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Trust and social capital in the regulation of lending activities

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Abstract

When a bank grants a loan, it takes the risk that the borrower will not honor his debt. To reduce this uncertainty, banks have created instrumental evaluation methods in order to try to evaluate the risk more objectively. An analysis of financial counselors' practices shows the limits of these methods. To obtain information needed for the financial risk evaluation and to reduce the information asymmetry between bankers and borrowers, financial counselors integrate social networks to establish bonds of trust and to accumulate social capital. The quality of the social bond determines the quality of the gathered information and therefore the quality of the risk evaluation. Bank management is aware of the limits of instrumental methods and the importance of social risk evaluation. To improve their economic efficiency, they modify their work organization and their management practices so as to facilitate the emergence of a bond of trust and the accumulation of social capital by their financial counselors. The analysis of economic actors' speech and behavior involved in activities of credit shows that behind the claimed altruism nature of the trust relationship exists an economic rationality whose social and temporal horizons of optimization differ from the model of the trade exchange seen in conventional economic theory.
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1. Introduction

Banking activity consists of lending financial resources to economic agents in need of financing. The exchange between the banker and the borrower does not concern a tangible

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product but the borrower's future capacity to honor the loan. The nature of this activity therefore implies risk-taking by financial establishments: that borrowers may not honor their debts. The profitability of banks depends on the quality of the *risk* evaluation and this depends on an accurate assessment of the debtors' reliability.

In an exchange relationship, there is an information asymmetry between the borrower and the banker (in the sense of Jensen and Meckling, 1976). The banker seeks to reduce this asymmetry in the risk evaluation process. What risk evaluation methods are used by banks? How does trust and the nature of the social bond intervene in the relationship between the banker and the borrower? Does the organization of the workplace facilitate the formation of trust relationships? Does the trust invoked by the contractors of the credit relationship square with the altruism or the economic rationality?

The banker is in the situation described by agency theory (Hart, 1987) in which the information asymmetry between the principal (the banker) and the agent (the borrower) comes with adverse selection (uncertainty regarding the viability of the project) and moral hazard (uncertainty regarding the reliability of the borrower) as described by Shapiro and Stiglitz (1984). To reduce this uncertainty, banks have created methods of evaluation that allow them to anticipate the risk of failure. Two approaches are opposed usually considered by banks seeking to reduce the risk of failure. One is an instrumental approach that seeks to define an objective method of risk evaluation. The other is a social evaluation in which the subjective perception of the borrower by the financial analyst and the holding of specific information gathered through social networks are the deciding factors in the decision of loan attribution.

We use different sociological concepts such as social capital (Bourdieu, 1980), social networks (Granovetter, 1973, 1974, 1985, 1991, 1994) and trust (Arrow, 1974) to define a framework for analyzing lending activities. These concepts are critical to our assessment of the following hypotheses:

H1. Scientific methods of risk evaluation and institutional devices intended to warn of risks of borrower failure are insufficient to efficiently reduce the risks taken by bankers in their lending activities.

H2. To reduce the inherent uncertainty in risk evaluation and to compensate for the limits of instrumental methods and institutional devices, financial counselors use a social risk evaluation. This evaluation corresponds to the acquisition of information through informal relationships based on trust. To be efficient in their job, financial counselors must accumulate social capital by exceeding 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 the information asymmetry depend on the quality of the social capital held by the financial evaluator, notably the extent of his integration in social networks which underpin the economic activities that he evaluates.

H3. Actors in the credit relationship (financial counselors and borrowers) invoke a relationship of trust that supposes a kind of altruism in their exchange relationship. The analysis of the actors' speech and behavior shows that the relationship of trust is in fact determined by economic rationality. The relationship of trust is built to gather information to optimize

the decision-making. This optimization is not made in the framework of an interpersonal and unique exchange as supposed by the conventional economic theory. The financial advisor optimizes a plurality of trades in the framework of a durable relationship with the borrower. Still, when a banker belongs to a social network, he has to calculate the potential profitability on the basis of his exchanges with this social network and not only on the basis of a one-time interpersonal exchange. With respect to game theory (Harsanyi, 1967; Kreps, 1990; Shubik, 1982), we argue that a financial advisor does not optimize an unique exchange with an unique borrower but optimizes several exchanges with all members of a social group in the context of incomplete information.

H4. Banks are aware of the limits of instrumental methods of risk evaluation and the efficiency of the social evaluation. Consequently, they have modified their management practices and their work organization to allow their financial counselors to accumulate social capital and to integrate social networks.

H5. From the employer's viewpoint, the social capital accumulated by financial counselors is a specific asset. The unsubstitutable nature of social capital owned by financial counselors modifies the power relationship they have with their employer.

In the first part, we will analyze instrumental methods of risk evaluation and institutional devices aiming to reduce the risk of borrower defection. We will show the limits of these methods in order to explain why financial counselors seek others methods of evaluation. In the second part, we define the theoretical framework of a social risk evaluation that we will illustrate by analyzing the financing of Parisian brasseries. We analyze how banking employers favor the reconstruction of interpersonal relationship between financial counselors and borrowers by new management practices. We will analyze why these new practices modify the nature of power relationships between financial counselors and their employer. Finally, in a theoretical perspective, we will examine how the relationship of trust invoked by economic actors corresponds to a rational behavior of economic optimization. Yet, the nature of this rational behavior differs from that which is defined by the conventional economic theory.

2. Instrumentation and depersonalization of risk evaluation: means and consequences

2.1. Instrumental risk evaluation

2.1.1. Principles of instrumental risk evaluation

The instrumental risk evaluation consists of formal rules intended to assess the clients' solvency from objective information. For the activity of consumption loans, statistical analysis has shown a strong correlation between objective and simple attributes of borrowers (age, profession, monthly income) and the regularity of reimbursement (Nakhla et al., 1997). Based on this information, scoring grids have been created and they are applied in a mechanical manner without taking into account subjective or contextual elements that the financial counselor could

have gathered through informal relationships with the borrower. From this experience on the household market, banks have tried to instrumentalize risk evaluation when they grant loans to small businesses. Instrumentalization of credit analysis is based on objective accounting data. The information is reprocessed for financial analysis (classification of assets according to their liquidity), for evaluating potential external risks of the project (sensitivity to the risk of currencies volatility, nature of the competition), and for examining the debt, the financial autonomy and the treasury of the borrower (Levasseur and Quintart, 1990).

To complete the analysis of projects, banks try to evaluate the quality of the entrepreneur by using instrumental methods. The analysis of *goodwill* shows that the entrepreneur contribute to the growth of his company by his training, his technical competencies and his experience (Vernier, 1996). From this perspective, a professional title (diploma, certificate of training) becomes a certification of competence. The professional experience can also be a proof of competence. For example, the importance of the entrepreneur to the viability of a project led one bank to ask an entrepreneur to take five HIV tests and four electrocardiograms in 2 months before granting him a loan. The bank asked this because the loan was guaranteed by a contract of life insurance.

In this instrumental risk evaluation process, the decision-making is centralized at the Department of Loans in the bank headquarters. It is strictly forbidden for the financial analysts of this department to meet borrowers. This is to avoid the financial analyst being influenced by the personality of the borrower. In this work organization, the financial counselor who is in a branch does not intervene in the risk evaluation. He essentially performs the administrative function of collecting data for the Department of Commitments.

2.1.2. The limits of the instrumental grid of risk evaluation

The instrumentation of risk evaluation in the financing of small businesses faces the difficulty of making information objective. This is particularly difficult during the creation phase of the enterprise because a strong uncertainty weighs on the future of its activity. Few elements can really insure the growth of a business and the return on investment. Consequently financial analysts are confronted with a problem of risk evaluation in an arena of uncertainty. It is impossible to determine a statistical distribution of the likelihood of bankruptcy within the context of an objective profile of the small business.

