Extending credit to small and medium size companies

Relationships and conflict management

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Abstract

Purpose – Funding small- and medium-sized enterprises (SMEs) may be especially valuable in China to stimulate innovation and its emerging market economy. These firms have been advised to build on the Chinese value of guanxi to manage conflicts and develop relationships with banks. This study aims to explore the nature of relationships that help SMEs inform banks and convince them to provide credit.

Design/methodology/approach – As this study's theorizing is about whether banks and firms that manage their conflicts for mutual benefit set the foundation for bank's confidence in extending credit, therefore, both the bank officers and the company managers were asked to provide information for the study. In total, 106 pairs of bank officers in the loan department of four banks and SME managers in Shanghai, China, completed a questionnaire survey for this study.

Findings – Results support the argument that marketing research on customer orientation and organization behavior research on conflict management identify how to develop effective marketing relationships between SMEs and banks in China. Banks that were customer-oriented laid the groundwork for managing conflict cooperatively and not competitively with borrowing firms. Cooperative conflict management in turn was found to convince banks that they could confidently provide credit and to convince borrowers that their transaction costs will be reasonable.

Originality/value – This study identifies that developing guanxi and the capacity to manage conflict cooperatively are an important foundation for providing credit to SMEs in China.

Keywords Transaction costs, Conflict management, Customer orientation, Credit worthiness

Paper type Research paper

Entrepreneurial and other small- and medium-sized enterprises (SMEs) in China are thought to be disadvantaged in obtaining financial credit because banks and other financial organizations consider extending credit to large, ongoing companies to be less

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risky and incur fewer transaction costs (Chen and Liu, 2012; Park, 2007; Wang and Yang, 2014). Banks confront asymmetrical information where they know much less than the borrowers about the project and the borrowers' intentions (Huang *et al.*, 2014). Bank loan managers feel more informed and confident with large, established businesses, as they are apt to believe they already understand the abilities and intentions of business managers (Tin and Estrin, 2007).

This study argues that entrepreneurial and other SME firms can build upon the traditional Chinese value of guanxi (relationship) to develop a foundation for obtaining credit from banks (Chen and Chen, 2004; Gold *et al.*, 2002; Hui and Graen, 1997; Law *et al.*, 2000). However, these relationships have to be carefully constructed, as they involve more than exchanging favors and must reduce asymmetrical information so that bank managers feel more knowledgeable and reassured that their risks and transaction costs are manageable (Huang *et al.*, 2014). This study uses Western research to specify the nature of relationships that help SMEs inform banks and convince them to provide credit. Specifically, it uses marketing research on customer orientation (Saxe and Weitz, 1982) and organization behavior research on conflict management (De Dreu and Gelfand, 2008; Deutsch *et al.*, 2014) to identify critical conditions to building effective business–bank relationships. Specifically, this study hypothesizes that banks that are customer-oriented are able to manage their conflicts cooperatively rather than competitively with SMEs, and this productive conflict management convinces bank loan officers that they can confidently provide credit with reasonable costs. This study tests these hypotheses with 106 pairs of banks and SMEs in Shanghai.

This study makes several contributions to the literature. It documents the value of effective relationships between banks and borrowers and in particular shows how these relationships can facilitate extending credit to entrepreneurial firms. This study provides evidence of the utility of marketing research on customer orientation and organization behavior research on conflict management to identify the conditions when banks and SMEs develop mutually beneficial relationships. Banks that are highly customer-oriented lay the foundation for cooperative conflict management between banks and the firms where they discuss and solve their difficulties openly and mutually. This open dialogue helps banks feel knowledgeable and confident that they can extend credit and that they will be able to keep transaction costs acceptable as they deal effectively with issues and problems that arise during the loan period.

Funding for entrepreneurial and other small- and medium-sized enterprises in China

The Asian financial crisis of the 1990s convinced many government officials, business people and economists that China should not rely so extensively on large state-owned enterprises (SOEs). They recognized that developing entrepreneurial SMEs is an important strategy in China, as these firms can be engines of innovation and job creation (Abdulsaleh and Worthington, 2013; Wang, 2004; Wang and Yang, 2014). However, government mechanisms for these firms to obtain adequate credit, for example, Shanghai SMEs Service Center in September 1998, have been short-lived and inadequate (Yao, 1999). Venture capital depends very much on stock prices that have been volatile in China. Surveys show that the vast majority of entrepreneurial firms want bank loans but find it very difficult to secure them and may even give up seeking loans from banks (Abdulsaleh and Worthington, 2013; Wang, 2004; Wang and Yang, 2014).

Although the Chinese economy has developed quickly, economists have questioned how efficiently capital is utilized in China (Cass, 1998). In particular, major Chinese banks are thought to be too risk-adverse, in that they are oriented to provide loans and other credit support to more established firms, especially if they also have strong government support, like SOEs (Berger *et al.*, 2014). Lu *et al.* (2005) found that SOEs, other things being equal, gained more loans than other firms; even SOEs with high default risks were able to borrow more than non-SOEs.

