses on behavioural consistency. In order to achieve this trust, the trustor must gather information in order to predict the trustee's behaviour accurately. In a supervisor-subordinate relationship both parties over time begin looking for common patterns in behaviour. This information is used to make specific prediction about future behaviour and estimate the amount of risk they are willing to take within their predictions. Behavioural consistency has shown to be related

to an employee's perception of managerial trustworthiness (Butler, 1991; Gabaro, 1978) and is considered an important trust factor for trust between a branch manager and a loan officer.

Communication

Communication is vital to the creation and maintenance of trust. When supervisor provide accurate information to employees, explain their decisions clearly to them and are open to feedback or any other communication, in that case employees are most likely to trust the supervisor. Since the branch manager-loan officer relationship is also a supervisor-subordinate relationship, proper communication between them is very important for the development of trust.

Culture

Ferrary's (2003) study raises culture as an issue in a trust relationship but it does not deal with trust as an important factor in the trust relationship. The study by Lehmann et. al (2000) which focus on German banks, identify culture as an important element of trust that are specific for a trusting relationship in German banks. From the studies of Ferrary (2003) and Lehman et. al (2001) it is observed that trust in banking relationship depends on the context and culture of players involved in a trusting relationship. The way the actors develop their relationship, change with change in context and culture. Culture therefore needs to be incorporated as an important factor in the trust between a branch manager and a loan officer and also needs to be included in a trust model.

In the context of discussion on Indian economic situation, cultural aspects play an important part. In his study of South Indian IT clusters, Tauebe (2004), found that culture is an essential part of social networks and that in the context of India, economic relationships should be looked into using not just economic and geographical factors but cultural factors as well. They found the evidence that software industry in South India is dominated by South Indian Brahmins, which explains the spatial concentration of this industry. They regard caste in the sense of varnas and ethnicity as important attributes for the growth of software industry in India. Although culture is a non-economic factor it influences the economy and is influenced by the later. Tauebe (2004) regards that the often-cited values, beliefs, traditions, norms are rarely observable and hence difficult to measure. The more visible manifestation of culture are actions, behaviour and actual social practices which are usually influenced through norms and values. Siehl and Singh (2004) found that in the Indian context, given the great diversity,

it is important to get a good grasp of culture–company cultures as well as national culture and subcultures. According to them an effective leader in India has to take into account the cultural differences due to diversity in religion, caste, language before putting together a team. It is indicative of the value that is attached to knowing culture in the Indian context. Tauebe(2004) regard caste and ethnicity as essential part of the Indian culture. Siehl and Singh(2004) regard language and religion also as essential parts of Indian culture. Nurturance and high degree of personal involvement are also regarded as Indian values which are considered different from the objectivity and personal detachment observed in western business models. Rishi (2002) in his study have found that values of affiliation, personal concern, dependence and personal warmth of nurturant leadership can create climate of trust and understanding between people in business in India. Their results strongly support culture-led leadership styles in India. It is therefore necessary that culture need to be incorporated as a determining factor in any trust relationship involving a branch manager and a loan officers of an Indian bank

Roles within the relationship

The relationship between two individuals depends on the status of the two individuals and not many studies focus on the trust relation between two individuals when their relative status differs from each other. In a branch manager-loan officer relationship, the relative status of two individuals will certainly have a bearing on the trust as each one of them perceive it to be. In an Indian cultural this dimension of relative status will have considerable influence on the branch manager-loan officer relationship because of values and beliefs associated with relative status and the power situation between the two. The loan officer is a subordinate and as a subordinate his or her behaviour in a trust relationship will be very different from that of a branch manager. Subordinates in Indian context have to demonstrate greater degree of loyalty, values of affiliation and respect towards the superior- a branch manager in this case. It is also expected a branch manager as a superior will have a nurturing attitude towards a loan officer. Communication between the two is also expected to be at a different level as compared to their western counterparts. Indian cultural values, norms and conditions such as caste and ethnicity could influence the way in which communication is done between a branch manager and a loan officer.