Moreover, small businesses frequently have a simplified accountancy (reduced to fiscal obligations) on which it is impossible to deploy sophisticated tools of analysis to judge the economic viability of their projects. Their adjustment to local markets or to specific groups of customers with which transactions are personalized and the diversity of legal status among small businesses render the financial evaluation of these small businesses difficult. Objective data may exist about the client and his project, but they have to be interpreted and put in context. For example, the lengthening the payment deadline for clients of a business is frequently interpreted as an alarming sign, yet is deemed acceptable when more precise information attributes this delayed payment deadline to the quality of particular clientele. The clients of big companies are considered more solvent and order higher volumes. They can obtain more time to pay their suppliers. To assess the pertinence of data it is necessary to associate it with other types of data.

It is also necessary to understand the borrower's personality. Evaluation of his motivations and his entrepreneurial competencies is needed to anticipate the probabilities of a

project's success. Financial counselors recognize that the business plan often brings only limited information on the real risk and that their work necessitates understanding the entrepreneur himself more than the project. The efficiency of the instrumentation is therefore denied by the heterogeneity of the environment. We end with conclusions similar to Trist and Bamforth (1951) who show, in their study on coal mines, the impossibility of implementing scientific work organization in an uncertain environment.

2.2. *State intervention in the regulation of credit activities*

2.2.1. *Institutional devices*

To reduce the information asymmetry between banks and borrowers, public authorities contribute to the socialization of information by creating a national file of delinquent payers and by ranking the enterprises' solvency.

In France, the State has also defined legal and institutional devices for the lenders' protection. According to these policies, banks can demand specific information about the entrepreneur to reduce the information asymmetry. They can take guarantees (mortgages, cautions, pledges, securities) against the borrower and his family to prevent the risk of failure. Public authorities also participate in the protection of lenders through penal punishment of failing borrowers. We are close to the incentive theory model (Laffont, 1991) in which the state modifies the calculation of optimization by the borrower and incites him to adopt an honest behavior by the threat of penal and financial punishments.

To the extent that economic agents have trust in state policies, economic regulation by means of the interpersonal trust between contractors could be replaced by an impersonal trust in institutions that regulate the economy (Shapiro, 1987). However, analysis of the banking sector shows that these institutional devices fail to warn of the failures of borrowers. They can not correctly evaluate the future borrower solvency nor prevent his opportunistic behavior.

2.2.2. *The limits of institutional devices designed to protect lenders*

A financial counselor knows the nature of the information he needs to evaluate the demand for a loan. The problem resides in the difficulty of accessing this information. The bank (through the client's credit history and the financial movements of his account) accumulates some information and other information can be found in the economic press and in public databases. The financial counselor can ask for some information: book-keeping, identity card, diplomas ... Yet, some information cannot be asked for by legal or conventional means; or the borrower can hide that information. For example, the borrower can make a false statement regarding his wealth to avoid it being used as a pledge or he can choose not to reveal his family's fortune to avoid it serving as a guarantee, or he can refuse to give information on the quality of his marital relationships (divorces are an important cause of bankruptcy in small family businesses). All this information is objective in nature but the financial counselor can not legally demand them in the framework of formal professional relationships.

In France, the legal protection of lenders has been weakened by recent evolutions in jurisprudence. The legislation allows the attorney in charge of managing the bankruptcy to denounce the amounts of credits granted by banks as excessive, by suggesting that the extension of credit has allowed the artificial maintenance of the enterprise's activity and deluded others

contractors. At the same time, the syndic of bankruptcy can reproach the bank for failing to extend credit. In this case, the bank is being accused of causing the bankruptcy. In both cases, the attorney can request financial compensation by the bank. Moreover, by article 99 of the 13 July 1967 law, trade courts can assert the bank's responsibility for business bankruptcy when one of the bank's financial counselor has contributed to the management of the business. The financial counselor need only have participated informally in the management of an enterprise or assisted at regular meetings regarding the future of the enterprise. In these cases, the bank qualifies as a manager and is declared responsible for the business's failure.

So, banks are seeking new methods of evaluation and new protection devices against the failure of borrowers because of limits inherent in the instrumentation of the risk evaluation and because of the weak protection provided by institutional devices.

3. Social evaluation in financial risk analysis

3.1. Social network, social capital and trust: three dimensions of the same social phenomenon

Many authors (Leff, 1979, Coleman, 1988, Karpik, 1989, Baker, 1990, Callon, 1991, Degenne and Forse, 1994, Ghoshal and Nahapiet, 1998), have shown that the quality of the economic agent's social bond with members of his socio-economic environment has an impact on his success. With the concept of "*embeddedness*," Granovetter (1973, 1974, 1985, 1991, 1994) has studied the impact of the social networks held by individuals and by communities on their economic success (job search, development of the American electrical system, . . .). One of the main findings of economic sociology is that social networks modify economic regulation because of the principle of solidarity that links their members and because the nature of the information that circulates in them changes the nature of the exchange. The mutual knowledge of the social network's members reduces the information asymmetry for trades made between these members.

The collective phenomenon of the social network can also be understood at the individual level using the concept of "social capital" (Bourdieu, 1980). Each individual holds social capital that corresponds to all of the resources that are linked to the possession of durable social relationships that are more or less institutionalized. In this case, the concept of social capital suggests that an individual's social relationships constitutes an advantage in his economic activity because information that he holds about the members of his social capital reduces the moral hazard in trades made with them.

The concepts of social network and social capital can be linked to the concept of trust in the understanding of economic regulation. We use the concept of trust in Arrow's sense (1974, p. 23); he defines it as "*an important lubricant of social activities*." The use of the concept of trust in the understanding of economic trade does not mean that we introduce a form of altruism in trade. Following Williamson (1993) we argue that trust in trade is a calculative trust. We hypothesize that the mutual knowledge between contractors reduces the moral hazard and allows each to anticipate honest behavior from the other contractor. The degree of mutual knowledge depends on the duration and the density of the interpersonal relationship.

We hypothesize that the incompleteness of contracts induced by the weakness of the instrumental method of risk evaluation and the limits of the institutional protection devices used by lenders can be solved by the quality of the social bonds between financial counselors and borrowers. The greater the density of interpersonal relationships the greater the access to information which is inaccessible in the framework of strict professional relationships. In some cases economic activity can be inhibited by the lack of trust between contractors when the overlapping between the private and professional spheres of the contractors is too weak (Geertz, 1962). The trust becomes here "*a form of social organization*" (Karpik, 1989, p. 197) that allows trades that would not be realized in the framework of formally organized markets. 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 expectations about the transaction by the actors. In economic trades, the social capital of an individual is constituted by the persons with whom he has trust relationships. The transitivity of this relationship (I trust X, that I do not know, because Y, that I know, trusts X, so I trust X) strengthens and maintains the social network by multiplying interpersonal relationships.

We define a social network as a group of individuals among whom the economic interaction frequency and the social relationship density reduces the moral hazard by differentiating dishonest members from honest members. The first characteristic of a social network is that the information that concerns its members circulates very quickly and reputations are built very rapidly among its members. This specific information structure creates an information asymmetry between members and nonmembers of the social network. The second is that there is a strong solidarity between members of the social network. Someone who interacts with a member of the network implicitly and indirectly interacts with all of the network's members. Moreover, the individual initiating an action with a member of the network is aware of this implied interaction with the entire network.

These characteristics modify the nature of the exchange. The social appreciation of the risk inherent in an exchange is not like that in an instantaneous relationship which is strictly professional and strictly individual. Rather, it is like that in a durable relationship, in which an informal and personal dimension intervenes between the contractors. The embeddedness of contractors in a social network means that each exchange implies, at least in an indirect way, relationships with all the members of the social network.

Before analyzing how a social evaluation constitutes a generalized mode of risk evaluation, we are going to show how information gathered through social networks can allow a better risk evaluation than an instrumental evaluation by using the example of the financing of Parisian brasseries in France.

