Quack, Sigrid; Hildebrandt, Swen

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Bank Services for Small and Medium Sized Enterprises in Germany and France

Sigrid Quack
Swen Hildebrandt

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D-10785 Berlin

Abstract

Deregulation of financial systems, internationalisation of financial markets and globalisation of product markets have led to considerable changes in the institutional and economic environment of banks and small and medium sized enterprises (SMEs). In this paper we examine the impact of these overall changes on the evolution of the exclusive „Hausbank"-relationship in Germany and the loose „fournisseur" (supplier) relationship in France. The cross-country comparison is informed by theoretical concepts which stress the social embeddedness of economic action. It aims at developing a more dynamic approach by first, looking at changes in the institutional framework; secondly, examining banks' and SMEs' financing behaviour; and thirdly, analysing how the main actors - state, banks and SMEs - have mutually influenced each other's strategies and behaviour. The results show that internationalisation and globalisation impact differently on the bank-company relationship depending on the historical legacy, the socio-economic conditions and the mutual relationships between the main actors in each country.

Zusammenfassung

Die Deregulierung der Finanzsysteme, die Internationalisierung der Finanzmärkte und die Globalisierung der Produktmärkte haben die institutionellen Umfeldbedingungen von Banken sowie Klein-und Mittelunternehmen (KMU) verändert. In dieser Studie werden die Auswirkungen dieser Veränderungen auf die Entwicklung der „Hausbank"-Beziehung in Deutschland und der „Fournisseur-" (Lieferanten-) Beziehung in Frankreich untersucht. Dem Ländervergleich liegen dabei theoretische Konzepte zugrunde, die die „soziale Einbettung" ökonomischen Handelns betonen. Ziel der Autoren ist es, den Aspekt der Dynamik in diesen Ansätzen weiterzuentwickeln: In einem ersten Schritt werden die Veränderungsprozesse im institutionellen Kontext aufgezeigt; in einem zweiten Schritt wird das Finanzierungsverhalten der Banken und der Unternehmen untersucht; und schließlich wird in einem dritten Schritt analysiert, wie die Hauptakteure - Staat, Banken und KMUs - sich gegenseitig in ihren Strategien und Verhaltensweisen beeinflussen. Die Ergebnisse verdeutlichen, daß Internationalisierung und Globalisierung unterschiedliche Auswirkungen auf die Bank-Unternehmens-Beziehung haben und daß diese von dem „historischen Erbe", den sozio-ökonomischen Bedingungen und den gegenseitigen Beziehungen zwischen den wesentlichen Akteuren in jedem Land abhängig sind.

Contents

1. Introduction[1]

The rise of small and medium sized enterprises (SMEs) has led to a growing interest in different national growth patterns in European countries. Financial systems and the bank-company relationship are among the factors which have been identified as explanatory variables (Zysman 1983; Cox 1986). So far, however, research has focused on the relationship between banks and large companies (Elston 1993) and only few studies have analysed national specifities of SME finance (Deeg 1992; Vitols 1994). Deregulation of financial systems, internationalisation of financial markets and globalisation of product markets have led to considerable changes in the institutional and economic environment of banks and SMEs. However, these changes are likely to have a different impact on the bank-company relationship depending on the historical legacy and the contemporary socio-economic conditions in different countries. In this paper we will analyse the relationship between banks and SMEs from both a dynamic and comparative perspective. Germany and France are interesting cases to examine because the closeness and exclusiveness of the bank-company relationship varies considerably between these two countries. In the following sections we will study the evolution of the exclusive „Hausbank"-relation in Germany and the loose „fournisseur" (supplier) relationship in France and discuss whether or not recent changes are likely to result in fundamental transformations of the bank-company relationship.

In the German „Hausbank" relation, SMEs give priority to one bank which runs the core of their banking business, banks give priority to their „Hausbank" customers, the relationship is long-term, stable and regarded as a partnership. In the French „fournisseur" relation, however, SMEs' first concern is to prevent dependency and therefore they maintain links to multiple banks without a clear priority given to anyone of them; the banks are reluctant to become involved exclusively with one company; the relationship is short-term and instable because of frequent breaks and shifts to other banks. These differences become also apparent in lending practices: In general, more long-term loans are available for German SMEs whereas in France SMEs experience a shortage of such loans. Thus, the French situation resembles more to the problems of credit rationing, information asymmetries and monitoring problems discussed in the economic literature (Hellwig 1991; Scholtens 1993).

1 We would like to thank Bernard Ganne, Michel Goyer, John Griffin, Christel Lane, Jacqueline O'Reilly and the participants of the EMOT workshop on „Financial Services" held in Paris, September 1994, for their helpful comments on an earlier version of this paper.

We will analyse the evolution of the bank-company relationship as embedded in distinctive social contexts. Studies in the tradition of the 'effet societal' and 'business system' approach have shown how financial, political and labour market institutions shape organisational strategies, structures and outcomes (Maurice et al. 1986; Sorge and Warner 1986; Lane 1989; Whitley 1992) and the market and task environment of organisations (Sorge 1991; Räsänen and Whipp 1992; Quack et al. 1995). Other studies inspired by new sociological institutionalism have analysed how relationships between social actors become institutionalised and are continuously reproduced by their behaviour (Granovetter 1985; Powell and DiMaggio 1991; Lane 1991). All these approaches regard the behaviour of economic actors as deeply interwoven with the social system and their focus is on the stability of relationships. In a more repidly changing economic and social environment with increasing international interdependencies, however, there is a need for a theoretical framework which gives more emphasis to change. In a recent paper, Sorge (1994) has suggested a concept of actors and systems as mutually constitutive, but analytically distinct. In this view actor's behaviour and social structure are in principle reciprocally related to each other, but they do not simply mirror each other. The actor has institutional and organisational structures and „norms" in mind and the organised system has an intersubjective understanding of the actor's perception. This cross-referencing does not exclude partial autonomy, the system's understanding of what the actors think is partially different from what the actors have in mind. Thus, actors modify systems and systems are modified by actors (see also Giddens 1984).

