Better safe than sorry: defensive loan assessment behaviour in a changing bank environment

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ABSTRACT

Lending officers (LOs) assess loan applications under conditions characterized by shifts in economic climate, wavering public credibility for banks and greater industry regulation. This paper examines the extent to which, in such an economic environment, the LOs’ assessment of commercial loan applications may be defensive, and, if so, which mechanisms that may trigger defensive loan assessment behaviour among LOs. Using data from interviews with 76 LOs in one major Swedish commercial bank and a focus group session, our findings suggest that in the economic environment studied, LOs tend to show a defensive approach to loan assessment with the intent to avoid risk and blame. This behaviour assumes different forms, including; avoiding change, playing safe, over-conforming, depersonalizing and using information symbolically. Triggering mechanisms reside on environmental, bank- and individual levels of analysis. Overall, this study contributes to the literature by demonstrating triggering mechanisms, intentions among LOs and forms of defensive loan assessment behaviour.

Keywords: defensive behaviour, intentions, lending officers, loan assessment, triggering mechanisms.
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1 Introduction

Lending officers (LOs) find themselves in the midst of several challenges faced by the banking industry. Steep shifts in economic climate, a public trust that falters and calls for greater regulation are increasingly common conditions. Despite these circumstances, LOs are expected to consistently carry out professional assessments of commercial loan applications and to present them to credit committees in a manner that maximizes their employer’s risk adjusted rate of return. On the one hand, the Basel II regulation calls for prudence in such decisions, as a lower level of risk results in a lower capital reserve in the bank, hence more capital to invest and increased profitability (Wahlström, 2009). On the other hand, findings also suggest that LOs are doubtful towards increased regulation and suffer from a reduction of discretion (ibid.). Under such conditions it is not necessarily true that LO behaviour favours effective loan assessment on behalf of the bank. Indeed, LOs behaviour might be defensive and self-protective.

From a conventional control point of view, such a goal congruence problem should be addressed by designing and implementing a control system ensuring a match between business strategy and behaviour (e.g., Anthony, 1965). Such an approach would allow the bank to avoid costly credit losses by detection of potential payment default (cf. Dietsch and Petey, 2002). After all, a potential profitability increase resulting from risk reduction as per the Basel II Accord would be visible in the profit and loss statement, and the wise LO would avoid blame for irresponsible loan approvals (cf. Hood, 2002). However, it would be difficult for the bank to measure the consequences of a concurrent productivity decline or the denial of a loan that would have been successfully repaid (cf. Deakins and Hussain, 1994).

The literature suggests that defensive behaviour can be triggered by mechanisms, that cause individuals to attempt to protect themselves from embarrassment and/or threat (cf. Argyris, 1977; 1985; 1990a; 1990b). Although scholars (Argyris, 1977; 1990a; Simons, 1995a) do suggest triggering mechanisms which could be related to defensive loan assessment, empirical evidence concerning this kind of behaviour in general has been described as “anecdotal and impressionistic” (Ashforth and Lee, 1990, p. 638). Moreover, we have not been able to identify studies that explore such behaviour in relation to loan assessment. Hence, the purpose of the present paper is to explore bank loan assessment among LOs in an economic environment in which defensive behaviour among LOs is plausible.

Our contribution to the literature is threefold. First, we connect the stream of research on loan assessment in banking with that of defensive behaviour in organizations to enable our exploration of LO behaviour. Second, we extend the loan assessment literature by providing empirical insights concerning defensive behaviour in loan assessment among LOs. In particular, we build on the findings by Wahlström (2009), which suggest scepticism among LOs in a changing bank environment. Third, we present triggering mechanisms and forms of defensive behaviour. Our findings have practical implications for business owners and managers that seek bank financing, as well as for bank managers, and designers and users of control and support systems in the banking industry.

The outline of the paper is the following. First we present our frame of reference concerning the intersection between individual level loan assessment research and the topic of defensive
behaviour. Thereafter we present our research methods and empirical evidence. In the final sections, we provide a discussion and conclusions, including our theoretical contribution, implications for practice and suggestions for future research.

2 Frame of reference

2.1 Individual level research on loan assessment

It is part of bank routines that the LO’s initial assessment of a loan application is conveyed to a credit committee which makes the decision to approve or reject a loan application (Fletcher, 1995). The information that the LOs collect, process and transmit about existing and potential clients is of two categories: hard, quantitative information and soft, qualitative information. Prior literature suggests that the LOs focus primarily on hard information such as financial statements, collateral, and cash flow forecasts in the loan assessment process (Liberti and Mian, 2009; Berry and Robertson, 2006). Soft information includes nature of client relationship, success of current owner/managers in the present and other business, the way he/she reacts under pressure and the business idea deployed (Mason and Stark, 2004; Udell, 2008). Such information may widen the knowledge about existing and prospective clients (Ferrary, 2002; Behr and Güttler, 2007).

One stream of literature in this area draws on the human information processing research tradition (e.g., Payne et al., 1993), which addresses loan assessment from a judgment or decision making point of view. Several studies draw on experimental designs and aim to identify decision strategies and biases (Taylor, 1995; Ruchala et al., 1996; Andersson, 2004). One finding is that once an initial loan has been granted, escalation of commitment can cause LOs to suggest to the credit committee to grant additional loans, despite information signalling considerable risk. The risk for such a bias is most conspicuous if the LO strongly identifies with the initial project decision, and if (s)he expects a low likelihood for blame if the loan is not repaid, due to diffusion of responsibility (Ruchala et al., 1996). There are also indications that switching between different decision support systems improves LO performance (Wheeler and Jones, 2006).