Finance researchers have argued that information asymmetry underlines the reluctance of Chinese banks to extend credit to SMEs (Huang *et al.*, 2014). Entrepreneurs seeking loans know more about their business, the particular project to be funded and their specific plans to use the funds than do the bank managers. Even after granting the credit, banks need information to help them manage the loan. Information asymmetry can lead to a "moral hazard" where banks are unable to observe and monitor the borrower who may violate the covenants of the loan and engage in high-risk investments. The most direct way for banks to avoid these moral hazards is to reject entrepreneurial firms' requests to extend credit.

A riskier approach to deal with information asymmetry is for loan officers to work diligently to try to understand the entrepreneur and the project more fully. These efforts add considerable transaction costs for the firms as well as the banks (Buvik and John, 2000). Would-be borrowers must explain their industry and project to try to reassure bank managers. Yet bank mangers might still suspect that entrepreneurs withhold their knowledge about emerging competition and other obstacles that might make the project look riskier to bank managers.

Business–bank relationships in China

Developing ongoing, mutual relationships might help both SME managers and loan officers deal effectively with asymmetrical information. Developing guanxi relationships has long been thought to build upon Chinese collectivist and other values; studies have shown that these relationships can contribute to effective coordination and joint success in China (Tjosvold *et al.*, 2014b). Indeed, SOEs and other large companies are considered advantaged in gaining credit because they already have developed relationships with banks before they request credit for specific projects (Berger *et al.*, 2014).

This relationship orientation of Chinese banks can be useful when governments encourage lending to competent firms (Heide and John, 1992; Kwong and Lee, 2005). However, this relationship orientation can be counterproductive for the economy as a whole, as young firms may be particularly innovative but under-funded; the lack of funds in turn can reduce banks' profitability and miss opportunities to upgrade Chinese products and services (Podpiera, 2006; Sufian, 2009).

Studies in the West have directly shown that the interaction and relationships between banks and borrowing firms affect financial support decisions (Batjargal and Liu, 2004; Bercovitz *et al.*, 2006; Heide and John, 1992; Hernández-Cánovas and Martínez-Solano, 2006; Paulin *et al.*, 1997; Saparito *et al.*, 2004). Banks have successfully developed relational marketing where they have committed themselves to and have built trust with firms (Morgan and Hunt, 1994). Peltoniemi (2007) found that long-term relationships tend to lower the cost of credit, to the benefit especially of high-risk firms; as the relationship matures, the loan premiums for high-risk firms decreases at a higher rate than those for low-risk firms. Researchers have argued that business managers in China and Hong Kong should develop effective relationships so that they can work together with banks, government agencies and other organizations in China (Adamson *et al.*, 2003; Guthrie, 2002; Peng, 2000; Wong and Tjosvold, 2010).

Management researchers have investigated relationships between organizations with concepts such as transactional costs and opportunism based on economics and strategy (Chen *et al.*, 2002; Luo *et al.*, 2009; White *et al.*, 2007). Studies have documented that productive relationships across such organizations as suppliers and marketers help them to meet global marketplace demands (Kale *et al.*, 2000). For example, competitive banks were found to form partnerships with each other so that they can combine resources and integrate their knowledge to improve market performance (Jacobides, 2005; Rowley *et al.*, 2005). They participated in loans so that they could share both the expected profits and bear the risks.

What is the nature of the relationship between entrepreneurs and banks that can deal with information asymmetry and lead to extending credit? The Chinese value of guanxi suggests the positive value of relationships between banks and firms, but it does not much specify the nature of these relationships. Guanxi is typically considered in terms of exchanging favors but the bank–entrepreneur relationship needs to deal with asymmetrical information so that banks believe they will avoid moral hazards (Huang *et al.*, 2014). Fortunately, research studies suggest that guanxi between organizations can lead not just to exchanging favors but to an openness to each other where they discuss their views and issues directly with each other (Wong and Tjosvold, 2010).

This study argues that Western-developed concepts are useful to understand the nature of entrepreneur–bank relationships that can result in the bank's willingness to extend credit. It proposes that these relationships are characterized by a long-term orientation toward each other. These relationships support constructive conflict management where issues and obstacles are identified and confronted and mutually beneficial resolutions are developed.

Customer orientation

Researchers have developed relationship marketing to identify how buying and selling firms develop long-term, mutually beneficial links that strengthen information exchange and foster ongoing business transactions (Davies, 1994; Kelly and Scott, 2012; Palmatier *et al.*, 2006). Developing these strong buying–selling relationships can be a major resource for both buying and seller companies. Buying firms can contribute to selling firms by being repeat buyers, by recruiting additional customers and by providing feedback and support for product and service innovation useful for both sellers and buyers (Gaurav, 2008). More generally, strategic management theorists have argued that strong, trusting relationships between organizations are an enduring competitive advantage because they are highly useful and difficult for others to imitate (Barney, 2001).

Marketing researchers have identified customer orientation as a critical ingredient to strong marketing relationships (Blocker *et al.*, 2011). With its emphasis on long-term customer satisfaction, high customer orientation reflects a strong concern for customers and low pressure to buy approach to serving customers.

Studies have focused on documenting the effects of customer orientation by examining its effects on salespeople (Saxe and Weitz, 1982). Salespeople with a high level of customer orientation find the process of satisfying customers' needs intrinsically pleasing (Brown *et al.*, 2002). These salespeople seem to better understand their service role and experience less role stress than salespeople low in customer orientation, thus resulting in reduced role conflict and ambiguity (Saxe and Weitz, 1982). Customer orientation increases self-rated performance and job satisfaction. Salespeople high in customer orientation believe that they are more effective and more satisfied with their jobs than salespeople low in customer orientation.

