

ABSTRACT:

Using hand-collected, proprietary data from the lending portfolio of a mid-sized regional bank in the United States, I empirically identify the channels that strengthen the relationship between a small business and its bank. I find that information exchange is only part of the mechanism that creates benefits from strong bank ties. I introduce two novel channels of relationship strength that embody an entrepreneur's profit appeal for a bank: (1) the depth of *cross-selling* of non-loan products to the entrepreneur, and (2) the breadth of additional bank business referred through the entrepreneur's social and professional *connections*. I show that a borrower's intensive margin of profit (the depth and profitability of cross-selling) and extensive margin of profit (the quantity and profitability of referrals) lower the cost of borrowing and generate access to more credit. These effects are additive. A one-standard deviation increase in both cross-selling and referral profits is associated with a 29 basis point reduction in the loan interest rate and a 21 percent increase in the amount of credit available to a firm.