A second stream of research which is related to LO behaviour when assessing loans draws on agency theory. Findings suggest that LOs choose not to report bad news to bank managers if it will reflect negatively on their own assessment abilities (Herzberg et al., 2010). Moreover, when there is a difference between the information collection tasks of the LO and the decision making responsibility of a credit committee, distance between these parties tend to lead to reliance on hard rather than soft information (Liberti and Mian, 2009).

2.2 The concept of defensive behaviour

The management literature includes several ways in which defensive behaviour can be defined and different strands of literature where the concept has been put to use. From a conceptual point of view, some bodies of work are particularly notable, for example that of Argyris (1977; 1985; 1990a; 1990b) followed by Sterman (1994), and that of Ashforth and Lee (1990). It is suggested that defensive behaviour is characterized by “little additivity in problem solving, low openness and trust, and high conformity and covering up of threatening issues” (Argyris, 1977, p. 119). Ashforth and Lee (1990) position defensive behaviours1 as part of political behaviour, i.e., discretionary social influence attempts to promote or protect the self-interests of individuals or groups that threaten the self-interests of others (Porter et

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1 Ashforth & Lee (1990) use the plural form, to convey that several behaviours may be defensive.
Ashforth and Lee (1990, p. 622) define defensive behaviours as "reactive and protective actions intended to reduce a perceived threat or to avoid an unwanted demand of an individual or group".

Other scholars use closely related concepts in different strands of literature. For example, Gianmarino et al. (1997) examine defensive mechanisms and managerial discretion in takeovers; Balthazard et al. (2000) find evidence of dysfunctional defensive styles which they link to a dysfunctional organization culture; and Sweeney and Pierce (2006) analyze the manipulation of time reports among auditors in terms of a defensive mechanism. Trubik and Smith (2000) draw on the idea of defensive behaviour in relation to offensive (attracting new clients) and defensive (preserving existing clients) strategies in the banking industry, and Wilson and Eilertsen (2010) analyze proactive and defensive firm-level responses to the economic crisis.

For the purposes of the present paper, we draw primarily on Argyris (1977; 1985; 1990a; 1990b) and Ashforth and Lee (1990) when we define defensive behaviour among LOs in terms of reactive and protective actions intended to protect oneself from experiencing embarrassment or threat. The identity of the LO as a competent professional is built and maintained by keeping his/her conduct in line with the expectations of the credit committee and the management of the bank (cf. Jönsson, 1996, p. 103). Ashforth and Lee (1990) propose that defensive behaviour typically is intended to avoid action, blame and/or change. According to their inductively derived conceptual framework there are different ways in which action, blame and change can be avoided in organizations. Avoiding action occurs through over-conforming, passing the buck, playing dumb, depersonalizing, smoothing and stretching, and stalling. As LOs are required to meet role expectations, avoidance of action is likely to presuppose the appearance of action, perhaps by using information symbolically, thus requesting and collecting information beyond the level of information needed for decision making (Feldman and March, 1981). Avoiding blame is accomplished through buffing (rigorously documenting activity to project an image of competence and thoroughness), playing safe, justifying, scapegoating, misrepresenting and escalating commitment. For a LO engaged in assessing loan applications in a shifting economic climate, characterized by threats to legitimacy and regulative initiatives, it can appear rational to avoid risk and situations which might reflect negatively upon the individual, thus avoiding blame (cf. Ashforth and Lee, 1990; Herzberg et al., 2010). Avoiding change takes place by means of resisting change and protecting turf. If change threatens to disrupt routines and behaviours taken for granted, it is likely that LOs will disregard information which propose that change would be required. Alternatively, signals may simply go undetected (Hedberg and Jönsson, 1978).

2.3 Mechanisms that trigger defensive behaviour among LOs

Both Ashforth and Lee (1990) and Argyris (e.g., 1990b) posit that antecedents to defensive behaviour may reside on environmental, organizational and individual levels. A financial crisis and a weak economic climate can be among the environmental level mechanisms that trigger defensive loan assessment behaviour among LOs (cf. Goddard et al., 2009). Increasing regulation through the Basel II Accord can affect the banks’ inclination to
compete in the commercial lending market, as uniform capital requirements are advocated in
the name of equal competition (Wahlström, 2009). Thus, the LOs may increasingly focus on
different elements of bureaucratic rationality including formalization and accountability (cf.

On the firm level, successful performance is often linked to the existence of a well-
configured mission and business strategy, where different components are interconnected and
contribute to the success of the organisation as a whole (e.g., Normann, 1975; Nilsson and
Häckner, 2007). When the strategy is ambiguous such that its’ components do not fit with
each other and/or they are unclear to the LOs, they may respond by attempting to protect
themselves, thus behaving defensively. Moreover, the bank management and credit
committee are responsible for results and need to find ways to “reduce the probability and
cost of error” (Argyris, 1977, p. 115) in loan assessments. One approach to take is to devise
control and support systems that signal when a loan application deviates from desired
tolerances. When credit granting procedures are strongly regulated and standardized, LOs are
expected to commence their assessment by processing information about the application
through the control and support system used (Mahmoud et al., 2008; Rada, 2008). However,
as suggested by Argyris (1977) and Jönsson and Grönlund (1988), the information processed
in central control systems may contrast with information needs on a local level. On a local
level, such as that of an LO, information needs may have concrete and intuitive features, and
include causal processes as well as closeness to the unique case. Local information is less
manageable and less transferable through a control and support system (Jönsson and
Grönlund, 1988). It may thus receive relatively less attention when it comes to lending
decisions, and errors related to its absence may go undetected. Central or “distant” control
systems, on the other hand, tend to be oriented towards output, impartiality, distance from
single cases and an emphasis on overall trends, and demands corresponding information (see
also Häckner and Nilsson, 2008).