The following cross-country comparison is informed by the concept which might enable a more dynamic study of organisations and relationships between organisations while retaining a notion of their social embeddedness (Morgan 1994). We look at institutionalised regularities of societies and their implications for the actors' behaviour and perceptions, the way in which actors imagine their social system and shape it by their behaviour, and the reciprocal influences between structures and actors. Section 2 examines the effects of changing institutional contexts on the financing behaviour of banks and SMEs. Section 3 analyses how distinct characteristics of SMEs impact on their relationship to banks. Section 4 is concerned with changing structures and strategies of banks and implications for their relationship to SMEs. Based on own case study data from the banking sector[2] and secondary material for the SME sector, we will show that despite a number of institutional and organisational changes the

[2] Our sample consists of 7 French and 9 German banks. In each country, there were commercial, saving and mutual banks included. During the period from October 1993 to March 1994, semi-structured interviews were conducted in each bank with representatives from different management functions. This included at least the personnel director and the director of the credit department for corporate or SME finance, most of them at the regional level. In some cases we also interviewed a branch manager. The research in German banks was undertaken in collaboration with Brent Keltner, Stanford University.

bank-SME relationship in Germany and France retains distinctive characteristics.

2. The institutional context of financing SMEs: Stability in Germany, discontinuity in France

In order to understand different national patterns of financing SMEs it is important to analyse them in the wider political and institutional context of each country's financial system. In the following section we give a short overview of the main characteristics of the German and French system and analyse to what extent they have been altered throughout the 1980s by changes in state policy, financial regulation and public or parapublic institutions.

2.1 Financial systems

In earlier studies, Zysman (1983) and Cox (1986) have classified Germany and France as countries with credit-based and bank-oriented financial systems in opposition to the Anglo-Saxon capital-market system. These studies also identified two major differences between Germany and France. Whereas the French state until the mid 1980s played an important role in administering credit prices and ceilings in order to direct industrial investments, the German model relies more on a close working relationships between banks and companies which is indirectly supported by the state or corporatist institutions. Furthermore, French regulation favoured a high degree of specialisation between commercial, merchant and medium-/long-term credit banks and restricted the activities of saving and mutual banks (de Boissieu 1990). In contrast, German banking regulation has been orientated towards universal banking.

During the 1980s, the French financial system has undergone considerable deregulation and despecialisation (Taillepied and de Bressieux 1994). With rising budgetary deficits the state was no longer able to subsidize loans on a large scale. The credit ceiling system was abolished in 1984 and since then an increasing part of loans have been indexed on market-based interest rates. Banks have no longer access to quasi-unlimited refinancing from the Banque de France. A number of government initiatives have aimed to develop capital markets and encourage financial innovations and a new taxation policy favoured money-market based products and investment funds. As a result, there has been a rapid securitisation combined with a significant degree of disintermediation. The availability of a broader range of financial products with different maturities has led to shift away from traditional saving accounts which served the financing of housing, state and industry. Whereas in the early 1980s, 70% of household assets were channeled into saving, the proportion decreased to 18% in 1992 (Cieply 1994). At the same time investment into *Organismes de placement collectif en valeurs mobilières* (OPCVM) and life insurance expanded rapidly (Artus 1991; Zerah 1993). In 1984 a new banking act grouped together nearly all financial institutions under the same legal framework. Saving banks have been allowed to diversify their activities into lending for SMEs and mutual banks could extent lending beyond their traditional customer groups in agriculture or urban artisans. It is still too early to assess whether the French financial system will develop more towards the German credit-market or the Anglo-saxon capital-market system. However, it is quite clear that the reforms have strengthened competition in financial markets, fostered a trend towards universal banking and increased the flow of finance which circulates independently of the banking system. Thus, there is no doubt that the French financial system has undergone fundamental modifications and now includes elements of a credit- and a capital-based system.

In contrast to France, changes in the German financial system have been more gradual and resulted mainly from market saturation and growing competition (Quack et al. 1995). The major regulatory changes imposed on banks came from the adaptation of European standards into German law but had no far-reaching consequences. After the liberalisation of money-market funds in 1994 they have rapidly attracted funds from households but the move towards such forms of short-term finance is not yet as pronounced as in France. The shift from saving into other investment products started already during the 1980s when markets for standardised saving products became increasingly saturated and households invested inceasingly in bonds and life insurances. According to D'Alessio and Oberbeck (1994) German banks were able - with the support of the Bundesbank and the government - to prevent the proliferation of short-term investment funds and the resulting negative effects on refinancing costs.

2.2 Incentives for banks to engage in long-term lending

In each of the financial systems there are different mechanisms at work in order to ensure the transformation of savings into investment. In the former state-administered French system, interest-rates and credit-ceilings were used as an instrument for industrial policy. The banks' activity in this field was largely influenced by political decision making and had a strong administrative element. The state shared a substantial part of the risks from corporate loans by the means of subsidized interest-rates and provided banks with the necessary funds by tax-privileged saving forms and generous refinancing from the Banque de France. Credit ceilings limited competition in the banking sector and gave no incentive to banks to lower their intermediation prices (Cieply 1993). This system of state-led credit allocation was largely confined to the growth and restructuring of the large company sector whereas the SME sector received only little attention until the 1980s (Ganne 1993). The rather close relationship between banks and large firms in France, at the expense of SMEs, has also to do with the nature of the education system. Heads of banks and large firms tend to share a common educational background from one of the Grandes Ecoles and follow a similar career pattern by shifting between the private and public sectors (Birnbaum 1977; Bourdieu 1990; Suleiman 1979). As a result, bankers and managers tend to know each other and to develop reciprocal expectations of what they will act like. At the time of the credit ceiling system particularly large companies benefited from this type of coordination whereas SMEs were outside of this soft form of „Hausbank".