3.2. An illustrative example: the financing of Parisian brasseries

During the 1980s, while implementing a new commercial strategy oriented to the financing of small businesses, French banks evaluated the financing of Parisian brasseries. A major bank attempted to understand this new market by using instrumental logic by defining a specific grid of financial scoring based on business plans and accounting data. Loans were granted if the project tallied with the objective profitability criteria and if guarantees (security, mortgage, ...) were available. Financial counselors financed all projects corresponding to

the criteria of the grid of financial scoring. Their personal judgement did not intervene in the decision.

Another bank oriented its commercial strategy to the same professional segment but with a different approach of risk evaluation. This bank noticed that 80% of Parisian brasseries were held by Aveyronais. More precisely by people from the Cardalez, a region north of the Aveyron, south of the Cantal and a part of the Lozére (three administrative districts in the centre of France). Members of this regional community occupy all jobs in the brasseries business: beverage wholesalers (wines, beers, coffee, mineral water, ...), accountants and attorneys associated with the sector, and all people working in these companies (waiters, deliverers, managers, representatives, ...). This community constitutes a social network in which each member holds inaccessible information inaccessible to external persons. This specific information allows each member to correctly anticipate the behavior of others members. This mutual knowledge is due to the fact that all the Aveyronais have frequented in their youth the same schools, the same parties, the same soccer clubs in their native region. The high level of intra-community marriage reinforces the solidity of this social network. In Paris, the community regularly gets together in institutions like the House of the Aveyron, that welcomes young people who arrive from the Cardalez, and in festivities which groups attend based on their village of origin. Moreover, each year in August, virtually all members of the community return to the Aveyron for holidays and celebrate together. The force of social bonds inside the community is maintained by the existence of common places of socialization.

Thus, the community of Aveyronais is a social network in which information circulates rapidly and where reputations are constructed rapidly about the reliability or unreliability of people (the community identifies alcoholics and gamblers with whom nobody does business). This high level of information circulation is induced by the density of social relationships and reduces moral hazard when trades are realized between members of the community. Moreover, the solidarity that unites members of the social system strengthens its economic efficiency. Thus, wholesalers will grant longest time for payment of invoices during bad periods of business and will give credit when banks refuse to do it.

This strong community integration radically modifies the risk evaluation in this sector. The risk is assessed differently according to whether the borrower is Aveyronais or not. Aveyronais bankers, residing in the Aveyron, grant loans for their Parisian compatriots[1] without looking at the business plan nor visiting the brasseries that they finance (things usually done by a "normal" financial counselor) because they hold enough information on the quality of borrowers and on their families thanks to their belonging to the same social network.

This banker's trust in the information diffused in the social network can also be explained by the specific role held by wholesalers' representatives. These representatives (who are Aveyronais too) implicitly regulate the market transactions of brasseries' property. When an Aveyronais wants to buy a brasserie, he contacts a representative coming from the same region as himself, perhaps from the same village. The representative evaluates the reliability of the potential buyer. He knows him very well because he has seen him evolve in the profession for several years as waiter and/or as brasserie manager. He may have information from other members of the community who know the buyer (former employers, friends, even from the buyer's family). As soon as the representative is assured of the reliability of the buyer, he puts him in touch with an owner who wants to sell his brasserie. The brasserie owner sells his property only

to buyers introduced by representatives because they trust them. Implicitly, the representative then assures the buyer a loan by introducing him to an Aveyronais banker who grants the loan because the representative morally guarantees the borrower. From the viewpoint of the banker, the risk evaluation is transferred to the wholesaler's representative. The former has an interest in introducing reliable borrowers if he does not want to decrease the banker trust in him and if he wants to be recognized by his community as a good professional.

Therefore, the social coercion exercised by members of the same social network limits opportunistic behavior. The borrower who has obtained the moral guarantee of a wholesaler to buy a brasserie has no interest in betraying this trust, since such a betrayal would come at a high economic and social cost. An economic cost, because the whole community would know his failure and after this nobody would want to work with him, either to fund him or to sell him a brasserie. A social cost because his professional failure in Paris would be diffused amongst his friends and his family. He would become the shame of his family and his family would be identified as the one which went bankrupt in Paris. Each summer when he returned to Aveyron for the holidays, he would be known by all the people of his village as the one who failed. Avoiding this shame and this social exclusion is a strong incentive to be successful in business.

The second bank that we have studied used a different risk evaluation policy based on its understanding of the importance of the social network to the activities of Parisian brasseries. It recruited the son of an Aveyronais wholesaler serving this sector as its financial counselor. So, in this bank the risk evaluation is done by a member of the community. The risk evaluation is not focused on financial or accounting facts but on the reliability of the client according to a member of the community and based on the reputation of the individual within his community. This trust in social evaluation led some bankers to give up all instrumental analysis. In this Parisian bank, the manager of the small business market confesses:

> If a young Aveyronais asks me for credit and he has got the moral guarantee of X (X being a Aveyronais wholesaler), I do not look at the business plan to grant the loan because I trust him. On the other hand, if he has not got this recommendation, I do not grant a credit.

Moreover, this recruitment has attracted some Aveyronais borrowers to the bank that now employs one of their compatriots. The financial counselor becomes a prescriptor of clients that belong to his social network.

The means of risk evaluation has a strong impact on economic results. The bank which chose the instrumental method of risk evaluation lost more than 200 million francs. This is due to the fact that this bank funded an Arabic man who did not belong to the social network underpinning the brasserie business. He did not benefit from community solidarity during economic depressions. On the other hand, the second bank has funded some of the best Parisian brasseries owned by Aveyronais. Their rate of default was lower, in part because ethnic solidarity ensured that Aveyronais brasseries maintained a clientele during economic downturns.

This example illustrates the limits of an instrumental method of risk evaluation, even when it is strengthened by legal guarantees brought by state policies. It is not the financial counselor's accounting competence which provides the correct risk evaluation but the information brought by his social capital. In terms of the technical capability of financial analysis, the financial counselor of a branch in the Aveyron (which is at 600 km from Paris) is not more competent

than his colleague in a Parisian branch. On the other hand he is better integrated into the social network which underlies this economic sector. Thanks to this better social integration he gathers relevant information to evaluate risks and he is protected by the solidarity which links the "honest" members of the community.

3.3. Towards a theory of the social risk evaluation

To build a theory of social risk evaluation it is necessary to explain the economic efficiency of the trust bond. The analysis of the actors' speech and behavior involved in the credit relationship (banker and borrower) shows us that the will to establish a trust relationship results from rational behavior and not from altruism. We call the "trust bond" the economic exchange relationship in which the moral hazard is reduced thanks to the mutual knowledge of actors and/or to their membership to a same social network. We are going to analyze the conditions of existence of this social bond and the constraints that it imposes on actors in the relationship.

3.3.1. The role of the trust bond in risk evaluation

There is a social risk evaluation when facts used for the evaluation have been obtained through interpersonal relationships and/or through a social network. The issue for the financial counselor is to transform a pure professional interaction into an informal and friendly interaction. A social and emotional proximity between the financial counselor and the borrower has two functions. Firstly, the banker can gain a better understanding of the specificities of his client's business. Secondly, he gathers more information from his client than he would obtain in a pure professional relationship. Thanks to his embeddedness in the same social network as the borrower, the banker can also obtain information indirectly through his relationships with members of the network.

The social bond built in the long-lasting relationship between the financial counselor and the borrower tallies with an accumulation of social capital and is a determining factor in the risk evaluation. This is the reason why older financial counselors are often more efficient than younger counselors. The difference is not due to a higher technical competence (often new graduates are better in this field) but to a better knowledge of their clients thanks to the higher quality of their interpersonal relationships with them. The social capital accumulated through professional relationships grows with time and leverages the technical "knowledge capital" of the financial counselor.