Control and support systems convey hard information within the banks’ organisation (Rada,
2008; Udell, 2008), and structure the assessments made by the LOs (Kumra et al., 2006). The
systems emphasize “facts” about the loan applicant (cf. McSweeney, 1996) rather than more
subjective and case sensitive impressions, and the credit committee relies on information
from them. Reliance on hard data on credit risk criteria processed in the control and support
system, rather than on interpretations based on soft information, can represent a way for the
LO to behave defensively in a demanding and challenging situation (e.g., Argyris, 1990). The
use of numbers signals responsible and justifiable decision making when exercising control
(Chua, 1996). Soft information is typically not numerical, hence difficult to transmit from
sender to lending officer and onwards to the credit committee and bank management (e.g.
Boland and Schultze, 1996; cf. also McSweeney, 1996).

When bank management and the credit committee need to “reduce the probability and cost of
error” (Argyris, 1977, p. 115) in loan assessments, there are two types of errors that may need
to be considered. Type I errors occur when a loan is rejected that has the potential to be
repaid with interest, implying a net revenue loss for the bank. Type II errors occur when the
bank approves loans that eventually result in a credit loss for the bank. However, evidence
suggests that LOs tend to focus primarily on reducing Type II errors (Deakins and Hussain,
1994). One possible contributing factor is that the Basel II Accord is essential to the
regulative system of banks (e.g., Wahlström, 2009). The Accord emphasizes credit risk in
order to promote prudence in the bank sector, which may contribute to the importance
attributed to Type II errors in loan assessments. Detectable errors are Type II and therefore
more likely to create embarrassment or threat than Type I errors. A fear of making mistakes among LOs is likely to encourage defensive loan assessment behaviour.

3 Method
3.1 Study context and research design
Four domestic banks control 74% of the Swedish lending market, suggesting an oligopolistic competitive situation (Svenska Bankföreningen, 2010). Our data forms part of the results from a research program of credit assessment in one of these banks, which gave us permission to collect and analyse empirical data. The selected bank is one of the banks in which Wahlström (2009) studied perceptions of Basel II, and it operates in several bank office locations in different regions. In this study we focus on the mid-Sweden region, and the LO and lending committee level, where the practice of loan assessment occurs and risk is managed (Wahlström, 2009). The mid-Sweden region includes three counties with a number of bank office locations, credit committees and LOs. The LOs assessments of loan applications are presented to a credit committee including bank managers and experienced LOs, and the credit committee decides if the loan will be granted or not.

At the time of the study, which took place in the end of 2009 and in the beginning of 2010, the bank was affected by a weak economic climate, new regulative initiatives including the Basel II Accord, and a low intensity of price competition. To manage and facilitate the adjusted loan assessment process the bank’s control and support system was given a more prominent role than before. Furthermore, as a result of the bank’s credit losses in the wake of the financial crisis, a new loan assessment strategy was formulated. It was intended that the LOs should focus on future repayment capability when assessing loan applications, i.e. a shift from historical to future-oriented information based assessments. It was also emphasized that the bank wanted to have clients with most of their financial affairs in the bank, i.e., a total client strategy. Taken together, there were several significant changes which affected the bank and the LOs at the time of the study.

One key approach for mitigating the likelihood of biased results was to use many and highly knowledgeable informants who viewed commercial loan assessment from diverse perspectives (Eisenhardt and Graebner, 2007). LOs with less than one year’s work experience in a bank office location in the selected bank and region were excluded due to their lack of possibilities to answer the questions properly. At the time of the study, the total number of available LOs with at least one year’s work experience, and regional bank managers with previous LO experience was 83. Seven LOs did not answer the questionnaire due to lack of time, leaving 76 LOs as informants. The sample includes different categories of LOs with respect to position, location, gender, education and experience (see Table 1).

| Table 1 about here |

The study was conducted as a combination of a questionnaire study and a focus group interview session. The reason for this blend of methods was that we wanted the LOs to first reflect individually on their work, and then to deepen and widen the knowledge about loan assessment through communicative interaction (Blumer, 1969). The focus group was also used to confirm and enlarge our understanding of the bank’s economic environment, their

3 One result of this approach was that in the four cases where the informants had been employed between one or two years, their responses to our questions concerned the time period of their employment although the questions originally were designed to cover a lengthier time period (see the Appendix).
business strategy, and the control and support system. Five of the 76 informants participated in the focus group session. The choice of these participants was made with respect to background variables. In particular, we included both LOs in the field (3) and LOs in the position as bank managers and credit committee members (2) in order to capture different frames of reference (cf. Wahlström, 2009).

3.2 Data collection, analysis and limitations
The questionnaire included seven open ended questions (see the Appendix), and was administered to the informants in the autumn of 2009. The open ended questions were intended to elicit the informants’ perceptions about their commercial loan assessments in a changing bank environment. The first three questions were focused on possible changes in loan assessment during the last few years and what the informants considered possible to assess more or less extensively. The following two questions were focused on the LOs likelihood of negotiating lending conditions in consideration of the situation at hand. In addition, the informants were asked if they had further comments in addition to their responses to specific questions asked, and if they had experience as business persons.