Since the reforms of the 1980s, there are much less incentives for banks to engage in medium- and long-term financing of corporate customers. Banks are more volatile to fluctuations in market interest-rates, have less access to tax-privileged funds destined for investment and, therefore, depend more on costly refinancing from the interbank market. This has led to a selective policy of credit allocation to corporate customers in general (Chanel-Reynaud 1994). According to Cieply (1994) the financial reforms of the 1980s have added further to the dualism between large and small firms as well as creating a new division between risky and stable SMEs. Large companies have direct access to capital and money markets and exert pressure on banks' prices and conditions. There are still strong personal ties between management elites in banks and large companies. SMEs, however, are much more affected by the banks' new cautiousness to award loans. Whereas larger SMEs become increasingly integrated into the self-financing of large industrial groups, the smallest enterprises which at the same time have often very high debts are the main victims of the financial reforms. The government policy of reducing subsidised loans makes the situation for these companies worse because it increases the risks for banks giving loans to companies with economic insecurity. SMEs are also excluded from the development of the second market and commercial papers. In order to overcome the shortage of bank loans for SMEs the government's policy is now directed towards strenghtening indirect incentives similar to those found in the German system.

This new policy is based on three elements: Firstly, the government introduced a tax-priviledged saving deposit (CODEVIs; *Comptes pour le developpement industriel*) of which banks have to transfer 86% into subsidised loans to SMEs which are directed towards small companies with less than FF 500 million turnover in industry, BTP and transport. The volume of these loans was restricted by the upper limit of FF 15.000 per person and has been extended to FF 30.000 in October 1994. The capacity of banks to forward subsidised loans depends on its share of CODEVIs. According to estimates, in 1992 the commercial banks belonging to the *Association Française des Banques* (AFB) issued about FF 12 milliard and saving banks about FF 5 milliard subsidised loans from CODEVIs. Secondly, SOFARIS (*Société Française de garantie de financements des Petites et Moyennes Entreprises*) was founded in 1982 which is a credit guarantee institution with the state and commercial banks as its main share-holders. The loan volume guaranteed is limited to 5 million FF per company and the risk divided between the bank and SOFARIS. Several programmes are directed towards business set-ups and companies in transition, most concentrate on small companies. According to CNCA (1993), one out of five industrial SMEs makes use of a SOFARIS guarantee. Thirdly, a specialised bank for SMEs emerged from a merger of three smaller institutions which were already in charge of financing SMEs before: *Caisse Nationale des Marchés, Caisse Centrale du Crédit Hôtelier, Industriel et Commercial and Groupement Interprofessionel des PME*. The *Crédit d'Equipement des Petites et Moyennes Entreprises* (CEPME) offers medium and long-term loans (3-20 years) for investments to SMEs and also gives credit guaranties. The major problem, however, is that CEPME needs more capital.

The German system is often identified solely with the governance structures which link large companies to the large German banks. Due to shareholding, delegated voting rights (*Depotstimmrecht*) and interlocked directorates the large banks have considerable insight into the business of the large companies. This information reduces their risks and makes them more ready to provide medium- and long-term finance. This explanation, however, does not apply to SMEs in which banks have no institutionalised direct control (Harms 1992).[3] Nevertheless, the relationship between the majority of SMEs and banks also tends to be long-term. The greater readiness of German banks to forward long-term finance to SMEs has been often related to indirect support from the government's *Mittelstandspolitik*. In addition to various programmes of technical and business advice, this policy also includes indirect financial support by subsidised loans and start-up capital distributed through public banks out of which the Kreditanstalt für Wiederaufbau (KfW) und Deutsche Ausgleichsbank (DAB) are the most important. These programmes are handled through the banking system, eg. the company inquires at its housebank for the KfW or DAB funds, which will only finance a part of the overall loan whereas the other part has to be financed by the bank. The risk of the loan remains with the housebank which has to monitor the credit engagement. The KfW loans are directed towards larger SMEs (companies up to DM 1 milliard turnover can apply), whereas the DAB is the main provider of official support for small entrepreneurs. In 1992, the KfW confirmed loans of DM 5 milliard to West German SMEs and DM 8 milliard to East German SMEs. The volume of DAB loans in 1991 was DM 15 milliard, thereof DM 2.8 milliard to West German companies. Another important element are public institutions which provide loan guaranties. In addition, Harms (1992) emphasizes the importance of the

3 Although many SMEs have advisory councils (*Beiräte*), only few members are bankers (Gaugler and Heimburger 1985, cited according to Harms 1992).

extreme monetary stability in Post-War Germany which made possible the long-term fixed interest-rate lending to the corporate sector in the first place.

Compared to the German policy, the French programmes of indirect support to SMEs still are more fragmented and concentrated on smaller SMEs. According to a study of de Saint-Louvent (1992) one out of two French SMEs received subsidised loans compared to only one out of four in Germany but the recipient companies were much smaller on the average. Thus, a smaller volume of subsidised loans is spread across a larger number of small companies in France. This would also explain why French recipients considered these loans as less important for their growth compared to their German counterparts.