But evidence also suggests that customer orientation itself does not result in repeat and other types of sales. High customer-oriented salespeople appear to believe that customer-oriented selling has long-term benefits, even if their short-term results are not recognized by managers or reflected in objective sales measures (Saxe and Weitz, 1982). This study proposes that customer orientation is useful because it helps promote the long-term relationship rather than immediate sales. In particular, customer orientation establishes an orientation to engage in open discussion of issues and difficulties that results in mutually beneficial solutions, which in turn convince banks that they can extend credit confidently. This study uses research on conflict management to examine the effects of customer orientation and marketing relationships.

Conflict management

Marketing and strategy researchers recognize that developing close buyer–seller relationships is a challenge and typically requires ongoing, skilled effort on the part of both organizations if the relationships are to deliver mutual value (Dwyer *et al.*, 1987; Sheppard and Sherman, 1998; Das and Teng, 1998, 2001). The organizations must confront difficulties and issues before they undermine their relationships. For example, selling firms must respond to service gaps quickly and effectively to maintain customer loyalty (Zeithaml *et al.*, 2001). Indeed, strong relationships have been found valuable in part because they facilitate the open exchange useful for dealing with important, challenging issues (Kale *et al.*, 2000).

This study uses the theory of cooperation and competition to analyze relationships and specifically conflict management between banks and firms. Research has documented that depending on how conflicts are managed, not conflict itself, collaboration and relationships are affected in China and in the West (Liu *et al.*, 2009; Somech *et al.*, 2009). Although conflict has traditionally been considered disruptive, well-managed conflict can contribute substantially to relationship and organizational effectiveness (De Dreu and Gelfand, 2008; Deutsch *et al.*, 2014; Tjosvold *et al.*, 2014a). Indeed, evidence indicates that task and relationship conflict can be managed for productive ends in China and the West (Parayitam *et al.*, 2010).

With constructive conflict management with business leaders, loan officers can be more assured that they understand the borrowers and their intensions and the project more fully. They also appreciate that when issues and problems arise after granting the loan, they can discuss them directly with business leaders and thus keep their transaction costs low and more effectively restore their confidence in the lender and the project.

Conflict involves incompatible activities; one person's actions interfere, obstruct or in some way get in the way of another's action (Deutsch, 1973). The theory of cooperation and competition identifies major approaches to managing conflict, namely, cooperative and competitive. In a cooperative approach to conflict, people emphasize their compatible goals and view conflict as a mutual problem that needs common consideration and solution. They have high concern for others as well as for their own interests, so that they engage in joint problem-solving (De Dreu *et al.*, 2001). Emphasizing shared rewards that they can receive through cooperative conflict management, people exchange their ideas, combine their positions and develop mutually beneficial solutions. They have opportunities to form and express their needs, opinions and positions and also to understand the perspectives of others.

Partners may also use a competitive approach when they focus on their own goal attainment and regard conflict as a win–lose struggle. With the emphasis on their own interests over and above others' interests, people attempt to coerce each other to do one's bidding but do not want to compromise themselves. This competitive approach frustrates exchange and integration of different ideas and often results in a deadlock or imposed solution.

Studies have documented that the cooperative compared to the competitive approach to conflict very much contributes high-quality solutions and commitment to them in China and in the West (Tjosvold *et al.*, 2014). Cooperative conflict was shown to be useful for integrating opposing ideas to make decisions as well as managing differences in interests and relationship conflicts (Tjosvold *et al.*, 2008, 2005; Tjosvold and Sun, 2003). Teams can develop trust through cooperative conflict management (Hempel *et al.*, 2009). Cooperative conflict management was found to be an important mediator between effective leadership and team performance (Zhang *et al.*, 2011). Transformational leaders were found to be effective not by dominating employees but by developing cooperative conflict management within employee teams. Then employee teams were able to coordinate effectively over the long term and be productive.

Experiments conducted in the West and in China have documented the processes of cooperative conflict management (Chen *et al.*, 2011; Tjosvold, 1982, 2008; Tjosvold and Sun, 2001; Tjosvold *et al.*, 2010). Compared to those in agreeable discussions, participants who disagreed directly and cooperatively indicated higher levels of internal uncertainty and asked their protagonists more questions, demonstrating greater interest in understanding the opposing perspective. They also recalled more opposing arguments and identified the reasoning others were using; they were willing to consider and incorporate opposing views into their own thinking and decisions. People who had cooperative compared to competitive goals were more open toward the opposing position and negotiator.

The customer orientation of banks toward SMEs is expected to have its effects by developing the cooperative approach to conflict. A high customer-oriented bank convinces the bank and borrower that they have a mutual relationship where they are concerned about each other's interests and communicate accurately and directly. Demonstrating these concerns and openness forms the basis for discussing conflicts cooperatively for mutual benefit. A bank with low levels of customer orientation communicates that it has little concern and communication with the entrepreneur, leaving both the bank and the entrepreneurial firm focused on their own self-interests. A focus on self-interest without concern for the interests of the other convinces partners that they should pursue their own interests even at the expense of the others, laying the foundation for the competitive approach to conflict (Deutsch, 1973).