When analysing the informants written answers, we found indications of defensive behaviour as well as the opposite. We used a coding scheme (see the Appendix), and decided to code every answer to each question in one category only, making the total number of answers to be 76 for each question. Regarding question 1, the first category was labelled “no change”, indicating that an informant had been unable to see that the loan assessments in the bank had changed during the last few years. Another category of defensive behaviour was the perceived change towards collateral and/or a more intense use of the control and support system (the second category). The third and the forth category – an observed change towards future-oriented information and future repayment capability or an observed change towards both future repayment capability and collateral – were not classified as defensive behaviour. The assessment of future oriented information was considered to require discretion on behalf of the LO rather than reactive and protective measures. Hence, the third and fourth categories are not italicized in the Appendix.

Regarding the second question, the first and the fourth category – no need to increase any kind of information and a need to increase all kinds of information – were interpreted as indicators of defensive behaviour in accordance to the frame of reference section. Regarding the third question, only the first category – no need to decrease any kind of information – was classified as an indicator of defensive behaviour. In the following questions (4 and 5) we classified “none or insignificant room for negotiations due to different triggering mechanisms” as indicators of defensive behaviour. Regarding question 6, answers that highlighted a strong focus on hard information used in the bank’s control and support system or that an informant disregard personal relationships were classified as “defensive”. Question 7 only included two categories (yes or no). Moreover, separate categories were used for informants that did not answer a particular question.

We classified the answers of the first 15 informants (20 % of the sample) separately before we compared our classifications and discussed the cases where they differed (cf. procedures used by Butterfield et al., 1996). We classified 91 percent of the answers identically, and more important, in all cases we agreed whether the answer was an indication of defensive behaviour or not. When our classifications differed, we discussed our interpretations until we arrived at an agreement. After that one of us classified the remaining informants’ answers.
We then discussed the few classifications considered uncertain. These discussions resulted in minor adjustments.

The focus group interview with the five selected participants was held after an initial analysis of the findings from the questionnaire study, to develop a deeper understanding than that captured by the open ended questions. During a three hour session in the beginning of 2010, we discussed the 76 informants’ answers to the open ended questions and the compiled findings. At the end of the session we inquired about the bank’s economic environment, loan assessment procedures, client strategy, and the control and support system to confirm and enlarge our understanding of the LOs working conditions in the bank. The focus group interview was recorded and transcribed and each participant’s statements were analyzed in relation to the statements of the other participants and the 76 informants’ written answers.

There are limitations of this study which need to be mentioned. First, this study relies on a questionnaire and a focus group interview and could have benefited from other data collection approaches, including participant observation. However, the confidentiality of banks can preclude such data collection approaches, and as will be demonstrated in section 4, our findings from the focus group session validate the informants’ answers to the open-ended questions. Second, the study does not allow us to empirically demonstrate explanatory cause-and effect relationships between triggering mechanisms and different forms of defensive behaviour. Rather, the findings do indicate that relationships between triggering mechanisms and behaviours may be characterized by equifinality and multifinality (e.g., Arbnor and Bjerke, 1994, p. 82f). Third, we are unable to establish a pattern concerning relationships that may exist among triggering mechanisms or among forms of defensive behaviours.

4 Findings
The findings related to each question in the questionnaire are numerically summarised in the Appendix. In the two following sections, these findings are presented together with findings from the focus group interview session. Overall, the differences between groups of informants were few. The most significant difference between bank managers and other LOs are commented on below. It should also be noted that seven of the nine informants who revealed no signs of defensive behaviour were LOs with long bank tenure and little formal education (public school).

4.1 Unwillingness to change and a focus on risk reduction
In their answers to question 1, six of the informants insisted that there had been no significant changes in the assessment of commercial loan applications over the last few years. This was expressed in the following way by one informant:

“No, I cannot see that it has changed. The loan assessments are performed in the same way as before.”

However, the remaining 70 informants pointed to changes in the loans assessment process. A total number of 41 informants answered that they nowadays were more concerned about future-oriented information and future repayment capability. Notably, all 13 bank managers expressed a forward-looking approach, and one of them argued that:

“The assessments are much more forward-looking today. The applicants’ future ability to repay the loans has become more pronounced than ever. Earlier, our assessments were more historical information based.”

The focus group interview confirmed that it is nowadays a part of the bank’s formal strategy to focus on the future, and that every LO is attempting to build an image of the applicants to
foresee their ability to repay a loan with interest. It was also confirmed in the focus group that the bank emphasized risk reduction in the wake of the financial crisis, and in line with the Basel II Accord. Notably, the findings from the focus group revealed that it was possible for LOs to interpret this “double message” – a focus on both future repayment capability and risk reduction – in his or her own way. Such an interpretation could be defensive, and rather many informants (23) expressed a one-sided focus on risk reduction when answering question 1:

“Nowadays it is more focus on risk than opportunity. Everything is assessed from a worst case scenario.”

“The financial crisis has made that we approve almost no full funding, and require several types of collaterals (bonds, mortgage companies and/or pledges of private property). The applicants should be pretty strong financially to be allowed to borrow money needed for their business.”

A perceived consequence of the weak economic climate, the regulations in the Basel II Accord, and the bank’s control and support system was articulated in the written answer of one of the informants:

“The conditions in the bank today, with increased regulation and control, are likely to give us a defensive approach to business.”

A total number of 17 informants were unable to suggest anything to assess more extensively (question 2), and 30 informants were unable to suggest anything to assess less extensively (question 3). The lack of willingness to change can be illustrated by the following answer:

“I do not think that it is necessary to add or take away anything from what we do.”

In addition to the reluctance to change, four answers on question 2 reveals a desire to collect more information than actually used thus indicating another form of defensive behaviour. Those LOs proposed a need for an increased amount of all kinds of information:

“It is important to observe the person behind the company, and to use both hard and soft information. This is the hardest part of the assessment procedure, and a lot of information is needed.”