2.3 Industrial policy and SMEs

In her comparison of SMEs in Germany, France and Britain, Christel Lane (1991) argues that the economic strength of the German *Handwerk* and *Mittelstand* goes back historically to the period of industrialisation. Due to the more conservative political climate and political fragmentation the guild system survived much longer than in other societies. The conservative corporatist element in German policy also contributed to a tradition of self-administration and industrial co-operation which is still very influential today (see also Streeck 1992). After the second world war, German industrial policy considered SMEs as an important pillar of economic reconstruction. Since then, German governments have persued a consequent *Mittelstandspolitik* which offers SMEs a dense network of support for economic, techological and financial development. The complexe institutional framework of vocational training, formalised practices, cooperative industrial relations and easy access to finance provide, according to Lane, a stable business environment which limits the development of a dualism between SMEs and large companies. German SMEs are also much more engaged in high quality and more specialised production than SMEs in other countries with a lower wage level.

In contrast, the craft sector in manufacturing in France was more or less destroyed during the French revolution and intermediary organisations were driven out by the dominant ideology which regarded them as sectional interests. French SMEs therefore never became embedded in an institutional network similar to that of their German counterparts. Instead, French SMEs maintained for a long time a strong family business character and relied on networks of family and local neighbourhood ties. Even today, they are still often regarded as more inward-looking and economically retarded compared to large French companies and SMEs in other countries. Since the Second World War, however, the French SME sector has undergone considerable changes as an indirect result of the French state support for the development of the large industrial company sector. The state-led restructuring policy often disrupted local networks between large and small companies. French SMEs became part of larger industrial groups or act as suppliers. Today, the "French industrial order is highly polarised between large companies and SMEs, and they are in a considerably weaker position vis-à-vis the industrial giants than are their German neighbours" (Lane 1991). It is only recently, that there have been attempts of the government to improve the institutional support for SMEs by regional decentralisation of the political administration and the foundation of para-public financing institutions.

3. SMEs in Germany and France: Comparing apples with pears?

Small and medium sized enterprises are often treated as a homogenous group with uniform financial demands vis-à-vis the banking sector. In fact, however, this category encompasses a great variety of companies which differ in terms of their size, production, markets and life cycle. The structure and characteristics of SMEs also vary considerably as a result of divergent historical developments and institutional frameworks between countries. In this section, we will analyse the specific features of German and French SMEs in order to get a better understanding of national differences in the type of customer and financial demand which banks have to meet in each country.[4]

As a consequence of the different institutional framework in France, there are many more "mirco" companies with no or only a few employees than in Germany. Particularly, there are considerably more "one-person" businesses in France. The core of "sound" small and medium-sized companies, however, is more developed in Germany. Companies with 10 up to 499 employees represent 13% of all German companies compared to only 7% of French companies. A report of the *Conseil National du Crédit* shows a similar picture: In Germany, there are approximately 31.000 SMEs with a turn-over between 50 and 500 million FF compared to only 17.000 in France - a difference which is particularly strong in the category with 50 - 150 million FF (de Saint-Louvent 1992). As banks treat the "micro" companies usually as 'particuliers' or private customers, we will concentrate in the following section on small and medium-sized companies (50 - 500 million FF).

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[4] In the following sections we will refer only to West Germany. For more details on structure and ownership in East German enterprises see Carlin and Mayer (1995). The evolution of the bank-company relationship throughout the transformation process has been analysed by Griffin (1993) and Deeg (1994).

In addition to size and number, the governance structure of German SMEs differs considerably from their French counterparts. In Germany, the majority of SMEs are still family owned and tend to mobilise either internal resources or capital from family partners during periods of growth. Even if there are external stake holders involved, the family members often hold the majority of shares. Three out of four German companies with a turnover of 50-300 million FF and one out of two German companies with a turnover of 300-500 million FF are family controlled. In the smallest quoted companies, however, family ownership accounts according to Carlin and Mayer (1995) to only 33%. In France, on the contrary, family ownership and control is much lower and confined to small companies (10-150 million FF turnover), whereas the majority of companies with a turnover of more than 150 million FF are branches of larger groups whose financing is coordinated by the central headquarters (Matray 1992).

Partly as a result of this, French SMEs are much more dependent on subcontracting than German SMEs. As German SMEs often provide specialised products, are more engaged in exports and have avoided exclusive ties with large buyers, their dependency is considered to be low by international standards. French SMEs, on the contrary, often provide extra capacity to larger firms, are weak in exports and sell a large proportion of their production to one or only a few large domestic buyers. This is often connected with long delays in payment which are detrimental to the small and medium-sized companies. On average, the realisation of payments from the buyer takes about 66 days in France compared to only 29 days in Germany (CNCA 1993). This is only one example for the low level of regulation and contractualization of the relationship between companies in France compared to Germany. This mode of production restricts long-term planning of business activities and investment in French SMEs compared to those in Germany.

Another important feature is the high turn-over of French SMEs compared to the greater stability of their German counterparts. The CNC report states that French companies on the average are much younger than German ones (de Saint-Louvent 1992). The average life duration of a new company in France decreased from 25 years in 1960 to only 15 years in 1990. About 20% of new business set-ups expire during the first year and 50% by the fourth year of their existence (Bizaguet 1991). The rate of bankruptcies has been increasing in both countries over the last years, but it is much higher in France (1,6%) than in Germany (0,4%) (CNC 1993a).[5] The high turnover is also reflected by the fact that French government policy is much more concerned with the financing of SMEs in periods of transition such as set-up, growth, "reprise" and transformation whereas German policy addresses companies of all categories of size, start-ups as well as mature companys.