Based on the above research and reasoning, we hypothesize:

H1. High customer orientation promotes cooperative conflict management between banks and borrowing firms.

H2. Low customer orientation promotes competitive conflict management between banks and borrowing firms.

Conflict management for gaining credit

Banks have a number of concerns as they decide whether to extend credit to a company. They often feel that business people know more than they do about the values and risks of the project (Huang *et al.*, 2014). They realize that they need to incur considerable transaction costs as they try to be more informed. Loan officers do not like the experience of being in a moral hazard and do not like surprises; they want to understand the borrowing firm and its managers. In addition to examining the firm's current assets and collateral and future prospects, they also want to be kept informed of new developments in the firm and its markets so that they can make decisions and adjustments in a timely manner. Their ability to manage conflict cooperatively helps banks become confident that they can now and will in the future obtain this information and understanding. They believe that they can manage the loan confidently without considerable oversight in making frequent demands on the borrowing firm to provide extensive information. Banks want strong relationships in part because they can help feel confident to extend credit and that they can oversee and manage the loan efficiently.

However, competitive conflict with borrowing firms makes extending credit less likely. As they deal with conflict, banks and firms feel that they need to focus on their own interests with little concern for the goals of others and thus approach conflict competitively. Banks are likely to conclude from competitive conflict that the borrowing firm will provide information to the extent that this information furthers its own interests even at the expense of the bank. Borrowing firms as well as the banks are apt to consider that managing the loan will require considerable costly surveillance but still not provide all relevant information to them.

Based on the above research and reasoning, we hypothesize:

H3. Cooperative conflict management between banks and borrowing firms promotes bank's willingness to extend credit and the conclusion that managing the loan incurs low transaction costs.

H4. Competitive conflict management between banks and borrowing firms impedes bank's willingness to extend credit and fosters the conclusion that managing the loan incurs high transaction costs.

Overall model

This study uses Western-developed concepts to understand the relationships that help banks feel more willing to extend credit to Chinese entrepreneurial firms. Theory and research reviewed suggest that conflict management approaches are useful to understand the mechanisms by which customer orientation affects interactions and outcomes between banks and firms in the Chinese settings. Conflict management mediates the relationship between high customer orientation and credit support: banks and firms that manage their conflicts for mutual benefit set the foundation for bank's confidence in extending credit and borrowing firm's conclusion that they will not suffer undue transaction costs (Figure 1):

H5. High customer orientation promotes cooperative conflict management between banks and borrowing firms, and this cooperative conflict management promotes bank's willingness to extend credit and the conclusion that managing the credit support incurs low transaction costs.

Method

Participants

The heads of the loan departments of China Bank of Construction, Bank of Communications, Shanghai Bank and China Minsheng Bank supported this study. These banks are known in Shanghai, China, to extend loans to entrepreneurs. The first two banks are ranked in the top five banks in China and the other two banks have recently worked to support SMEs. Similar to previous studies of inter-organization relationships (Morgan and Hunt, 1994; Rindfleisch and Moorman, 2001), we used the key informant approach. Serving as key informants, the bank credit officers responsible for SME loans were each asked to focus on their collaboration with a company in filling the questionnaire. We then independently contacted the company to identify a manager knowledgeable about the relationship with the bank's loan department and willing to complete the questionnaire. Respondents did not know who was completing the other questionnaire and were assured that their responses would be kept confidential.

We sent out 120 sets of questionnaires and 117 sets were collected. Out of the 117 returned sets of questionnaires, there are 106 usable sets of questionnaires after deleting those questionnaires that were not finished completely and those that did not have their matching pairs. Thus, 106 sets of questionnaires were included in the data analysis.

This study's theorizing is about whether banks and firms that manage their conflicts for mutual benefit set the foundation for bank's confidence in extending credit and the borrowing firm's conclusion that they will not suffer under transaction cost. Therefore, both the bank officers and the company managers were asked to provide information for the study. The company managers were asked to complete the measures of customer orientation of the loan department, conflict management and transaction costs, while the bank officers completed the outcome measure of credit worthiness. This procedure should help reduce same source bias.

The respondents from SMEs had an average age of 38 years; 43 per cent of them were male. Their education level was 54 per cent at university level, 33 per cent at college

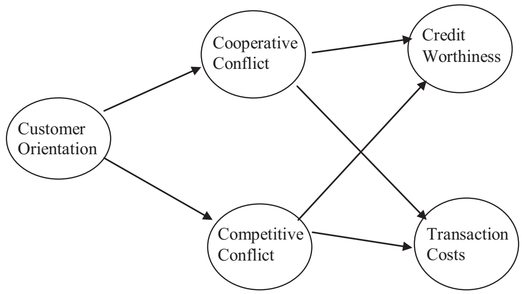

Figure 1.
Hypothesized model

level, 8.5 per cent at secondary level and 4.5 per cent at postgraduate level. On average, the respondents had worked in the SMEs for 6.3 years, and most of them were finance managers. The average number of employees in the SMEs was 313.

Regarding the industry of the SMEs, 66 per cent were in wholesale, retail and catering; 10 per cent each in both manufacturing and construction; and the remaining 14 per cent of companies were in other industries.