An important task for a financial counselor is to identify the social networks and the nodes of information convergence in these networks. The development of cordial and intimate interpersonal relationships, the exchange of nonprofessional information and the participation in local life aim to embed the commercial relationships in a larger social exchange context. For this integration into the social environment, the banker must exit from a purely professional relationship in order to participate in the community life. He does this with an ulterior professional motive. For example Benoît D. (Branch manager) recognizes:

> I go to the café and I learn a lot things during discussions at the counter, notably in the evening at the moment of the aperitif. It is necessary to discuss clients with clients to gather information. Some shopkeepers are very talkative and they give us information.

And he illustrates this by an example:

> During an athletic competition organized by the city I made the acquaintance of the person in charge of the small businesses development program at the town council. Now, thanks to him, I know when the town council decides to finance a civil engineering project in the street. This is the kind of fact that your borrower would not tell you because it may cause a decline in his brasserie's turnover; a fact which will unfavourably influence the financial counselor in his risk evaluation.

The banker's strategy of social infiltration depends on which social network underlies the business that he wants to evaluate. When a social network is geographically-based (for example, the area around the branch), the successful financial counselor should frequent places where his potential clients socialize in order to find individuals who have information and to learn the local actors' reputation. Yet, there are several social networks that coexist in large cities, including family-based or geography-based social networks. There are also social networks based on a profession (pharmacists, publishers, . . .), on ethnic origin (Basques, Chinese, Indians, . . .), on religion (Jews, Protestants, . . .) and on a specific social group membership (prestigious clubs—Rotary, Lion's—aristocrats, old boy associations, members of a prestigious golf club, . . .).

The successful financial counselor should find and penetrate the borrower's social network (his clients, his suppliers, others entrepreneurs, his friends, . . .) in order to evaluate risks by gathering information that circulates in the network. Banks do not recruit their financial counselors only for their technical competence (financial analysis, accounting, . . .) but also for the pertinence of their social capital in regards to the kind of business that banks want to fund. This kind of social strategy of recruitment is particularly visible in investment banks. For example in Lazard (the major French investment bank), the partners come from all major social networks of the French economy. There are Jews, Protestants, aristocrats, and alumni from ENA, Polytechnique, HEC (which are the most prestigious French postsecondary institutions in administration, engineering and business). In these social networks relevant and confidential information circulates that allows investment bankers to make social risk evaluations and ensures that they are included in profitable deals in the mergers and acquisitions business.

We argue that there is a new nature of exchange when trust is established between the financial counselor and the borrower. The competition changes and is no longer based strictly on interest rates because obtaining a better rate becomes less important for the entrepreneur than the assurance of having a long-term partner who understands his business and reacts quickly. This lesser sensitivity to the interest rate should not be interpreted as a kind of altruism but as a temporal and qualitative change in the calculation of profitability. The long-term relationship reduces the cost of information gathering. For each new transaction the financial counselor already has information about the borrower. The uncertainty and the moral hazard decrease with the length of the commercial relationship. It is a kind of reputation effect (Milgrom and Roberts, 1992) created by several repeated social interactions. To form this kind of relationship the entrepreneur gives up the right to negotiate the interest rate in order to establish a more reliable source of credit from his banker. The financial counselor accepts the deal because this kind of relationship reduces risk and uncertainty. In the following discussion, an entrepreneur gives us an example of the self-interest that drives his efforts to develop a long-term relationship

with his banker. He testified that:

> On Thursday, we learned that a bid had been launched by a Tunisian company for a machine tool. The deadline for answering was on Monday. In order to win this bid we needed a guarantee from our bank on this export market before Monday morning. Our financial counselor called the correspondent of his bank in Tunisia to obtain the guarantee for us and we got the contract. If we had not had a long-lasting relationship with our financial counselor it would have taken more time to get the guarantee. If it had been our first relationship, he would have wanted more information about us to evaluate the risk and we would have missed the deadline.

The relationship of trust between contractors has another effect. Due to the transitivity between members of the same social network, the social network can bring new clients by cooptation. The existence of a preliminary social bond with a prospect is determining to get as client. Classic methods for seeking clients among a target population include solicitation by mail and calling prospects to make an appointment. This process is called "hard prospecting," because there is not a pre-existing social bond, directly or indirectly, between the financial counselor and the prospect.

Another way of prospecting is to coopt clients using existing social networks. This might be done by existing clients or by official intermediary. Notaries, attorneys or accountants can introduce their clients to a financial counselor. In these cases, the introduction is underpinned by the transitivity of the bond of trust. In this relationship, the new client trusts the financial counselor because he trusts the recruiter who himself trusts the financial counselor. This process is named "relational prospecting" because there is an indirect pre-existing social bond between the financial counselor and the prospective client.

We tested these two methods of prospecting clients in a bank. For 1,564 recruits contacted through a hard prospecting process, just seven opened an account (0.44% of the population). For 217 prospects contacted through a relational prospecting process, the number of open accounts was 12 (5.52% of the population). The relational prospecting process is 12 times more efficient than the hard prospecting process. This calculation does not take into account the fact that the intermediary is going to generate a continual flow of new clients when the financial advisor has established a relation of trust with him[2]. Moreover, the use of social networking as an efficient way of prospecting is reinforced by the fact that an intermediary has no interest in destroying the relationship of trust with his banker by introducing bad quality borrowers. Implicitly, the risk evaluation is socialized by the social network.

3.3.2. Conditions of existence of the trust bond in a trade relationship

3.3.2.1. The geographical proximity of the contractors. Geographical proximity is the first condition needed to establish an interpersonal bond of trust (Ghoshal and Nahapiet, 1998) because such proximity improves the quality of the interpersonal relationship[3]. The risk evaluation is a mix of accounting information, subtler information gathered thanks to the proximity with the borrower and subjective understanding of this information. Describing his decision-making process, a financial counselor explains that he examines the evolution of the financial ratios and compares them to the other enterprises in the sector. In addition, he looks at the potential of the geographical area and the borrower's age. The counselor questions him to

evaluate his knowledge of management principles. Given the frequency of alcoholism among brasserie owners, he then tries to ascertain the likelihood of a drinking problem. He goes to see the shop owner in his workplace in order to evaluate his seriousness, to see how well he welcomes his clients and to ascertain how well he runs his shop. He questions other shopkeepers in the same area in order to gather information and in order to assess the borrower's reputation. In this approach, it is the physical proximity between the financial counselor and the borrower that conditions the quality of the interpersonal relationship i.e., that allows the financial counselor to formulate a closer interpersonal relationship.

The importance of physical proximity for establishing a trust bond with small businesses gives a competitive advantage to regional banks that are closer to their clients. Thanks to this intimate knowledge of their clients, they evaluate the risk with a greater reliability than the larger more centralized banks (Carmoy, 1990). This partly explains their higher profitability in comparison with major national banks such as BNP, Crédit Lyonnais or Société Générale (Commission Bancaire, 1995).

A similar analysis has been done by McKinsey in their survey of the American banking system (Bryan, 1988). This survey showed that community banks are more profitable because of their knowledge of their local market. They have strong trust relationships with major decision-makers in the community (local businessmen, real estate promoters, jurists, accountants and others) and use these relationships to acquire information needed for risk evaluation. The existence of local branches allows a geographical proximity that favors the creation of interpersonal knowledge which underlies the establishing of the trust bond.

3.3.2.2. The need for long-lasting exchange relationships. A long-lasting exchange relationship reduces the costs of access to information because it allows a mutual apprenticeship between contractors. The contractors' interest is to enter into a financial relationship close to the logic of a repeated game between the same players rather than one of unrelated unique transactions. The is true since it is the regularity of the relationship that produces information. A borrower having a long-lasting relationship with his banker will have an advantage over other borrowers and will be able to obtain a greater reliability from his banker. Without a common history between the banker and the borrower, the uncertainty is higher and more information has to be exchanged to reduce it. Successive negotiations correspond to a mutual apprenticeship that creates trust between the banker and the borrower, so simplifying future negotiations. That is, trust is based on upon mutual knowledge that allows the participants to anticipate reliable behavior from the other contractor.