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[5] The proportion of bankruptcies for Germany might be underestimated, because German courts reject them often in the case of small companies without estate.

The greater vulnerability of French SMEs also applies to their financial structure. French SMEs have less own capital, they are more often in debt, they rely more on short-term financing and are considered to be more dependent on bank loans (Bizaguet 1991; Matray 1992). A more detailed analysis, however, reveals that the term-structure of bank loans to SMEs is quite similiar in both countries: In 1990, 50% of the overall volume of bank loans to French SMEs was short-term. In 1989, the proportion was 40% for small and 50% for medium-sized companies in Germany (CNCA 1993, Deutsche Bundesbank 1992). The overall higher volume of short-term finance of French SMEs derives from the greater volume of inter-company loans in France. The volume of inter-company loans is estimated to be two or three times as high as the volume of short-term bank-loans (de Saint-Louvent 1992). This means on the one hand, that French companies can draw from more alternative sources for short-term finance which should make them more independent of banks than SMEs. On the other hand, French SMEs are more dependent on bank loans because they have less own capital and intercompany loans are unreliable.

Financial functions within French SMEs are less developed and sophisticated than in German SMEs. As a result of the greater polarisation within SMEs in France, the financial management of companies shows a greater variety of financial management styles. The majority of German SMEs rely mostly on internal mobilisation of financial resources. Among the largest SMEs there is a majority managed as a "small large enterprise" with a high importance given to the financial department and a greater openness towards the financial environment. The logics of financial management in French SMEs are much more heterogenous: The latter model is only prevalent among the larger SMEs which belong to industrial groups anyway. A majority of industrial sector French SMEs in the categories 50-300 million FF turnover, have only a few internal resources with little openness towards external financing; their major aim is 'keep things running'. Furthermore, there is a minority with a solid internal mobilisation as well as a minority with only weak internal resources but an opportunistic attitude towards external financial institutions. This is also reflected by the fact that French SMEs choose their bank more according to quality and price, whereas for German SMEs fidelity, quality and personal relationships have a higher priority.

The empirical evidence, thus, underlines the greater polarisation among French SMEs and the greater dependency on subcontracting compared to their German counterparts. Furthermore, it shows a much higher instability and volatility of SMEs in France than in Germany. The distance between the "sound" and "risky" companies seems to be much wider in the French than in the German SME-sector which reflects the more stable and homogenising institutional framework for German SMEs. The high number of French undercapitalised, small companies in transition means that there is a stonger need for capital participation, loans and consultancy services for business set-ups, whereas in Germany there are relatively more established companies with long-term investment needs to be found among the SME customers. It also means that French SMEs have less assets to provide as collateral and the riskiness of their business is more difficult to assess. The segment of "sound" companies with a continuous demand for a varied range of financial products in France is considerably smaller and therefore, a less interesting market for banks than in Germany. The number of potential bank customers from this group has been diminished further by the creation of alternative financing circuits within industrial groups (Cieply 1994).

4. German banks for SMEs, French banks of SMEs: Different structures, strategies and practices

The German and French banking sector have been shaped by differences in the institutional context outlined above, such as the intervention of the state and banking regulation. In this section, we will analyse to which extent the position of banks vis-à-vis SMEs is also affected by their market and task environment, their strategies in the SME market and their internal practices of refinancing and risk assessment, as well as the human resources available to ensure a high standard of risk assessment and quality of services.

4.1 Which banks provide financial services for SMEs?

In Germany, small and medium sized companies are predominantly financed by small and medium sized banks which do however belong to larger networks. The most important are the saving banks (including regional *Landesbanken*) and the mutual banks, followed by regional commercial banks. The strong position of the saving banks in lending to companies is reflected by their market share of 34% of all bank loans to companies in 1993, compared to commercial banks with 30% (including the three big banks with only 13%), cooperative banks with 14% and specialised banks with 12%. The saving and mutual banks are more engaged in medium- and long-term lending, whereas the commercial banks concentrate on short-term loans (Deeg 1994). Although statistics are not comprehensive, the available evidence indicates that the dominance of the saving banks is even stronger in financing SMEs. In 1991, they provided 57% of the credit volume to crafts businesses (*Handwerk*), followed by the mutual banks with 24% and the commercial banks with only 11% (Ellgering 1993). By 1993 they had increased their market share up to 61%. According to a company survey, in 1989 nearly one out of two German companies (44%) considered a saving bank, and one out of three a cooperative bank as its "main bank". Only 13% of companies reported a primary relationship with one of the three large German commercial banks and very few deal with foreign banks.

During the 1980s, however, an increasing number of SMEs enlisted a second bank for their main business. This trend towards a "double Housbank" is a result of more sophisticated financial management in German SMEs and increasing competition in the banking sector.

The German saving banks are strongly engaged in the development of the local economy which is also layed down in the regulation and reflected by representatives from local business and political institutions on their supervisory boards. However, despite their smaller market share, large commercial banks also consider business with SMEs as an expanding and profitable market. Since the mid 1980s, the big banks have made considerable efforts to intensify their customer base among larger SMEs in order to compensate for narrowing profit margins with large companies. Thus, there was increased competition between them and the traditional lenders to SMEs. The recession and reunification made German banks more risk aware, and many of them are implementing a more segmented approach to SMEs as a customer group. Mutual banks define micro and small firms, saving banks small and mediums-sized firms, and large and regional commercial banks medium and larger SMEs up to DM 500 million turnover as their main focus. Despite segmentation, all segments of SMEs are the focus of at least two major banking groups. Independently of group affiliation, German banks consider SMEs as a lucrative future market for financial services. The future strategy aims at increasing the income from the most intensive customer relations by selling a full range of loan and investment products as well as ancillary services such as electronic banking, information services, insurances and consultancy in financial and legal questions. The tendancy to segment customers is most developed in large commercial banks and least developed in the mutual banks. In all banking groups, very small companies are likely to be treated as private customers in the future unless they have a special demand.