The respondents from the loan departments had an average age of 32 years; 55 per cent of them were male. Their education level was 82 per cent at university level, 6 per cent at college level, 2 per cent at secondary level and 10 per cent at postgraduate level. On average, the respondents had worked in the loan department for 6.2 years, and most of them held the post of account executive. The average number of employees in the loan department was 16.

Measures

Customer orientation. We adopted Thakor and Joshi's (2005) five-item scale to measure customer orientation that was created by adapting relevant items from the existing Saxe and Weitz (1982) scale. Company managers were asked to rate customer orientation of the loan departments. A sample item of the scale is "Staff in this loan department try to determine how they can best help us solve our problem". The scale had a Cronbach's alpha of 0.91. Appendix provides all the items for the study's measures.

Conflict management approaches. We modified scales previously developed to measure conflict management approaches in self-managing teams in the USA (Alper *et al.*, 2000). The cooperative and competitive conflict approach scales were developed from a series of experimental and field studies and have been examined in the Chinese context with strong evidence of reliability and validity (Chen *et al.*, 2005, 2006; Tjosvold *et al.*, 2006). Company managers rated these two scales. The cooperative approach scale consisted of five items measuring the emphasis on mutual goals, understanding everyone's views, orientation toward joint benefit and incorporating different positions to find a solution that is good for all. A sample item is "This loan department and we treat conflict as a mutual problem to solve".

The competitive approach scale consisted of four items measuring team members' assumptions concerning whether conflict is win–lose and the use of pressure to get others to conform to their views. A sample item is "This loan department and we treat conflict as a win-lose contest". The Cronbach's alpha for the cooperative approach is 0.91 and for the competitive approach 0.93.

Transaction costs. We adopted the scale from Buvik and John (2000) to measure the transaction costs incurred to manage the loan support. Transaction costs are the bargaining and monitoring costs incurred by the SMEs as they attempt to arrange and manage the loan support. A sample item is "Our firm uses far too much time and resources to fulfill the requirements from this loan department". The company managers rated this four-item scale and it had a Cronbach's alpha of 0.91.

Credit worthiness. We developed four items that would measure the willingness of the loan department to provide a loan or other form of credit. Before collecting data from the study's sample, loan officers indicated that the proposed items measured their interest in providing credit to SMEs and therefore demonstrated a level of content validity. We assessed the credit worthiness of the SMEs by asking the loan departments to rate this four-item scale. We measured whether the loan departments were willing to provide loans and other credit support to the SMEs in view of their relationships with and the present situation of the firms. This four-item scale also measured whether the loan departments believed whether it is safe to extend loans to the SMEs and that the SMEs were able to meet their debt obligations. A sample item of the scale is "In view of our existing relationship with this firm, it is likely that we will provide loans and other credit support to the firm if it approaches us". This scale had a Cronbach's alpha of 0.88.

Analyses

Scale validation

In the structural equation modeling practice, the measurement model should be examined with confirmatory factor analysis prior to the simultaneous estimation of the measurement and structural models (Anderson and Gerbing, 1988). Therefore, we conducted a series of confirmatory factor analyses to test whether the respondents' rating would load on five distinct factors, namely, customer orientation, cooperative and competitive conflict management, credit worthiness and transaction costs, to ensure that the items were measuring distinct constructs. The confirmatory factor analyses were conducted using LISREL8 (Joöreskog and Soörbom, 1996). The effective sample size for the present study was 106 pairs.

Results (Table I) from a series of confirmatory factor analyses (CFA) suggest that our proposed five-factor model, Model M_0, fits the data quite well (χ^2 = 345.89, df = 162; RMSEA = 0.10; CFI = 0.96; IFI = 0.96). This five-factor model was then compared to two different four-factor models. Each of these four-factor models was formed by merging two of the five variables into one aggregate factor. These two alternative four-factor models were selected based on the logic that the aggregated variables may not be distinctly understood and on the basis of the inter-correlations among the five variables. Competitive conflict management and transaction cost are highly related (r = 0.80), while customer orientation is highly related to cooperative conflict management (r = 0.73). These two pairs of variables were each combined to form a single factor that was tested against the proposed five-factor model. This method has often been adopted to evaluate discriminant validity (Brooke *et al.*, 1988; Mathieu and Farr, 1991).

Results in Table I show that model χ^2 values increase significantly when we move from the five-factor model to any of the two four-factor models. The χ^2 statistics can be used to directly compare the fit of nested models to the data. A significant increase in the χ^2 statistics indicates a significantly poorer fit of the alternative model. Therefore, the comparisons of the fits of the five-factor model to

Variables	Mean	SD	Item	Alpha	1	2	3	4	5
1. Customer orientation	5.48	1.11	5	0.91	(0.86)				
2. Cooperative conflict	5.48	1.06	5	0.91	0.73**	(0.81)			
3. Competitive conflict	2.67	1.41	4	0.93	−0.57**	−0.41**	(0.89)		
4. Transaction cost	3.05	1.34	4	0.91	−0.49**	−0.42**	0.80**	(0.88)	
5. Credit worthiness	5.52	0.94	4	0.88	0.60**	0.55**	−0.35**	−0.29**	(0.83)

Notes: Values on the diagonal are the square root of the average variance explained (Fornell and Larcher 1981a, 1981b); $^{**}p < 0.01$

Table I. Means, standard deviations, reliabilities and correlations two alternative four-factor models suggest that the five factors are distinct measures of the constructs in our study.