4.2 Little room to negotiate, a focus on the control and support system and salient contacts with the credit committee

Answers to question 4 showed that more than half of the informants claimed that different mechanisms had affected the LOs discretion. For instance, price competition was more intense between the banks in the mid-Sweden region before the financial crisis and it was rather easy for clients to manoeuvre the banks to receive “better” loans. When the economic climate became weaker and the price competition between the banks decreased, the clients had to take or leave the lending conditions given by the bank and the LOs. This indicates that the room for negotiations was perceived to be limited. A total number of 45 informants argued in line with the following two answers:

“In a booming market, the competition between banks is very stiff. After the recession, the bank is prepared to lose good clients who want to borrow more money, if collaterals are not completely satisfactory.”

“Negotiations on the terms of the loan are less common in recession. We calculate interest rates based on risk, which represents little negotiating conditions. It's more up to us to decide if we want to do business with the client or not.”

It was confirmed in the focus group that the bank’s and the LOs’ propensity to determine lending conditions was greater after the financial crisis and when price competition declined. The focus group also revealed that the LOs’ assessments commenced with considering hard information required by the bank’s control and support system. The design and use of the system was explained by the two bank managers as a need for structuring the assessment process, and by the relative easiness of transmitting hard information within the bank. A
The consequence of using the control and support system was that the LOs considered the same basic criteria independent of type of loan, and that all applicants were treated in a similar way. It was also argued that several LOs were emphasizing risk more than earning opportunities when they assessed loan applications. A reason for this was said to be that the LOs were motivated by the control and support system to focus on collaterals and to avoid Type II errors. A related comment was expressed in one of the written answers:

“We nowadays use the control and support systems frequently. That has opened my eyes for risk, and I have perhaps become more cautious than before.”

The three LOs without bank manager experience who participated in the focus group, said that it was easier for the members of a credit committee to make sense of hard information than soft. Soft information was considered difficult to capture in the control and support system. Therefore, it needed to be transmitted by the LOs in oral form to the committee. A possible reason for the perceived difficulties to persuade the credit committee with soft information such as business idea characteristics, was the LOs lack of business experience. Only 20 percent of the informants (16 of 76) had previous experiences as entrepreneurs or business persons, and in most cases this experience was rather limited and/or outdated. The three LOs argued that second opinions from colleagues were needed to convince the committee members to approve a loan application dependent on soft information. Occasionally, these second opinions were used for confirmation and support of a LOs initial assessment.

The way in which LOs proposals were treated by the credit committees was given much attention in the focus group. There was consensus that the credit committee was and should be the decision-making body. However, it appeared rather surprising for the two bank managers when one of the other participants in the focus group stated that:

“One of the worst things that could happen is if the credit committee say no to my proposal to grant a loan to a client.”

Such a situation was perceived to be equally embarrassing for the LO, as a situation in which the credit committee approved a recommended application that eventually turned out to be a Type II error, i.e. a credit loss for the bank. The impact on the LOs when the credit committee decided to reject a recommended loan application was expressed in a rather wordy answer by one of the 76 informants, who obviously had received a “slap on the wrist” when trying to convince the credit committee to grant a loan:

“I have become little harsher in the view of my work, according to the high collateral requirements and the focus on low risk. I have tried to be open to new ideas and see the possibilities in the loan applications since all clients are supposed to have a chance to borrow money. After being involved in a few credit losses and then being turned down by the credit committee, it is clear that I think more of the bank's loss risks than earning opportunities. Unfortunately!”

When the impact of the banks’ total client strategy on the LOs possibilities to negotiate lending conditions was pondered (question 5), 70 informants saw such a connection. Around half of these informants described the importance of client relationship and/or profitability conditions, while the others explicitly emphasized the importance of the bank’s total client strategy, i.e. that the bank wanted to have clients with most of their financial affairs in the bank:

“The banks’ total client strategy has a major influence. We can do a better arrangement for clients with all their affairs in the bank, and develop better relationships with those clients on a business level. These clients are given a larger room for negotiations.”
The two bank managers in the focus group explained that the total client strategy was a way for the bank to focus on the revenue side of bank affairs. The idea was to retain the clients and to expand the businesses with them. This indicated that the bank’s total client strategy was a triggering mechanism for LOs possibilities to negotiate lending conditions (in contrast to mechanisms reducing the perceived room for lending negotiations). Accordingly, in this case only six informants showed a defensive approach, suggesting none or little room for negotiations with clients who had most of their financial affairs in the bank. The reason mentioned for the perceived lack of discretion was the bank’s control and support system.

Regarding question 6, a total number of 12 informants showed signs of defensive behaviour, arguing explicitly that they focused heavily on hard information used in the bank’s control and support systems or that they disregarded personal relationships when assessing loan applications.

5 Discussion and conclusions

5.1 Discussion

We find three interesting patterns in our empirical findings on the aggregate level. First, the results show that a great majority of the informants (67) demonstrate a defensive approach to loan assessment in one way or another. A total number of 43 informants show two or more signs of defensive behaviour. Second, seven of the nine informants who reveal no signs of defensive behaviour are LOs with long bank tenure and little formal education. Third, LOs in managerial positions emphasize the strategic change towards future-oriented information and the future repayment capability criterion to a greater extent than those who uphold strictly operational positions. One interpretation is that the scepticism towards changes in the banking sector observed by Wahlström (2009) can manifest itself in defensive behaviour among LOs. Our evidence also supports his observations of different frames of reference among managerial and operational LO categories.