The financial counselor and the entrepreneur have a mutual interest in creating a reservoir of shared knowledge. The more the borrower gives information to prove his honesty and reveal his behavior, the more his banker gives him the best financial conditions. There is a continuum going from distrust to trust and the information level defines the nature of the relationship. The length of time over which an exchange relationship has been pursued is important for establishing a trust relationship because time is necessary to allow for information sharing between contractors.

3.3.2.3. The need to modify the nature of the professional relationship. Close proximity and a longer duration of the professional relationship are necessary but not sufficient conditions for

the establishment of a trust bond. The nature of the relationship also has to evolve to create an *intuiti personae* between contractors[4]. The best financial banking counselors strengthen their professional relationships by informal and friendly relationships which allow the emergence of the *intuiti personae*. A human resource director of a bank explained:

> Beyond the technical competence needed, the financial counselor has to have exceptional relational qualities. Because without intuiti personae, the ambience of trust which is absolutely essential for a good development of the activity can not be established. We always prefer to recruit a candidate who has a good sense of contact, even if his technical competence is not perfect, rather than a good financial analyst who is unable to establish a trust relationship with his clients.

The professional relationship becomes a pretext for informal relationships in which information is exchanged without a direct link with the business. This conviviality does not only result from the natural sociability of human beings but rather squares with the strategies of rational actors. A better knowledge of the private life of the borrower may improve the risk evaluation. By these informal relationships, the financial advisor can discover the borrower's personality and evaluate his style of management. He can observe his ability to cope with different business-related events and he may also discover the quality of an owner's relationship with his wife (which is very important when the couple works in the same business).

A financial counselor insisted on the necessity of having a convivial relationship with the client by speaking about family and extra-professional activities that would not be discussed within the confines of a strictly professional relationship[5]. He argues:

> It is necessary for a financial counselor to have an intimate knowledge of his client. To create a convivial relationship it is important to know the subjects about which it is possible to joke. We have to be pleasant, attentive and joking to create more than a pure professional relationship. With the clients, it is necessary to speak about their leisure, to be interested in their trips, to talk about their children. It is important to know the names of the client's children because it is more convivial.

These civilities allow the exchange of information important to risk evaluation, by allowing for the formation of a trust relationship.

On the other hand, an entrepreneur who wants to obtain the trust of his banker has an interest in giving a lot of information in order to reveal his behavior and his personality. In order to establish informal relationships some entrepreneurs visit their financial counselors just to talk about their private life and to maintain friendly bonds. A document of advice for entrepreneurs published by a Chamber of Trade incites them "*to obtain the trust of his banker*" by meeting him in an informal arena in order to create an extra-professional relationship. This document gives the example of an entrepreneur who meets his banker regularly at meetings organized by the Chamber of Trade. In this vignette, the client presented a positive image of his personality to his banker by talking about extra-professional subjects during these meetings.

For the financial counselor, the necessity of transforming a professional relationship into a friendly relationship supposes the renunciation of a strict separation between his professional and private lives. He must accept that there will be overlaps, that work maybe done outside of normal working hours, and that his family may well be implicated in the establishment of

social relationships with clients. Work is not limited to the workplace nor to the official work time. Work and private life become blurred.

Many financial counselors engage in extra-professional activities with their clients (golf, running, concerts, exhibitions, ...)[6] and frequent their clients' places of socialization in order to penetrate their social networks. A financial counselor working in the Paris area who specializes in the textile industry explained:

> I play petanque with members of the textiles community and I talk with them about business. Everybody gives information about everybody. I gather facts that I tally between various sources. I discover people's reputations. I know who the crooks are in the community. I have information about health troubles and family relationships. These are the kinds of information that people hide when they ask for credit.

A trade relationship based on trust presupposes physical proximity and a long-term and private relationship between contractors. It is this kind of social relationship that allows mutual social learning and reduces the risk linked to the moral hazard associated with the credit relationship.

3.3.3. Social network membership modifies the nature of the exchange

3.3.3.1. The contractors have to provide proof of the new nature of the relationship. When a trade relationship is based on trust, the exchange between the financial counselor and the entrepreneur is not limited to a pure professional relationship centered around the obtaining of a loan, but rather it becomes a more complex relationship. A new kind of solidarity is established between the banker and the borrower. For example, a financial counselor from the textiles area that we surveyed knows four or five entrepreneurs of this craft very well. He trusts them and he solicits them for information when a textile craftsman seeks to obtain a loan. In this case, recommendations by these members of the textile community reduce the banker's uncertainty about the borrower's behavior.

Conversely, a banker can give a client information about his competitors or about possible partners. An entrepreneur confessed:

> One of my suppliers has the same bank as me. I know the branch manager well because we are friends and we dive together. One day in a discussion he told me that my supplier had payment problems and that he was in danger of bankruptcy. I then took some precautions and found another supplier. I think that he would not have given me this information if we had not been friends.

Establishing friendly relationships involves several symbolic acts to provide proof of the new nature of the relationship. It is necessary to provide some extra-professional services to prove that the relationship is not a purely professional one. For example, a financial counselor acknowledged that:

> I took a client's daughter for an internship because she had to do one for her masters degree. The client appreciated this and I think it influenced him when he decided to give me more funds for management.

Sometimes a financial counselor has to break the rules of his bank in order to offer proof of the trust relationship. A branch manager confirmed when he is in a trusted relationship with an entrepreneur, he frequently applies administrative rules with less rigour. For example he recounted that:

> One time I decided in five minutes to grant an overdraft of 500,000 francs to an entrepreneur. I knew him well, so I did not respect the internal rules. We formalized the situation later by writing a contract. But he had already begun to use his overdraft.

Similarly, Estelle R. (a branch manager) said us that:

> Sometimes we bring cash to clients in their home. The management strictly forbids this. But clients appreciate these small services and it is way to earn their confidence.

The financial counselor is not motivated by altruism. Rather, the financial counselor self-consciously engages in such behaviors because they know that the immediate "cost" of such symbolic acts will prove profitable later. For example, the client for whom the financial counselor has broken the bank's internal rules is more likely to buy different financial products from the counselor and he is more likely to grant the counselor important information. The financial counselor chooses to offer his services for free because he knows that he will be in a better position when negotiating future trades. His economic optimization is not calculated upon the basis of a unique exchange, but upon the probability that there will be future trades in his ongoing relationship with his client.

3.3.3.2. From economic optimization of the transaction to the economic optimization of social capital. When a financial counselor has become integrated into a social network (family, professional community, club, religious group, . . .), he has to manage the diffusion of information within the network. An exchange with a member of the social network corresponds to an indirect exchange with the whole social group. The financial counselor not only has to manage the profitability of his relationship with a borrower but the profitability of his relationship with their entire social network. At an individual level, it may be rational to refuse a loan to a person, but this decision may entail the disapproval of the borrower's whole community. Some financial counselors' behavior can therefore appear irrational from the point of view of short-term profitability. However, such behaviors are completely rational if we understand them as an attempt to nurture the "profitability" of the financial counselor's long-term social capital. Punctual losses in an exchange with a given client are often compensated for by profits made in other trades with the other members of the social network.

A decision can modify the interpersonal relationship between the banker and the borrower but it can also modify the banker's relationship with the other members of the social network. In negotiations, contractors use their ability to modify reputations by diffusing information in the social network as a negotiating tactic. In negotiations with his banker, an entrepreneur can threaten to ruin the banker's reputation within the community. Thus an entrepreneur in the building trade explained:

> The Crédit Agricole branch manager refused to reduce the interest rate on my loan when the interest rate declined. On the other hand, the Crédit Mutuel agreed to reduce my loan's interest

> rate. I told this to all the other entrepreneurs that I met on the building site. Some of them have changed banks as a result and now go to the Crédit Mutuel.