The literature suggests that the direction of trust and the role within a relationship are important factors of trust development. Gabaro et. al (1978) found in their study that there

were differences in the antecedent of supervisor trust versus subordinate trust. The most important factors for a supervisor's trust in subordinate include behavioural integrity, competence and behavioural consistency whereas the most important factors for a subordinate trust in a supervisor included behaviour integrity, loyalty and openness. Butler and Cantrell (1984) found the most important factors as competence, integrity and loyalty and openness. Their study was limited by the fact that they used students, who projected themselves as both subordinates and supervisors. Velez (2000) in her study have found that correlates of trust depend on the direction of the trust. Variables that relate to trust from a subordinate to supervisor will differ from the variables from a subordinate to supervisor trust in addition to the type of trust. In the present context the correlates of trust from Branch manager to loan officer could be different than from the correlates of trust in case of loan officer to branch manager trust.

Reciprocity has been found as a key factor in trust relationship between a supervisor and subordinate. Butler (1993) have found that strongest predictor of a boss' trust in the secretary was the secretary's trust in the boss. Their findings overshadow the impact of relationship, personality traits and other' needs concerning control. Velez (2000) have arrived at similar conclusions in regard to the reciprocity. It may not always be possible in India context to have the same level of reciprocity as in the west. The behaviour of subordinate towards superior needs to be culturally acceptable.

Conclusions

The present paper focuses on the trust relationship between a branch manager and a loan officer of a bank branch in India. This trust relationship is important because the environment in which a branch manager and a loan officer of Indian banks work, is very different and risky as compared to those of western banks. The quantitative risk based models used in evaluating banks in the west are inadequate to explain this relationship. This study suggests a social risk evaluation approach to describe this relationship. This study also identifies various factors of trust relevant to trust relationship between a branch manager and a loan officer of Indian bank. These factors are – similarity, ability, benevolence, behavioural integrity, behavioural consistency, communication and culture. Out of these, culture is a very important factor in trust development in Indian context. It is predicted that a trusting relationship

between the branch managers and the loan officers of Indian banks should help the bank branches in improving their lending performances. The influence of culture on development of trust relationship between a branch manager and loan officer and the resulting improvement in lending performance of bank branches may however not be limited to Indian bank branches.

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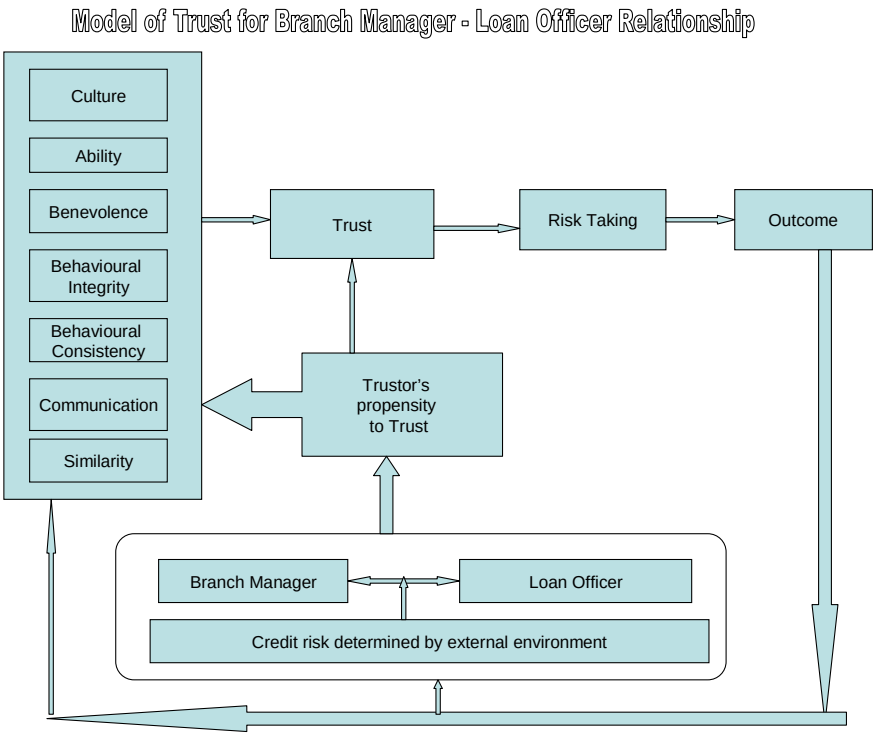

Fig.1: Model of Trust between Branch managers and Loan Officers of Indian Banks