Cost of Soft Information and Lending Technology Choice

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Abstract

Relationship lending has an advantage over transactions-based lending from the viewpoint of information richness. But financial intermediaries use not only relationship lending but also transactions-based lending. We consider a factor of lending technology choice by a focus on an incentive problem inside the financial intermediary’s organization. A loan officer has an incentive to shirk if his monitoring activity is not observable and the information is soft. This incentive incurs an agency cost, and this cost distorts efficient lending technology choice. Furthermore, if distortion is severe, a project that should be done cannot get the loan, and credit rationing occurs.

JEL Classification Code: D82, G21, L22
Keywords: Lending technology, Relationship lending, Soft information, Loan officer, Hierarchies

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