In France, there is more variation among the financial institutions involved in financing companies. Many of them, however, concentrate either on a more specialised range of services or on a smaller category of companies than in Germany. Furthermore, French banks define the SME business more narrowly than their German counterparts. The large commercial banks, for example, consider companies with DM 17 - 170 million turnover as SMEs. The commercial AFB banks are the main providers of loans to such companies. Whereas between 1980 and 1992, the proportion of loans to all companies issued by AFB banks decreased from 47% to 45%, mutual banks could extend their market share from 8% to 12%. The saving banks which were not allowed to distribute loans until 1987, have been expanding their business; with a market share of less than one percent, however, they are still a tiny dwarf compared to their German counterpart. More important are the *Caisse des Dépôts et des Consignations* (CDC) and specialised financial institutions which in 1992 accounted for about 14% and 13% resp. of loans to all companies. Finally, as a result of the more frequent use of leasing, the category of Sociétés financières has expanded its share from 9% in 1980 to 15% in 1992 (AFB 1990; Banque de France 1993). AFB banks are mainly short-term lenders, whereas the other banking groups concentrate more exclusively on medium- and long term loans. Except for the very small companies which are mainly customers of mutual banks, there is no correlation between the size of the company and the size of the bank similar to the one in Germany. This difference is particularly apparent in the field of medium-sized companies: In absence of a powerful saving bank group, French medium-sized companies are either dependent on large national commercial banks such as BNP, Crédit Lyonnais or Société Générale, or towards regional AFB banks like *Banque Régionale de l'Ouest* or others. As the large national AFB banks have adopted a rather restrictive loan policy, many of the medium-sized companies have to address several banks including specialised banks for medium- and long-term loans. As a result, the average medium-sized French company is likely to be more often connected with a much larger and less locally orientated bank than its German counterpart. Some of the differences in the bank-SME relationship, thus, can be related to historically evolved different structure and size of the various banking groups. But there are also national differences within each banking group which privilege German SMEs in their access to relatively cheap finance.

4.2 National differences between similar banking groups

German saving banks and co-operative banks do not operate as isolated entities. They form part of a network with other group members and centralised refinancing institutions (*Landesbanken* and *genossenschaftliche Zentralbanken*) which has similarities with a strategic alliance to share refinancing, information and strategic planning at the same time as delimiting local areas of business. It is only within this framework, that saving banks are able to compete with large commercial banks and even gain some advantages over them. According to Vitols (1994), saving and co-operative banks developed historically centralised institutions in order to overcome risk transformation from short-term deposits into long-term lending. The pooling of deposits enables saving banks and mutual banks to refinance at a more advantageous rate than private large banks and thereby reduces their disadvantages in terms of size. Another important point which has been neglected in the literature so far, is that saving and co-operative banks also share a considerable amount of information on customers within each group. Pooled data-bases of financial information on corporate and particularly SME customers enable each member bank to process a sophisticated analysis of credit worthiness. For example, the saving banks operate an up-to-date data-base of 100.000 company balance sheets which is unique in the German banking sector and enables detailed breakdowns by industry, company-size and form of business-organisation (DSGV 1993) which now are also used for advisory services for companies. Furthermore, saving and mutual banks are engaged in a continuous exchange on strategic planning and human resource management. Normally, pilot projects are run by some member banks and then, the instruments are made available to all members of the group. This reduces the expenses of each saving or mutual bank considerably and gives them access to much more sophisticated business practices than each could afford on their own.

French saving and cooperative banks, however, lack most of these network synergies. As a result of French state intervention, the saving banks were historically restricted to collecting deposits which then went into the state controlled CDC. French saving banks remained excluded from lending until recently and although they are now allowed to use more of their funds for lending, there is no centralised refinancing mechanism as in Germany. Due to their smaller size and restricted market segment, French saving banks cannot share information to the same extent as their German counterparts. Although the influence of the French association of saving banks on the business activities of member banks has been strengthened recently, French saving banks are only beginners in exploiting group advantages and lack the technical and human resources for a rapid expansion in the market for SMEs. In contrast to Germany, the French co-operative banking sector has remained fragmented. Even today there are five groups operating in different regions and different customer groups (*Crédit Agricole, Banques Populaires, Crédit Mutuel, Crédit Cooperatif* and *Crédit Mutuel Agricole et Rurale-Group*). As a result of this particularism, French cooperative banks cannot rely to the same extent as their German counterparts on the pooling of refinancing and information. After the banking law of 1984, some of them like Crédit Agricole and the Banques Populaires, expanded substantially their loans to SMEs. Only these two, Crédit Agricole and Banques Populaires, have a sufficient business volume, customer base and a multi-level structure at the national and regional level to exploit "group" advantages (CNCA 1993). In sum, the French savings and co-operative banking sector historically developed to a lesser degree than the German one the pooling mechanisms necessary for small banks in order to provide short- and long-term loans beyond the narrow range of micro and small firms.

What remains to be explained, however, is the different approach of *German and French commercial banks* to SMEs. As mentioned before, commercial banks in both countries tend to lend more short-term. Nevertheless, German banks are more ready to provide long-term lending as well as other services to SME customers. Furthermore, their assessment of the profitability of the SME as customer group is much more positive compared to their French counterparts. These differences are the result of a number factors. First of all, the number of profitable customers from the middle and higher segment of SMEs is much lower than in Germany (see above) and furthermore restricted by the more narrow definition of SMEs which French commercial banks apply.