Our results suggest that certain mechanisms can trigger defensive behaviour among LOs. The financial crisis and the weak economic climate tighten up the granting of credit, and the regulation associated with the Basel II Accord also encourages risk reduction. Accordingly, there is a decline in price competition between banks. This is an interesting observation also because even if uniformity and equal competition are important justifications for the Accord (Wahlström, 2009), lower price competition appears to be a consequence in practice. In contrast to Ashforth & Lee (1990) who emphasize organizational and individual level antecedents to defensive behaviour in organizations, these results highlight the potential impact of environmental events for eliciting such behaviour among LOs.

However, we do not find that organizational and individual level factors are unimportant for defensive behaviour among LOs. On the contrary, the results reveal how defensive behaviour among LOs may be driven by a bank strategy which is inconsistent and open to multiple interpretations. Indeed, while some LOs interpreted the strategy to be oriented towards future repayment capability (with a focus on avoiding Type I errors), others saw only risk reduction (emphasizing the avoidance of Type II errors). In turn, the detection and correction of errors is intimately related to the control and support system (Argyris, 1977). Basel regulations require numerical risk assessment (Wahlström, 2009) and contribute to a control and support system with a more one-sided orientation towards detectable Type II errors (cf. Deakins and Hussain, 1994). Like any model, the bank’s control and support system is a simplified representation which highlights certain aspects of the social world at the expense of others (Lakoff and Johnson, 1980; Power, 2004). Consequently, it is hardly surprising that loan
assessment procedures among LOs appear to be governed by the control and support system (Kumra et al., 2006). Overall, our findings when it comes to organizational level mechanisms behind defensive loan assessment behaviour support Ashforth & Lee’s (1990) suggestions that bureaucratic rationality (the control and support system) and ambiguity (of strategy) may be among the influential factors.

Turning to the individual LO level, our results suggest that defensive loan assessment behaviour may occur because of difficulties to make sense of and transmit soft information, and a tendency to avoid situations where individual mistakes might occur. While these difficulties with soft information are firmly supported in previous financial sector research (Rada, 2008; Udell, 2008; Liberti & Mian, 2009) and in research from other contexts (e.g., Jönsson & Grönlund, 1988; McSweeney, 1996, Chua, 1996; Boland & Schultze, 1996), our findings suggest that sensemaking difficulties may cause defensive loan assessment behaviour. The results also illustrate how an individual LO can be affected by “a slap on the wrist” from bank management or the credit committee. These findings seem to differ somewhat from suggestions by Ashforth & Lee (1990), who stress psychological explanations when they theorize about individual level antecedents.

Interestingly, our results do not corroborate Ashforth & Lee’s (1990) claim that defensive behaviour occurs to avoid action, blame or change, and that those behaviours can be subdivided to a wide array of defensive behaviours. Rather, we find a multitude of mechanisms which seem to jointly contribute to the LOs intention to avoid risk and blame (cf. Hood, 2002). In turn these intentions seem to contribute to different forms of defensive behaviour, including avoiding change, playing safe, over-conforming, depersonalizing and using information symbolically.

At this point we find several important differences between our results and the theoretical typology of defensive behaviour developed by Ashforth & Lee (1990). First, our results do not indicate that avoiding action is a likely form of defensive loan assessment behaviour among LOs. We would even be prepared to suggest that avoiding action many times would be associated with blame in the work context of LOs. Secondly, our findings do not allow us to differentiate between avoiding blame and avoiding change as two important main forms of defensive behaviour (Ashforth & Lee, 1990). Rather, we find that the two types of LO intentions, avoiding risk and avoiding blame, can be associated with different forms of defensive behaviour.

Avoiding change is the first form of defensive loan assessment behaviour that we can identify in our empirical results. If change threatens to disrupt routines and behaviours taken for granted, it is likely that LOs will not notice or disregard information which propose that change would be required (Hedberg and Jönsson, 1978; Ashforth and Lee, 1990). Our results show that several LOs respond to information which suggests that loan assessment should be broader by not noticing the introduced changes or by disregarding the need for change. In either case, avoiding change can be regarded as a form of defensive loan assessment behaviour, most strongly associated with the intention to avoid risk. Thus, our findings suggest that avoiding change is one subform of defensive behaviour which results from intentions among LOs, which in turn are triggered by mechanisms on macro-, bank- and individual levels, not a main behavioural category as suggested by Ashforth & Lee (1990).

Playing safe constitute another form of defensive loan assessment behaviour among LOs. For a LO engaged in assessing loan applications in a shifting economic climate, characterized by
regulative initiatives, our results show that it can appear rational to avoid risk and situations which might reflect negatively upon the individual. In the focus group interview session it was suggested that the LOs rely on second opinions although they serve mainly for confirmation and support of initial assessments. It is therefore tempting to suggest that “second opinions” may in practice be “the same opinion twice”. The intentional inclusion of this type of safety precautions illustrates playing safe as a form of defensive loan assessment behaviour, possibly associated with avoiding risk as well as avoiding blame (cf. Ruchala et al., 1996; Herzberg et al., 2010).

Over-conforming is a third form of defensive behaviour in the bank context. LOs can choose to over-conform by strictly assessing a loan application according to standard procedure as per the control and support system, at the expense of considering particular nuances of the individual case (cf. Argyris, 1977; Jönsson and Grönlund, 1988; Ashforth and Lee, 1990). Our results suggest that existing loan assessment routines begin with the use of hard information, which can be processed in the control and support system (cf. Rada, 2008; Udell, 2008; see also Boland, 1979). The LOs are accountable to the bank and the credit committee and may prefer to make their case concerning a loan application based on information which is perceived to be “factual” (e.g., McSweeney, 1996). The LOs tend to be reluctant to “promote” applications where they are not confident that the credit committee will approve. This type of over-conforming behaviour is likely when the LO previously has received “a slap on the wrist” when facing the credit committee, and therefore eager to avoid blame in the future.