Apart from conducting the series of CFA, we also followed the procedure outlined by Fornell and Larcker (1981a, 1981b) and calculated the square root of the average variance explained (AVE) for each of the scales in our study to assess the discriminant validity of our scales. To meet the requirements for discriminant validity, the square root of the AVE must exceed the corresponding latent variable correlations with other variables. Results in Table II indicate that the shared variance between the latent variables (as measured by the correlations between the variables) is less than the variance shared by a variable with its indicators (measured by the square root of the AVE coefficient). These results indicate that there is discriminant validity among the five latent variables in our study.

The convergent validity of the constructs was evaluated by checking the standardized factor loadings of each construct. They were all significant and greater than 0.5 (Gerbing and Anderson, 1988; Hildebrand, 1987; Steenkamp and Van Trijp, 1991). Therefore, the five latent variables also have convergent validity.

Hypotheses testing

Correlational analyses were used as an initial test of the hypotheses. Structural equation analyses were used to test the proposed model connecting customer orientation, cooperative conflict and competitive conflict management, credit worthiness and transaction costs. The covariance structure analysis of the inter-relationship among these constructs was analyzed using LISREL8 (Joöreskog and Soörbom, 1996).

In addition to evaluating the overall model fit and specific parameter estimates, a common approach is to compare nested models to one another so as to identify the best model (Hayduk, 1987; Ullman and Bentler, 2003). A nested model test was used to evaluate the argument that conflict management approach mediates the link between customer orientation and credit worthiness and transaction costs. The Mediating Effects, also called the Hypothesized model, was compared to the Full Effects model that posited that customer orientation also has direct effects on the outcome variables in

Models	χ^2	df	$\Delta\chi^2$	NNFI	CFI	IFI	RMSEA	SRMR
Baseline Five-Factor model (M0)	345.89	162		0.95	0.96	0.96	0.10	0.066
Four-Factor model (M1) Combined Competitive Conflict with Transaction Cost	383.05	166	37.16**	0.94	0.96	0.96	0.11	0.067
Four-Factor model (M1) Combined Cooperative Conflict with customer orientation	364.64	166	18.75**	0.94	0.96	0.96	0.11	0.072

Notes: Five-factor model includes customer orientation, cooperative conflict, competitive conflict, credit worthiness and transaction costs; χ^2 is the model chi-square; $\Delta\chi^2$ is the change in model chi-square; NNFI = non-normed fit index; IFI = incremental fit index; CFI = comparative fit index; RMSEA = root mean square error of approximation; Std RMR = root mean square residual; $^{**}p <$ 0.01

Table II. Scale validation–confirmatory factor analysis[a] addition to being mediated by the conflict management approaches. In addition, the Mediated Effects model was also compared to the Direct Effects model that posited that customer orientation and conflict management approaches have direct effects on the outcome variables.

Results

Zero-order correlations provide an initial examination of the hypotheses linking customer orientation, conflict management approaches, transaction costs and credit worthiness (Table II). Consistent with *H1*, results suggest that high customer orientation promotes cooperative conflict management between banks and borrowing firms. Customer orientation was positively and significantly correlated with cooperative conflict management ($r = 0.73$, $p < 0.01$). In support of *H2*, results suggest that low customer orientation promotes competitive conflict management between banks and borrowing firms. Customer orientation was negatively and significantly correlated with competitive conflict management ($r = -0.57$, $p < 0.01$).

Results provide support for *H3* that to the extent that borrowing firms and banks approach their conflicts cooperatively, they promote bank's willingness to extend credit ($r = 0.55$, $p < 0.01$) and borrowing firms' conclusion that managing the credit support incurs low transaction costs ($r = -0.42$, $p < 0.01$). Consistent with *H4*, results suggest that to the extent that banks and borrowing firms approach their conflicts competitively, they impede bank's willingness to extend credit ($r = -0.35$, $p < 0.01$) and foster borrowing firms' conclusion that managing the credit support incurs high transaction costs ($r = 0.80$, $p < 0.01$).

Structural equation analyses were used to examine possible causal relationships (Table III). The Mediating Effects model was compared with the Full Effects and Direct Effects models. Using a standard likelihood ratio-based nested χ^2 test for model fit (Bollen, 1989; Kaplan, 2009), the difference between the Full Effects model and the Mediating Effects model was insignificant ($\Delta\chi^2 = 2.12$, df = 2, *ns*), suggesting that the Mediating Effects model provides a similar fit as the Full Effects model. Therefore, the Mediating Effects model is considered as the best model among the three models because it is more parsimonious and has a similar fit when compared to the Direct Effects model.