Secondly, French commercial banks can draw less on deposits and subsidised loans than their German colleagues, and therefore their refinancing is more costly and volatile. On the one hand, there has been a rapid shift of private saving from tax-privileged deposits to investment funds issued by *Organismes de placement collectif en valeurs mobilières* (OPCVM). A study of the CNC (1993b) estimated that the shift from savings to OPCVM created additional costs for the banks of 6 to 30% of their income. On the other hand, the use of subsidised loans in France is connected to the deposit structure of each bank. AFB banks have only a relatively small volume of CODEVI deposits from which they could finance SMEs at a privileged interest rate. In Germany, application for KfW loans operates independently of the bank's portfolio and furthermore, a part of the loan volume is financed by the public banks. This creates a stronger incentive for commercial banks to lend long-term to SMEs. These incentives, however, should not be overestimated as they apply only to a small part of the loans distributed by commercial banks.

Thirdly, the importance given to SME customers has to be analysed within the overall market position and strategy of German and French commercial banks. The traditional base of large German banks has been industrial and domestic banking. Traditionally, German commercial banks are strong in interest-rate based business, corporate finance and issuing securities of large companies. The evolution of their profits has been rather stable and increasing over the last decades. Nevertheless, their interest margins with large companies decreased during the 1980s because large companies increasingly used internal finance. Given this background, it seemed logical to extend into financial services for SMEs. German commercial banks could apply their knowledge in credit assessment and commission-based services developed for large companies to the upper segment of SMEs. In order to compete with the saving banks, they developed a more regional approach to this customer group (Deeg 1992). In contrast, French commercial banks had a very different starting point after the deregulation of the mid 1980s. Under the system of credit-ceilings, their role in providing loans was more that of an administration than of a risk-taking credit institution. Deregulation led to an increase in competition at the same time as the commercial banks' volatility from exposure to interest rate variations increased. Profits and commission-based income were very low, whereas operating costs were very high by international standards. The development of capital markets and financial innovations led to disintermediation. Banks suffered particularly from a decline in volume and profitability in their wholesale lending business, i.e. the market for loans to large, low risk companies. As a reaction to actual and anticipated loans losses from overseas and real estate business, AFB banks had a dramatic increase of provisions for risks (Szymczak 1992). As a consequence, AFB banks' strategy was orientated much more towards broadening their activities with non-interest income such as more sophisticated forms of financing, financial innovations and ancillary services. Large commercial banks have also followed much more than their German counterparts a strategy of internationalisation. Whereas in 1991, the three largest AFB banks generated about half of their business volume and income abroad, it is only one third for the Commerzbank and one fifth for the Deutsche Bank (Connor 1994). Thus, for the large AFB banks, financial services for SMEs is no more than one market segment among others. After the deregulation, they expanded into lending to SMEs for a short period, but then the growth market was increasingly perceived as a problem market. Today, SMEs are seen as a risky customer group and particularly large commercial banks are reluctant to become the only or main lender. Within the large AFB banks, traditional functions such as the loan department increasingly get into conflict with new functions such as participations and risk capital, partly because they compete for the same customers (Ullmo 1991).

Of all banking groups, *regional commercial banks* seem to have most in common in Germany and France. In both countries, regional commercial banks have traditionally a strong basis in the SME sector and a high proximity to the local economy. Their approach to SMEs is treating them as a developing company, eg. they usually follow their customers over their life cycle. This is also reflected by their broader definiton of SMEs with a considerably higher upper limit. The two banks interviewed in France, furthermore, declared their customers to be very loyal and their own approach to be very similar to a German "Hausbank". Whether these results are representative for regional AFB banks in France has still to be investigated in our future research.

To conclude, the strategies of French banks towards SME customers vary more than in Germany and are correlated to their positioning at the time of deregulation. Across different banking groups there is a more cautious attitude towards this business which depends on economic risks related to the business but also on internal organisational problems and decisions such as priority to other markets, interest conflicts between different departments, underdeveloped methods and technology, and lack of a sufficiently skilled labour force. For German banks, despite their higher risk awareness SMEs still represent a profitable customer group in which they aim to expand their business. The specific structure of German SMEs enables German banks to mutualise risks from large and small SMEs, whereas French banks have less scope to do so. Differences in business strategies are also reflected by the bank's work organisation.

4.3 National differences in work organisation

Surprisingly, however, German and French banks are implementing a similar reorganisation of their branch network. This consists of a more graded branch structure for standard customers with specialised branches for high-worth customers and corporate/SME customers. Again, there is more variety between the French banks depending on their actual market position. The regional banks in our sample, for example, did not plan to establish such a graded network. Furthermore, the reasons for such a network vary between countries and banking groups. German banks refer quite uniformly to a double explanation: Small and medium sized companies are becoming more demanding concerning the quality of services and, thus, a more skilled workforce has to be available for them. In order to reduce costs and increase profit margins, such personnel cannot be employed in every local branch, instead they are located in specialised regional centres. For the French banks, however, the establishment of such "centres d'affaires" is also a means of opening up a so far underdeveloped market. Whereas AFB banks are more concerned about the cost cutting effects of graded branch networks, for saving and mutual banks they are virtually the only method to expand their position in the SME market because they have only very few skilled employees for this task and their potential for investment in new technology is also restricted.

This points to the differences in work organisation, business practices and qualification profiles which we found between German and French banks (for details see Quack and Hildebrandt 1995). Such differences seem to have an important impact on the relationship between banks and the company and particularly affect their ability for a high-standard risk-assessment and evaluation of the economic potential of the customers. There are three important differences: Firstly, the amount of information that banks require from their firm customers with respect to a loan application. Secondly, the way in which this information is processed within the bank. And thirdly, the type of qualification which is seen as important to fullfill this task.