If over-conforming occurs, certain indications in our empirical results indicate that it may possibly contribute to defensive loan assessment also in terms of depersonalizing (Ashforth and Lee, 1990), such that customers are dealt with uniformly rather than in terms of their unique needs. Our findings provide indications that loan assessments are treated in a rather uniform fashion by the LOs, since uniformity fits well to central information requirements (e.g., Jönsson and Grönlund, 1988).

Some evidence also suggests another possible form of defensive behaviour that may be “rational” for LOs with the intention to avoid blame. A handful of the LOs would be inclined to assess loan applications more extensively by means of a greater amount of all kinds of information. This finding can be interpreted in terms of using information symbolically. Requesting and collecting information beyond the level of information needed for the assessments can enhance perceived competence, demonstrate rational choice and improve legitimacy (Feldman and March, 1981). Demonstrating “rationality” is important for LOs (cf. Jönsson, 1996).

5.2 Conclusions and suggestions for further research

Overall, this study contributes to the literature by empirically demonstrating different forms defensive loan assessment behaviour among LOs, triggering mechanisms on different levels and intentions among LOs that seem to correspond to the triggering mechanisms and forms of behaviour. Doing so, the findings allow for the refinement of a conceptual framework on defensive behaviour developed by Ashforth and Lee (1990) and for its adaptation to loan assessment behaviour. In addition, this paper moves the analysis by Wahlström (2009) one step forward by outlining forms of behaviour, intentions and triggering mechanisms which in practice are likely to be intimately related to the doubtful attitude to change among LOs which was observed in his study.
Overall, defensive behaviours among LOs in commercial loan assessment can assume different forms. Avoiding change occurs when the individual LO does not acknowledge any changes in loan assessment behaviour in recent years, despite a new strategy and increased emphasis on the control and support system. Playing safe refers to a collection of practices which in different situations helps the individual LO to accomplish intentions of avoiding risk and blame. Over-conforming entails a practice where policies and guidelines contribute to a uniform treatment of credit applications at the expense of judgement and consideration of the nuances of each client and loan application. Depersonalizing refers to the detachment from personal relationships with clients, despite requirements to operate with a total client strategy. Using information symbolically occurs when the individual LO attempts to convey an image of being a rational decision-maker.

We also propose a number of specific triggering mechanisms. Externally, the financial crisis, the weak economic climate, the increasing regulation and the less intense price competition affect the banks and encourage them to take less risk. Internally, the triggering mechanisms include a central head office strategy which is fraught with ambiguity and an internal control and support system which is oriented towards hard information and designed to detect Type II rather than Type I errors. It also includes LOs that have difficulty in making sense of soft information and in transmitting such information to the credit committee. One explanation for this pattern seems to be that the LOs tend to lack business experience. A fourth internal triggering mechanism seems to be that LOs experience a fear of making mistakes, especially those that have received a “slap on the wrist” (see Figure 1 below).

Our findings do not allow us to determine patterns concerning the consequences of defensive loan assessment behaviour. We may hypothesize that approval/rejection decisions will be based on hard information and that clients may be treated as objects or numbers. However, over the longer term, extensive reliance on formal systems rather than judgment could reduce the discretion of the LO, which would negatively influence his/her professionalism (cf. Wahlström, 2009). For the bank, we may speculate that defensive behaviour lowers the level of risk in the portfolio of loans. In turns this risk reduction can be used to demonstrate effective risk management in the supervisory review, thus lowering the capital reserves requirement and increasing yield. An orientation towards detection of Type II errors at the expense of Type I errors may characterize not only the LOs but also the bank as a whole.

For business owners and managers that seek bank financing, it would seem important to back the case up with financial “facts” that can be processed internally in the bank and presented to the credit committee. From a bank managers’ or a control and support system designers’ point of view, our findings illustrate the value of understanding operational implications of the way in which the control and support system is configured. It would seem that a system for this type of setting would benefit from being less oriented towards providing answers (“are key ratios in order?”) and more oriented towards promoting inquiry, debate and dialogue (“why these key ratios? Is it plausible that management can improve ratios that aren’t satisfactory?”) (Simons, 1995b). It is also important not to implement a strategy which is fraught with ambiguity. From a LO point of view, our findings suggest that the prospects for this group to retain its’ professionalism in the future would improve if it were to regain some discretion.
Future studies concerning defensive behaviour could benefit from participant observation and client interviews conducted longitudinally, to enable the capturing of behaviour that becomes routine. One promising venue for future studies would be to track the processes and the interfaces between the different links in the loan assessment chain, from business owner and manager to LO, from LO to credit committee and from the local branch office to central head office. Another research opportunity would be to use the notion of priming (e.g., Boland et al., 2001) to investigate the decision making schemata involved in credit assessments. Our findings suggest that such assessment begins with hard information, which is conservative and risk-oriented but more suited to uniform treatment than sensitive to the circumstances of individual cases. Additional in depth studies of this kind could result in more firm conclusions concerning behaviours and triggering mechanisms. It is also interesting to note that LOs with long bank tenure and little formal education (public school) may show a lower propensity to behave defensively in loan assessment than other bank employees. A survey design could allow this pattern to be tested on a broader scale and possibly shed light on underlying causes. The study of defensive loan assessment behaviour and its triggering mechanisms is relatively unexplored and a fertile ground for future research.