The shift from a purely professional relationship to a friendly relationship modifies the nature of the optimization for both contracting parties. The resulting optimization is not a strict economic one because it integrates both a psychological and a social dimension. When a client declares bankruptcy, the banker does not only see the failure of a client but also the failure of a friend. Conversely, an entrepreneur loses the esteem of his banker and destroys the capital of trust accumulated when he fails in his credit commitment. The nature of these exchanges is not purely economic. They are symbolic and social too. Because of the implicit social network regulation, a moral coercion (the will not to betray a friend) and a social one (to be identified as traitorous and as a loser) are added to the explicit legal and judicial coercion. Therefore, the banker has an interest in transforming a purely professional relationship into a more friendly relationship which allows him to establish interpersonal relationships with the members of his client's social network. There are some risks for the financial counselor, because if he refuses a loan to an entrepreneur in a way not considered legitimate by the community, he will become suspect in the community.

4. New management practices to favor the accumulation of social capital

Banks have modified their management practices. In order to overcome the limits of the instrumental method, they now seek to develop social risk evaluations of lending activities. They have improved the proximity and the personalization of the lender–client relationship, because they recognize the economic value of longer-term relationships between the financial counselor and the borrower. These changes have involved both work organization and human resource management.

4.1. Decentralization of the decision-making process

The incorporation of trust in lending practices implies that the central departments of banks (staff) accept the formation of informal and personal relationships between financial counselors (line) and clients. The reconstruction of the social bond between personal lines and clients implies a deinstrumentalization of the financial exchange and a labor organization that gives more responsibility to financial counselors. Ten years ago, the autonomy of loans authorization for a branch manager was low. He could only grant a few 1,000 francs without the authorization of the Loans Department. Now, the decision-making has been decentralized and a branch manager can grant higher loans—up to several millions for some loans—with complete autonomy. The decentralization and the higher autonomy of financial counselors squares with the deintrumentalization of the relationship with the client and is the necessary by-product of the implementation of a subjective appreciation of risk by the financial counselor. Now, the financial counselor is no longer part of an administrative mechanism (i.e., to collect accounting documents for the Loans Department). Instead, he is responsible for the financial risks taken when he grants a loan. The subjective evaluation becomes important because the

financial counselor has his own understanding of relevant facts for a risk evaluation and he has a personal definition of risk.

This decentralization of the decision-making process allows a specialization of financial counselors by geographical area and/or by business sector. This specialization has two objectives. First, the financial counselor can acquire a technical knowledge about a given business sector (high-tech, publishing, ...) by learning the specificities of production tools, business cycles, specific accounting rules and prospectives for development. This technically specific knowledge reduces the information asymmetry linked to adverse selection. Secondly, this decentralization helps the financial counselor to penetrate the social networks that underlie a given business sector. By accessing these social networks, the financial counselor gathers information about individuals that reduces uncertainty due to moral hazard. The technical evaluation is then strengthened by a social evaluation.

To reach these two targets, one Parisian bank has created a branch that specializes in the financing of the publishing business. Financial counselors of this branch have been trained in the technical specifics of this business. They attend all professional meetings and social gatherings of this profession in order to be accepted into its social network. This bank is one of the few banks that realizes a profit by financing this business sector. Thanks to his specialization, the financial counselor can undertake a technical analysis of the credit risk and then strengthen this assessment by making a social evaluation of the risk. Thus, a financial counselor mobilizes both his technical knowledge and his social knowledge to evaluate risks. He can, for example, refuse a loan because he believes that the choice of production tool is wrong. As a practitioner explained:

> If I know a business sector well, there is no subjectivity involved in the evaluation of a project's feasibility. If an editor wants a loan to finance a German machine which costs fifteen million Francs, I explain to him that there are Japanese machines that make the same thing but that cost only 4 million.

The same financial counselor can also invoke more informal information to justify his decisions:

> I met X, a publisher that wants a loan to launch a new collection. Two months ago I met one of his partners. He [the partner] told me that he wanted to leave the enterprise. Moreover, the rumors about X that I have heard in the profession are not very good. Somebody told me that he drinks a lot of alcohol. So I refused to grant him a loan.

In the first case, it is the technical expertise of the financial counselor which underlies the decision and which reduces the uncertainty linked to adverse selection. In the second case, it is the information obtained by his membership in the borrower's social network that reduced the uncertainty linked to moral hazard.

4.2. Management strategies for fostering personalization and long-term relationships

Banks personalize relationships between financial counselors and clients in order to help foster trust relationships and to facilitate the accumulation of social capital. Banks give financial advisors specific client portfolios (the sizes of portfolios vary from 30 clients on the medium

sized businesses market to 250–300 on the smaller sized businesses market). To personalize the relationship between the counselor and client, the financial counselor is made the unique interlocutor of the borrower. This management rule allows a plurality of trades between the same contractors over the long-term and facilitates the establishment of mutual knowledge between them. The personalization and the continuity of the relationship allows both a mutual apprenticeship by the contractors and the formation of the *intuiti personae* needed for the exchange. Thus for Gilbert N. (financial counselor) explains:

> Every financial counselor knows his client very well because he is in charge of the relationship for a long time. The confidence between them can not be shared. There are lots of clients who do not want to be managed by another counselor. They do not want to change the relationship habits that they have established with a specific interlocutor.

The personalization of relationships has been extended to other clientele. For example, at the Crédit Lyonnais 93% of all clients are followed individually by a specific financial counselor. Similarly, CIC Paris has built its strategy in the household market around the theme of constructing a durable bond with the client. This bank's sales pitch hinges on the argument that all customers are offered a personal counselor: "*your financial advisor becomes your privileged interlocutor. Because he knows you, he only proposes those products that interest you. This guarantees that you pay only for the services that you need and that you will have personalized advice according to your priorities*." CIC Paris assures customers that such personal service is of mutual benefit to the client and the bank: "*the low number a accounts managed by a financial advisor allows both the intensive exploitation and the development of the portfolio. The exploitation of this portfolio involves regular appointments with the client because these appointments are the basis of the building of a trust relationship . . . A happy client will recommend you and our establishment to his friends and to his relationships*.[7]"

Banks implement new management practices to ensure that there is continuity in the relationship between financial counselors and their clients, chiefly by guaranteeing employment to counselors so that they have sufficient time to build up trust relationships with their clients. There is a consensus among bank managers on the length of time needed to form trust relationships with clients and integrate the social networks of the borrowers. When this question is asked of different actors in the banking sector (financial counselors, branch managers, recruitment managers): "*Take two technically competent financial counselors who have the same level of technical competence and are equally efficient in their jobs. Put each of them in the other's job. They still mobilize the same technical competence but their social knowledge of their new portfolio of clients is nil. In this situation, how long does it take for these financial counselors to be efficient in their new position?*" Invariably, bank managers respond that "*between one and two years are needed for a financial counselor to know all the specifics of his new clients and to establish a trust relationship with his clients. This trust is necessary for an accurate risk evaluation*."

The formation of a durable interpersonal relationship between financial counselors and borrowers is a kind of investment in human capital, in Becker's (1974) sense of the term. Human resources management must be organized differently in order to facilitate the accumulation of social capital, in addition to technical competency. Because social capital takes time to accumulate, the first year of the financial counselor's job must be considered an investment

i.e., a necessary first step towards creating profitable long-term counselor–client relationships. Banks have modified their management practices in order to make this initial period of social capital accumulation profitable. During the 1980s, it was thought that a financial counselor should not be remain in his job for more than 3 years. A high level of internal mobility was the rule. By the beginning of the 1990s, this principle of management had changed. For example, at the BNP, a financial counselor now has to remain in his job for a minimum of 3 years. First, the financial counselor's stability is necessary to allow him to accumulate social capital. Second, this stability is needed if the bank is to profit from the social capital accumulated by the financial counselor.