The path coefficients of the Mediating Effects model help to explore the findings more specifically (Figure 2). Customer orientation had a significant positive impact on cooperative conflict ($\beta = 0.80$, $p < 0.01$) but a significant negative impact on competitive conflict ($\beta = -0.53$, $p < 0.01$). Cooperative conflict had a significant positive impact on credit worthiness ($\beta = 0.60$, $p < 0.01$), and a negative though non-significant impact on transaction costs ($\beta = -0.07$, *ns*). Competitive conflict management had a non-significant negative impact on credit worthiness ($\beta = -0.08$, *ns*), and a significant positive impact on transaction costs ($\beta = 0.80$, $p < 0.01$). Findings on path coefficients

Table III.
Full effects, direct effects and mediated effects models

Models	χ^2	df	$\Delta\chi^2$	NNFI	CFI	IFI	RMSEA	SRMR
Full effects model	346.87	164		0.95	0.96	0.96	0.10	0.069
Direct effects model	346.76	163	0.11	0.95	0.96	0.96	0.10	0.067
Mediating effects (Theorized) model	348.99	166	2.12	0.95	0.96	0.96	0.10	0.070

generally provide good support for the study's hypotheses, except that the paths from cooperative conflict to transaction costs and from competitive conflict to credit worthiness were not statistically significant.

Discussion

Results support the argument that entrepreneur–bank relationships can help banks feel informed and confident enough to extend credit. Bank managers recognize that they might be much less informed about the proposed project for funding and the specific plans than would-be borrowers (Huang *et al.*, 2014). They fear a moral hazard where they are much less informed than the borrowers. Chinese values, as well as Western research, suggest that under these conditions, constructive relationships can be a strong basis for obtaining credit.

To specify the nature of these relationships and identify important conditions for developing effective marketing relationships between SMEs and banks in China, this study used marketing research on customer orientation (Saxe and Weitz, 1982) and organization behavior research on conflict management (De Dreu and Gelfand, 2008; Deutsch *et al.*, 2014). Results support that banks that are customer-oriented are able to manage conflict cooperatively and not competitively with borrowing firms; cooperative conflict management in turn was found to convince loan officers that they can confidently provide credit and convince borrowing firms that their transaction costs will be reasonable.

Customer orientation for conflict management

In addition to emphasizing the value of strong relationships between buyers and sellers, marketing researchers have argued that selling companies can display customer orientation. This orientation communicates a deep concern for customers and efforts to help customers solve problems rather than pressure them to buy (Brown *et al.*, 2002). But research has not found customer orientation to have consistent, powerful effects on such marketing outcomes as sales (Saxe and Weitz, 1982). Results of this study suggest that customer orientation can strengthen effective, two-way communication that in turn affects marketing outcomes. Specially, loan departments who were highly customer-oriented laid the basis for the open, cooperative discussion of different ideas and divisive issues. In addition, customer orientation reduced the reliance on competitive, win–lose approaches to dealing with conflict.

Results are consistent with marketing researchers' argument that customer orientation promotes the long-term relationship rather than immediate sales (Saxe and

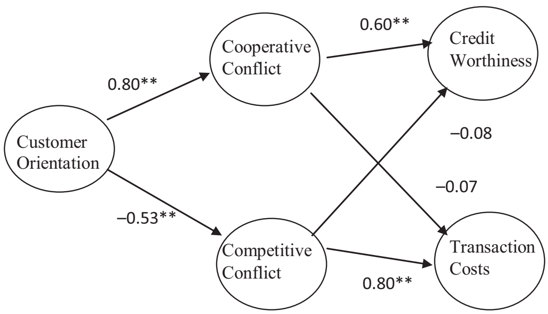

Figure 2.
Path estimates for the hypothesized model

Weitz, 1982). This study complements this argument by finding that customer orientation lays the foundation for conflict management. Indeed, these findings on the value of cooperative conflict management may be surprising, in that they challenge the traditional notion that relationships between seller and buyers should be smooth, even "conflict-free". These results also challenge the traditional notion that effective relationships in China are characterized by harmony and conflict avoidance (Hwang, 1987).

Conflict has traditionally been considered a dark side of work relationships, as it is aggressive and destructive. Indeed, conflict has long been defined as win–lose; if one protagonist is successful, then others lose (Pondy, 1967). It is now more widely understood that conflict can also occur when people have mutual, overlapping interests and can be used to promote mutual benefit (Deutsch *et al.*, 2014; Pruitt and Carnevale, 1993). Researchers have documented the positive contributions of conflict for strengthening relationships and for resolving problems (Tjosvold, 2007).

However, conflict has to be effectively managed to be constructive. Cooperative conflict management has been proposed as a critical way to understand how protagonists can discuss their conflicts to make them productive. In cooperative conflict, people express their own views fully and directly, but they also seek to understand and consider the ideas and perspectives of others; then they are in a position to integrate the best ideas from all to develop and implement mutually beneficial solutions (Deutsch *et al.*, 2014; Tjosvold *et al.*, 2014a). Customer orientation with its emphasis on long-term customer satisfaction, strong concern for customers, low-pressure selling and problem–solution approaches (Blocker *et al.*, 2011) lay the foundation for the openness and integration dynamics of cooperative conflict management.

Conflict management for lending confidence

The relationship marketing perspective holds that non-tangible, economic benefit and cost analyses affect buying and selling decisions (Morgan and Hunt, 1994; Peltoniemi, 2007). This study found that how banks and companies discuss their conflicts very much affects confidence in lending and anticipated costs of borrowing. Research can further our understanding of why the cooperative approach to conflict is quite useful in the lending relationship (Deutsch *et al.*, 2011).

Through open, cooperative discussion of diverse issues and ideas, loan officers can better understand the project and the capabilities and intensions of the business managers. As they feel more informed, they are less concerned about creating moral hazards by lending to business leaders who know much more about the project than they do (Huang *et al.*, 2014).