In general, French banks have less information from their customers in order to process a loan application. This applies to short-term as well as to long-term lending. In order to provide a short-term operation credit, in addition to the balance sheet, French banks have less often a provisonal plan of finance or sales at their disposition than German banks. They also demand less collaterals than their German counterparts (de Saint-Louvent 1992). This is partly related to the different nature of operation credits in France which are often confined to a small and restricted project, whereas in Germany they have more the character of a global credit line with fixed interest rates over a period of 6 months or a year. Compared to Germany, global transfer of collaterals is less usual in France and bankruptcy legislation gives less priority to banks (Dietsch 1993). Another factor might be that French SMEs and their owners simply have less assets to transfer. Furthermore, French banks can draw to a much lesser extent on information from the current accounts of the company than the German "Hausbank", where this information has the function of an early alarm signal for financial problems. A similar picture arises with regard to long-term lending. According to Cieply (1993), French banks follow a more mechanical approach to loan assessment which is based on financial information from the balance sheet, current financial information and collate-rals. German banks, on the contrary, have a more dynamic and future orientated approach. Balance sheet analysis is based on a cash-flow analysis (of at least the past two years), as well as previsional financial accounts for the current year. Furthermore, they require them to provide a detailed outline of the investment project, including an evaluation of product markets, technology and competitors and a plan of repayments. This information, together with the available collaterals, is processed in order to assess the credit worthiness of SMEs. The bank compares the information with their own information on industry branches, products etc. and the balance sheet with a data-base in order to assess its position in relation to the average of an industry. Furthermore, a viewing of the company and an assessment of the management is considered as important element of the credit decision. This wide range of information was the standard in all German banks which we interviewed, whereas it is still an exception in France (see also Homé 1991). As a consequence of this more holistic approach in Germany, the qualification profile of the employees differs considerably compared to that in French banks. In Germany, a good relationship manager for SMEs has not only to be a qualified as a sales person, he or she must also have passed some years in the credit department and have experience in the assessment of business information. As a standard, there are at least "four eyes" involved in the credit decision. The business information is assessed independently of the relationship manager by a second employee in the credit department. This is meant to control for the case that a relationship manager gets too involved in the interest of the company compared to the risks of the bank. In France, the qualification profile of the relationship manager is more orientated towards selling and involves less qualifications in the credit department. French banks recruit more university graduates with a banking specialisation in order to close the existing skill gap. Promotion in French banks is faster than in German banks and does not require experience as credit officer. As a result, French employees can become a SME relationship manager after only a few years. The French relationship manager has more discretion and back-office only a support function. French banks change their relationship managers more often in order to prevent a too familiar relationship to their SME customers. This job rotation, however, entails the danger of breaks in the bank-company relationship.

5. Conclusion

At the empirical level, the aim of the paper was to identify changes in the relationship between banks and SMEs in Germany and France. The evidence suggests that the German „Hausbank“ relationship is gradually loosing some of its exclusiveness, but still remains a main bank relationship. In France, however, despite many more institutional changes the relationship between banks and SMEs has retained its loose character. In fact, if we look at the ruptures and shifts in the link between banks and their clients, the relationship seems to have worsened as a result of deregulation and economic crisis. Thus, in a period which was characterised by increasing competition in both countries, deregulation and despecialisation in France, whilst institutional stability in Germany, there are persistant, if not increasing differences in the bank-company relationship betweem both countries.

At the analytical level, the aim of the paper was twofold. Firstly, we wanted to examine the impact of institutional changes on the financing behaviour of banks and SMEs. Secondly, we were interested to see how the financing of SMEs has been affected by changes in the mutual relationships between the main actors - state, banks and SMEs. The results show that identities and strategies of these actors are shaped to some extent - varying according to the density and comprehensiveness of regulations - by the institutional context. Market and organisational characteristics also proved to be important factors which impact on the links between banks and SMEs. Finally, the strategies of banks and SMEs influence each other reciprocally.

In Germany, the institutional environment favours a more symmetric distribution of information between SMEs and banks. The specific characteristics of the German "Mittelstand" make it an attractive market segment for banks and enables them to mutualise risks of different types of companies. The historical strength of saving and mutual banks ensures the availability of bank finance at the regional level. Within this context, increasing demands for quality from SMEs, growing bank competition and the organisational restructuring have led to gradual modifications of the bank-company relationship. The strategies of state banks and SMEs, however, are still orientated towards cooperation and the mutual expectations are quite homogeneous.

In the French case, banks and SMEs have contradictory interests and diverging organisational dynamics which reinforce historically developed perceptions of adversarialism and mistrust. Some of the changes in the institutional environment are designed to favour a more partnership-like relationship between banks and SMEs, such as despecialisation and indirect support for financing SMEs. However, they are counteracted by the banks' and SMEs' strategies. French banks follow a policy of limited risk taking in a market which is characterised by ist small size and limited attraction. French SMEs continue to have a short-term planning horizon and try to maintain as much independence from banks as possible. Either they participate from the internal financing of large industrial groups, compensate the lack of bank finance by intercompany loans or postpone investment projects. Given the strength of these factors, it is very unlikely that changes in one isolated area are likely to lead to a breakthrough of the existing vicious cycle of "fournisseur" financing. The results of the study, thus, emphasize the importance of a combined analysis of changes at the actors and system level in order to develop a better understanding of how actors behaviour and perceptions mediate the impact of the institutional context.

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