Since banks have recognizes the role of social capital in risk evaluation, recruitment criteria has also evolved. Now, Human Resource Departments seek recruits who will accept a higher degree of professional stability. At the beginning of their new strategy for the small business market, banks' Human Resource Management Departments were focused on technical competence. Banks had essentially recruited graduates from the best French business schools (HEC, ESSEC, ESCP, Dauphine University, ...) who had this kind of competence. In one bank we surveyed, graduates from these schools represented more than 70% of the financial counselors recruited between 1985 and 1990. Yet, the Human Resources Department observed a high correlation between the rate of labor turnover and the level of diploma. The higher the financial advisor's graduate level, the more often he wanted to change jobs. Financial counselors who obtained their position due to internal promotion were more stable than financial counselor's who had recently graduated from these prestigious schools. This bank has now decided to favor internal promotion in order to facilitate the accumulation of social capital. To implement this strategy, the HR Department now encourages its employees to pursue a training program at the Technical Bank Institute that certifies them as financial counselors[8]. In other words, banks are reinternalizing training costs in an attempt to improve the longevity of their financial counselor's careers with the firm, thereby increasing their counselor's human capital and the bank's longer-term profits. Human capital is improved *via* the internal labour market while the external labour market is relied upon to supply technical competence. Bank's recognize that regulation by the internal labor market (Doeringer and Piore, 1971) is more efficient for accumulating social capital and they adjust their management strategies accordingly.

These new human management practices and the creation of an internal labor market represent a generalized change in French banks. External flexibility is relied upon when human capital is understood and managed as the sum of technical competencies, because the external labor market is able to provide such competencies. Diplomas from prestigious graduate schools effectively signal technical competencies on the labor market. But external flexibility and the use of the external labor market are not efficient for accumulating social capital. Banks that understand the importance of social capital for the effectiveness and efficiency of the financial counselor's evaluation of risk, ought to change their policies in accordance with this recognition. Social capital is the idiosyncratic attribute of an individual. It is the financial counselor's holding more than the bank's holding. Social capital is lost for the bank when a financial counselor resigns. In normal banking business, it is more difficult to recruit individuals with the right social capital than individuals with the necessary technical skills. Social capital is not an intellectual competence that can be learned outside of the environment in which it is

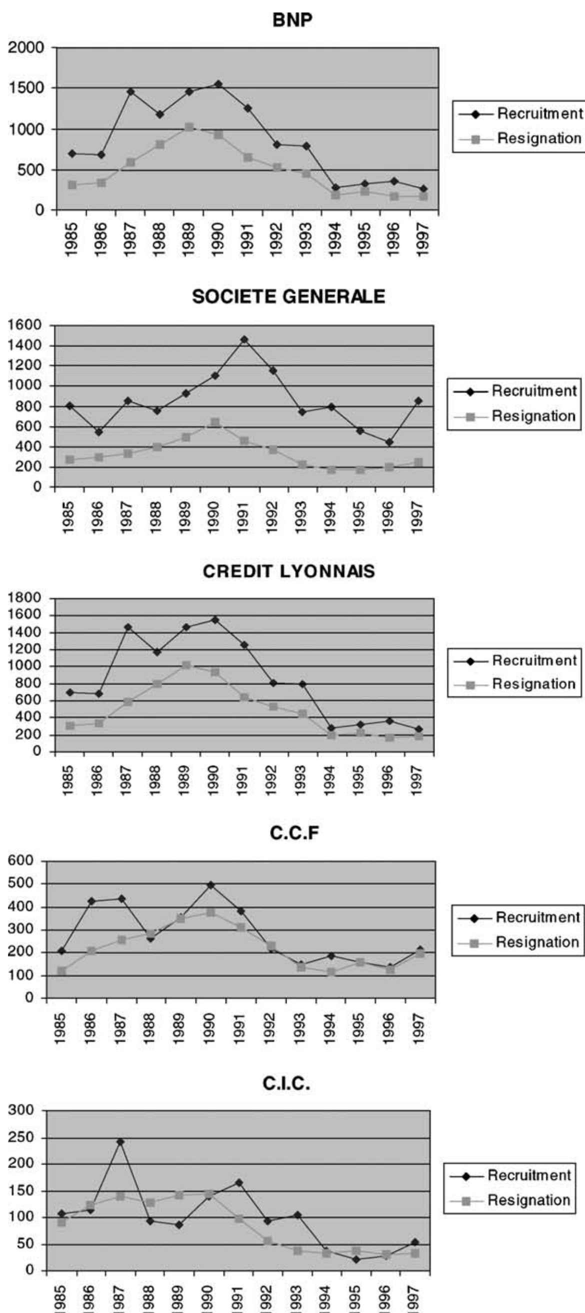

Fig. 1. Evolution of resignation and recruitment from 1985 to 1997.

accumulated. It is a specifically social competence embedded in the social environment that can only be accumulated by an interaction with this social environment.

Banks are using internal labor flexibility more than external flexibility in order to accumulate social capital. For example, BNP recruited 1,349 people in 1990 and only 593 in 1997. During

the same period, figures fell from 1,649 to 259 at the Crédit Lyonnais and from 499 to 213 at the CCF. The Société Générale recruited 1,463 people in 1991 and only 861 in 1997 (450 in 1996). During the same period, figures fell from 140 to 53 at the CIC. At the same time, the number of resignations also declined. At the BNP, the number of resignations was 1,071 in 1990 and 126 in 1997. At the Crédit Lyonnais, the figures fell from 935 in 1990 to 178 in 1997. At the Société Générale 648 people resigned in 1990 and only 249 in 1997. At the CCF, figures declined from 377 in 1990 to 197 in 1997 and at the CIC the number was 142 resignations in 1990 and 33 in 1997 (graphs comparing the evolution of recruitments and resignations from 1985 to 1997 are in the appendix). These figures are consistent with the idea that banks are now promoting counselors internally, rather than relying on external recruitment. Moreover, such figures suggest that banks are realizing their goals of a more stable labor force, since there are far fewer resignations now than at the beginning of the decade (Fig. 1).

5. The limits of social risk evaluation: the specificity and the unsubstitutability of owners of social capital

5.1. A new kind of specificity of the human capital

Human capital is specific when it can not be transferred from the employing firm to another firm with the same level of productivity. Human capital is specific because it consists of individual competencies which are not transferable to another firm. The specificity of human capital is not limited to its technical dimension, which is the focus of Becker's (1974) human capital theory. The specificity also includes a social dimension. The worker's efficiency depends on the quality of his interfaces with others workers and/or with his interlocutors outside of the enterprise. This observation was first made by Marshall (1890) who noted the limited transferability of employees whose skills depend upon their "*familiarity with people and things of the house*." Such employees have no value in another "house" and cannot sell their specific competencies to another enterprise.

In banks, interpersonal relationships between financial counselors and borrowers generate specific human capital because the accumulated social capital is strictly owned by the individuals in the relationship. Competencies mobilized by the financial counselor are technical (credit analysis) and relational (selling capability). Their optimization depends on the quality of the social relationship between the individual who owns these competencies and borrowers with whom he interacts. The definition of the *intuiti personae* captures the specificity of the social relationship by taking care of the consideration that the contractors have for each other.

By nature, the social relationship is one of low transferability. The social bond is specific to individuals who compose it by their interaction. A bank destroys the social bond that a financial counselor has created with his clients by transferring him. If we only consider technical competencies, a financial counselor is perfectly transferable because in all branches he would be in the same technical environment. The IT system, the work organization, products and financial services are same in all branches. On the other hand, he would no longer be in the same social environment and he would no longer have an interpersonal knowledge of the borrowers that he evaluates. So, technical competence is transferable and idiosyncratic

social capital is not transferable. This is a concern for human resource management. For example, a bank manager in charge of the small businesses market explains that it is difficult for him to move the financial counselor in charge of the textile industry, which is situated in a particular locale in Paris. The financial counselor has worked in the area for 10 years and has a near-perfect understanding of the social environment. If his manager decides to move him to another branch, then the social capital accumulated by the financial counselor would not be used and would become obsolete. In addition, this mobility creates a new cost, namely the wages that the bank must pay to a new financial counselor during the time that he integrates into the very specific social network of the Parisian textile industry (estimated to be 2 or 3 years). Thus, all job mobility has a double cost. On the one hand, the social capital accumulated by the departing financial counselor is lost and, on the other hand, there is an investment cost in time and wages for reconstituting the social capital of the new financial counselor.