Cooperative conflict management is also useful for keeping transaction costs of managing the loan reasonable. Bank managers typically develop a plan for a loan that outlines how the loan will be re-paid, including how the borrowing firm will manage their business and funds to fulfill this plan. However, bank and business managers also realize that unexpected changes in the market and operations of the firm will occur, perhaps especially in rapidly developing China, that may question how realistic the repayment schedule is. Loan officers and borrowers can expect to have different understandings of these changes and develop diverse views on how the firms should respond, including the loan repayment. Recognizing that these conflicts are likely and simple harmony is unrealistic, loan officers and business managers realize that frequent, open and constructive discussion of these different perspectives offers a realistic approach to managing the loan and the lending relationship. With the capacity to manage conflict cooperatively, bank officials are confident about the project and that their transaction costs will be acceptable.

The study's results on the role of cooperative conflict management joins recent research that challenge the traditional view that effective relationships in China are characterized by simple, superficial harmony (Leung *et al.*, 2002). For example, experimental and survey studies have found that collectivist values support the open discussions and integration of diverse views in Chinese teams (Tjosvold *et al.*, 2014b).

Limitations

Although this study has methodological strengths such as dual-source and inter-organizational analysis, the findings are limited by the study's sample and operations. Results are correlational, and causal inferences are not warranted. Findings may not be highly representative, as the data were collected in one country, Mainland China. Research is needed to test the hypothesis in different settings, using experimental and other methods, to develop more evidence about the proposed causal relationships between customer orientation, cooperative conflict management and lending outcomes.

Practical implications

In addition to strengthening theoretical understanding, support for the hypotheses can have important practical implications for enhancing relationships and customer service. Banks and borrowing companies can study customer orientation and develop reasons why they should strengthen their long-term relationship so that it emphasizes how they can promote each other's interests and help each other solve problems.

SME managers and loan officers can also develop relevant skills to discuss their views openly and cooperatively. They are trained to express their ideas, positions and feelings directly without accusations. Previous research provides guidance for developing cooperative conflict skills (Tjosvold, 2008). They put themselves in each other's shoes and see the problem from each other's perspectives. They seek mutually beneficial resolutions and integrate the best ideas to create new solutions. They agree on the solution that is most effective for both and implement it. Managers recognize that they should use their conflicts to coordinate their effort and integrate their ideas to serve the interests of the bank and borrowing firms.

SMEs have been thought to be under-funded and thus unable to contribute to the dynamism and development of the Chinese economy as they could (Podpiera, 2006; Sufian, 2009). Relational marketing offers the potential that strengthening the links between banks and borrowing firms can help SMEs obtain needed financial credit. Results of this study found that banks that are oriented toward their customer want a long-term relationship focused on joint problem-solving and mutual benefit; this approach in turn is a foundation for successful marketing relationships. Customer orientation was found to be so useful because it promotes the open, cooperative discussion of different ideas and other conflicts that can inform and reassure loan officers. Loan officials and entrepreneurs realize that there are many issues and changes that will occur over the term of the loan, and not all of these can be anticipated. Although specific conflicts may not be predictable, it is predictable that they will likely have conflicts and that if banks and borrowing firms are able to manage them effectively, they can be confident about providing credit and managing transaction costs of lending. Focusing on a mutually beneficial relationships and strengthening the capacity to manage conflict cooperatively appear to be an important foundation for banks' willingness to provide credit to SMEs in China.

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Appendix

Measures rated by company managers

(1) Customer orientation:
- Staff in this loan department try to determine how they can best help us solve our problem.
- Staff in this loan department always present us with a realistic picture of what their products/services can do.
- Staff in this loan department spend much of their time listening to our talk about our firm's needs.
- Staff in this loan department wait until they fully understand our needs before making their sales presentation.
- Staff in this loan department are always candid in discussions with us.

(2) Cooperative conflict:
- This loan department and we encourage a "we are in it together" attitude.
- This loan department and we seek a solution that will be good for all of us.
- This loan department and we treat conflict as a mutual problem to solve.
- This loan department and we work so that to the extent possible we all get what we really want.
- This loan department and we combine the best of positions to make an effective decision.

(3) Competitive conflict:
- This loan department and we demand that the other agree to our own position.
- This loan department and we want the other to make concessions but do not want to make concessions ourselves.
- This loan department and we treat conflict as a win–lose contest.
- This loan department and we overstate our own position to get its way.

(4) Transaction cost:
- Our firm uses far too much time and resources to fulfill the requirements from this loan department.
- It is very time-consuming and difficult to get necessary verification of the performance of this loan department.
- The coordination of the relationship with this loan department is too costly compared to the resulting outcomes of these interactions.
- It is very time-consuming and difficult to accomplish negotiations between this loan department and our firm.

Measure rated by bank officers

(1) Credit worthiness
- In view of our existing relationship with this firm, it is likely that we will provide loans and other credit support to the firm if it approaches us.
- In view of the present situation of the firm, it is likely that we will provide loans and other credit support to the firm if it approaches us.
- In view of the present situation of the firm, we believe that it is not risky to provide loans and other credit support to the firm if it approaches us.
- In view of the present situation of the firm, we believe that the firm is able to meet its debt obligations if we provide it with loans and other credit support.

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