Acknowledgements

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References


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Table 1: Informant categories with respect to position, location, gender, education and experience

<table>
<thead>
<tr>
<th>Position</th>
<th>Location</th>
<th>Gender</th>
<th>Education</th>
<th>Experience</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>County 1</td>
<td>Male</td>
<td>Public school</td>
<td>&lt; 6 years</td>
</tr>
<tr>
<td>Lending officers and not members of the</td>
<td>17</td>
<td>29</td>
<td>14</td>
<td>17</td>
</tr>
<tr>
<td>credit committee</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(48)</td>
<td></td>
<td></td>
<td>19</td>
<td>16</td>
</tr>
<tr>
<td>Lending officers and members of the</td>
<td>13</td>
<td>18</td>
<td>19</td>
<td>15</td>
</tr>
<tr>
<td>credit committee</td>
<td></td>
<td></td>
<td>14</td>
<td>19</td>
</tr>
<tr>
<td>(15)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank managers and members of the credit</td>
<td>5</td>
<td>12</td>
<td>12</td>
<td>12</td>
</tr>
<tr>
<td>committee</td>
<td></td>
<td></td>
<td>1</td>
<td>4</td>
</tr>
<tr>
<td>(13)</td>
<td></td>
<td></td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>Total</td>
<td>29</td>
<td>50</td>
<td>26</td>
<td>25</td>
</tr>
<tr>
<td>(76)</td>
<td></td>
<td></td>
<td>26</td>
<td>25</td>
</tr>
</tbody>
</table>

Figure 1: Triggering mechanisms, LO intentions, and forms of defensive loan assessment behaviour among LOs.
Appendix: Answers to the open ended questions

<table>
<thead>
<tr>
<th>Question</th>
<th>Response</th>
</tr>
</thead>
<tbody>
<tr>
<td>1) Do you think your loan assessments have changed during the last few years? If this is the case, in what way?</td>
<td>I = no change</td>
</tr>
<tr>
<td></td>
<td>2 = change (towards collateral and/or the use of the control and support system)</td>
</tr>
<tr>
<td></td>
<td>3 = change (towards the applicants’ future repayment capability and/or individual judgments)</td>
</tr>
<tr>
<td></td>
<td>4 = change (towards both collateral and the applicants’ future repayment capability)</td>
</tr>
<tr>
<td></td>
<td>9 = no comments</td>
</tr>
<tr>
<td>2) What could be possible to assess more extensively to improve the outcome of the assessments?</td>
<td>I = no need to increase the amount of any kind of information</td>
</tr>
<tr>
<td></td>
<td>2 = a need to increase the amount of historical and/or hard information</td>
</tr>
<tr>
<td></td>
<td>3 = a need to increase the amount of future-oriented and/or soft information</td>
</tr>
<tr>
<td></td>
<td>4 = a need to increase the amount of all kinds of information</td>
</tr>
<tr>
<td></td>
<td>9 = no comments</td>
</tr>
<tr>
<td>3) What could be possible to assess less extensively without risking negative effects for the outcome of the assessments?</td>
<td>I = no need to decrease the amount of any kind of information</td>
</tr>
<tr>
<td></td>
<td>2 = a need to decrease the amount of historical and/or hard information</td>
</tr>
<tr>
<td></td>
<td>3 = a need to decrease the amount of future-oriented and/or soft information</td>
</tr>
<tr>
<td></td>
<td>4 = a need to decrease the amount of all kinds of information</td>
</tr>
<tr>
<td></td>
<td>9 = no comments</td>
</tr>
<tr>
<td>4) Do you think that the current situation is affecting your possibilities to negotiate lending conditions? Please exemplify!</td>
<td>I = none or insignificant room for negotiations due to the financial crisis/the weak economic climate</td>
</tr>
<tr>
<td></td>
<td>2 = none or insignificant room for negotiations due to increased regulation/the bank’s control and support system</td>
</tr>
<tr>
<td></td>
<td>3 = none or insignificant room for negotiations due to decreased price competition between banks</td>
</tr>
<tr>
<td></td>
<td>4 = considerable room to negotiate lending conditions</td>
</tr>
<tr>
<td></td>
<td>9 = no comments</td>
</tr>
<tr>
<td>5) Do you think that the bank’s client strategy is affecting your possibilities to negotiate lending conditions? Please exemplify!</td>
<td>I = none or insignificant room for negotiations due to the bank’s control and support system</td>
</tr>
<tr>
<td></td>
<td>2 = considerable room to negotiate lending conditions</td>
</tr>
<tr>
<td></td>
<td>9 = no comments</td>
</tr>
<tr>
<td>6) Is there anything you would like to add?</td>
<td>I = we focus heavily on hard information used in the bank’s control and support system</td>
</tr>
<tr>
<td></td>
<td>2 = we disregard personal relationships</td>
</tr>
<tr>
<td></td>
<td>3 = we need more future-oriented and soft information</td>
</tr>
<tr>
<td></td>
<td>4 = we prioritise to offer additional services to our clients</td>
</tr>
<tr>
<td></td>
<td>9 = no comments</td>
</tr>
<tr>
<td>7) Do you have any previous experiences as entrepreneur or business person? Please exemplify!</td>
<td>I = yes</td>
</tr>
<tr>
<td></td>
<td>2 = no</td>
</tr>
</tbody>
</table>

* Indicating defensive behaviour. These categories are italicized (see section 3.2)