5.2. The unsubstitutability of the social capital owner modifies the power relationship between the financial counselor and his employer

A bank takes two risks by favoring the emergence of an interpersonal bond between the financial counselor and the borrower. First, in the relationship between the employer, the financial counselor and the borrower, the financial counselor may favor the interest of his client against his employer's interests. If the interpersonal bond is too strong, the financial counselor may incorrectly assess risk because he wants to help a friend. Worse, he can collude with the borrower to organize a swindle.

The second risk is that the power relationship may swing in favor of the financial counselor. Often, institutions seek to standardize individual knowledge so that it may be taught. This process of "instrumentation," which is at the heart of Scientific Management (Marglin, 1983), ensures that knowledge is no longer held by particular individuals but by the organization. The instrumentation of knowledge weakens the experts' power. By favoring social risk evaluation through the decentralization of the decision-making process and by personalizing the professional relationship, the new form of work organization generates a new specific knowledge. The specificity of social capital allows financial counselors to reconstitute strategic resources (Crozier and Friedberg, 1977) that may be mobilized in their power relationships with their employer. For example, in an investment bank, some financial counselors have obtained a stock options program by threatening to leave the firm and take their best clients with them.

The quality of risk evaluation depends on the quality of the personal relationship between the financial counselor and the borrower. The bank profitability then depends on this social evaluation and not on the instrumental evaluation. For management the concern is that the social capital is held by individuals and not by the organization. The *intuiti personae* is formed between two individuals and not between an individual and an organization. The financial counselors own the social capital and this gives them substantial resources in their negotiation with management.

Banks have modified the nature of their power relationship with their employees by favoring the accumulation of social capital as a means to improving risk evaluation. The issue for management is to find new practices for avoiding opportunistic behaviors by financial counselors. Firms are seeking new protections, like clauses in the work contract that forbid resigning

for the purposes of defecting to a competitor—a development that is consistent with the economic theory of contract. Other efforts by firms to retain counselors that accord with economic incentive theories include offering higher wages or differing remuneration (i.e., with a stock options program). Such measures increase the cost of resignation to the financial counselor. Finally, firm recruitment is focused on people who want stability or who have a lesser market value, another measure aimed at ensuring the retainment of financial counselors.

6. Conclusion: for a new understanding of the notion of trust

By analyzing the decision-making process of granting credit in banks we have raised questions about the nature and role of trust in economic. Notwithstanding rhetoric around such issues, it is clear from the analysis of actual practice that the creation of trust relationships is not about the altruism of economic agents. Rather, it corresponds to a certain kind of optimization. The banker does not grant credit to satisfy a friend (although, as noted above, the firm does run the risk that positive affect between counselor and client may interfere with rigorous risk evaluation). Rather, the counselor grants credit because establishing friendly relationships with clients has allowed him to gather enough information to reduce the moral hazard that such a decision would otherwise represent to the creditor. Trades based on trust relationships do not exclude the economic rationality of contractors but presuppose another kind of economic rationality. The economic rationality in trust relationships is based on a different temporality and on a different social space. The financial counselor no longer wants to make a profitable one-time transaction with an individual but instead seeks to create a profitable long-term relationship with a social group.

With the concept of embeddedness, economic sociology solves the problem of information asymmetry in a different way from traditional economic theories of incentives (Akerloff and Yellen, 1986). Traditional economists' solutions emphasize the use of financial incentives to reveal information in the framework of an interpersonal exchange and in terms of complete contracts which constrain actors. In contrast, the sociological analysis emphasizes that the contractor's social network can be used to gather information needed to reduce the uncertainty inherent in a commercial exchange. This social network can predate the trade exchange (as in the case of an ethnic or religious community) or it may be constructed through regular trade exchanges that allow a mutual apprenticeship between contractors.

Bank management has recently begun to foster the accumulation of social capital by new work organization and new human resource practices that favor proximity and long-term relationships between borrowers and financial counselors. However these management practices modify the nature of power relationships between employers and financial counselors. Management practices that favor the development of idiosyncratic interpersonal bonds reverse the power relationship in favor of the financial counselor. In response to this development, bank management has modified its recruitment policy and its remuneration policy in an effort to retain its financial counselors.

At a macrosocial level, the analysis of the banking sector shows that the point is not to know if there is a society of defiance or a society of trust (Peyrefitte, 1995). There are only societies where social networks either are, or are not, dense enough to crystallize and to collectivize

information in such a way that there is no moral hazard in trades between members of the community. A society of defiance is the result of certain state policies and of instrumental methods that were designed to replace the function of social bonds by reducing the inherent uncertainty of the exchange. A society of trust is the result of other state and firm policies, ones which encourage the formation of interpersonal ties as a means of reducing uncertainty in interpersonal transactions.

Notes

1. Traditionally, Parisian brasseries are not financed by Parisian branches of the major French banks (BNP, Société Générale, Crédit Lyonnais, Credit Agricole, . . .) but by their branches in Aveyron where their compatriots work.
2. The superior efficiency of the relational prospecting process has been confirmed by a poll commissioned by 800 clients of this same bank. To the question "*By which means did you establish the relation with your bank?*" 41% respondents answered that it was established by a personal or a family relationship, 34% by recommendation of an intermediary (notary, attorney, accountant, . . .), 3% by his alone initiative and 13% by an initiative of the Bank.
3. Patrick Careil, CEO of the Bank Hervet, summarizes the importance of the quality of the social interaction in the establishment of a trust bond to optimize the risk evaluation:

   > The increasing role of information technologies and the diversification of products could not hid this reality: the bank is a trade based on trust and personal relationships. The human factor is essential and machines do not change this important fact. Techniques of scoring, as elaborated they are, can never play an important role for the commercial bank. They are a useful assistant in the decision-making process, but in no case they can be a substitute for the human evaluation. The banking relationship remains an activity of proximity. Proximity that, if it is not always geographical, is at least psychological. The banker, like the notary or the family doctor, has to be a trusted person. This relationship of trust constitutes the foundation of our business and guarantees its durability. The proximity with the client is a consubtantial characteristic with the bank business.

4. In French law: "A contract is done *intuitus personae* when its execution depends on the personality of the contractors. The consideration of the person constitutes the cause of the contract. In these contracts, an offer can be accepted only if the solicitor has given his approval to a particular person. These kinds of contract are made *intuiti personae* because of the trust that units the contractors. The *intuiti personae* is often relative and subjective. It could take into consideration the individual qualities of the person ("because it was him, because it was me"). For each of the two parts, the consideration of the person (talent, reputation, skill, political opinions, religious, morals, honesty, . . .) by the other is a determinant fact of the contract (Aynes and Malaurie, 1990, p. 180).
5. Sometimes, this kind of informal and private relationship can reach extremes as for this branch manager who suggested that she has "romantic" relationships with some of these clients and asserted: "*I accept invitations to lunch done by my clients because I gather more information during these informal chats than in a professional talk in my*

office. I can learn more easily whether they have an account in another bank or if they have another house on which I could take a guarantee for a new credit. Men are very talkative when they seek to seduce."

6. The tax law recognizes the role of these practices in business. In France, the inscription at a golf club is deductible from the company's benefits if the beneficiary demonstrates that this membership allows him to acquire new clients.
7. In the same logic of creation of personalized bond, the Citibank asserts in its advertisements: "*you want a personalized service, an available and competent speaker, with which you could discuss in trust relationship in all discretion, that knows to assist you for an active management of your money. For replying at your needs we have created Citigold, a preferential banking service based on a narrow collaboration with your personal counselor. As a client of Citigold, you have a privileged Citibank speaker: your personal counselor Citigold. He is highly available because he manages a portfolio of only ten clients. You can meet him in the quiet atmosphere of a luxurious Citigold center*."
8. The Technical Bank Institute is a specific training program which is managed by banks and which delivers a professional diploma.

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