# How the Financialization of Firms Occurs: The Role of Regulation and Management Tools

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# *How the Financialization of Firms Occurs: The Role of Regulation and Management Tools*
## *The Case of Bank Credit*

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Abstract. A study of the implementation, in a small mutual bank, of the Basel II Agreements makes it possible to document some processes in the financialization of firms. Financialization does not necessarily occur through the acquisition of capital in firms by institutional investors whose goal is to create value for shareholders. In the case studied here it was regulatory decisions taken by both the European Union and by the French banking supervisor that led the bank to totally transform its organization and working methods, and to adopt practices informed by prevailing financial theory. These changes then had an effect on its clientele of small- and medium-sized enterprises who thus became subject, via the new credit allocation procedures, to new financial discipline.

Keywords. FINANCIALIZATION—CREDIT RISK—BANK—MANAGEMENT TOOLS—EVALUATION—REGULATION

One of the major changes in capitalism in recent decades is undoubtedly what is referred to as financialization. This refers both to the growing role played by the financial markets and their actors in the functioning of the economy and the gradual imposition of indicators and objectives that serve their interests in the conduct of economic activities (Epstein 2005). Many studies have documented the growing importance of financial activities in the economy (Krippner 2005; Crotty 2005) and the growing role of financial transactions in non-financial sectors (Froud *et al*. 2002; Baud and Durand 2012). Most of these studies were concerned by the consequences of this new capitalism in terms of stability (Boyer 2000) and inequalities between workers and between labour and capital (Dumenil and Levy 2001; Godechot 2012; Lin and Tomaskovic-Devey 2013). Effects on the daily activities of businesses have also been noted: this financialization of management appears in most of the research as the result of actions taken by directors to achieve "financialized" goals generally set by shareholders from institutionalized financial markets[1] (Lazonick and O'Sullivan 2000; Andersson *et al* 2010). These changes are reflected internally by struggles mostly leading to the domination of financial groups over

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1. Especially the spread of mechanisms that, as in the case of stock options, encourage directors to emphasise the valuation of capital shares in the management of businesses.

other professional groups (Gleadle and Cornelius 2008; Ezzamel *et al*. 2008) and the establishment of a financial concept of corporate, governance, and control (Fligstein 1990; Davis 2009). Despite the abundance of existing literature, however, we know little about how the changes to the financial markets affect all businesses, including those which do not have recourse to the markets or investment funds to finance themselves, either because they are too small to access them, or because they prefer to have recourse to bank credit, self-financing or even to family-type funding.

We propose in this article to help document these transmission processes by studying the case of a particular business, the Banque Mutuelle ("Mutual Bank"—BM), which has recently experienced significant change in its management methods which we interpret as a form of financialization. The bank is remarkable in that none of the causes typically cited to explain financialization is really relevant to its case. It does not in fact fall within the model of the large international bank for private profit. BM is a French mutual (cooperative) bank backed by one of the major French banking groups, the UBM (Union of Mutual Banks). It was created by organizations whose specific characteristics were poorly understood by conventional banks and who wished to jointly develop their access to banking services. Its customers, mostly SMEs, are all members of the bank. The owners of capital are thus the bank's customers whose primary objective is to achieve a high quality banking service, not maximum profitability. In accordance with the principles of the cooperative movement, when a dividend is paid on the shares of the BM this is also at a fairly low rate that cannot by law exceed the average rate in bond yields. This does not mean that the BM is a bank in decline (its business is in fact quite dynamic) or vulnerable (it is well capitalized). It is thus hardly dependent at all on the assessments of financial markets and is intentionally not designed to maximize return on capital.

The case study of this bank shows that the factor that initiated its financialization is the implementation in France of prudential regulations following the Basel Accords (Box 1). The financialization of credit that has come into operation at the BM is not the product of the pressure of financial markets or banking competition but of a regulation that aims to ensure the stability of the financial system by limiting the risks taken by large international banks in order to maximize the profitability of their capital. Where this small bank is concerned, regulation and the implementation of policy decisions seem to act in reverse because although it does not resemble the model of major international banks in which the cost of capital and profitability prevail in their definition of lending policy, it is obliged to change its traditional practices in terms of providing credit and to fuel the financialization process. The role of the public authorities in the construction of financial markets and the increasing power of financial actors is recognized (Schwartz & Seabrooke 2008; Coriat 2008; Krippner 2011; Montagne 2006) but the process of financialization through the regulation of organizational management practices remains to be documented. In the case of the Basel Accords, several studies have indeed suggested their contribution to the transformation of credit relations (Blum and Martens 2009; Lazarus 2012b), but the actual processes involved have not been revealed. In order to carry out such work, we followed exactly how the provisions in the "Basel II" Agreements concerning credit risk have been translated into the management methods within BM and the effects they have had on the bank's credit relations.

The second reason for our interest in the case of the BM to understand how financialization has come into those businesses that are the least involved in capital markets is related to the fact that its clientele is largely made up of SMEs. Banks,

### Box 1.—*The Basel Accords and their transposition*

The Basel Accords aim to harmonize at international level the regulatory requirements for banks that have international activities. They come from a committee, the Basel Committee, which brings together the public authorities for banking supervision of the major world powers[2]. The Basel Accords have been amended several times, giving rise to three successive versions: "Basel I" (1988), "Basel II" (2004) and "Basel III" (2010). The second version, although it appears to have broadened the framework established by "Basel I," in fact made a radical change in the regulatory system whose tools have been extended and supplemented by the "Basel III" Accords (Baud 2013a).

The Accords are not directly legally binding. Their application requires implementation into national law. The significance of this scheme for the French banking system is mainly explained by the policy choices made in France at the level of the European Union (EU), which contrast sharply with the American situation. Although the reform leading to the "Basel II" agreements was launched in 1998 at the initiative of the Federal Reserve Board of the United States, its implementation in that country came late (in 2011 although the expected date was 2006), and was incomplete, and includes reinterpretations of many major points of the reform. In comparison, the EU has been an exemplary figure since what are known as the "CRD" (Capital Requirements Directives) implementing the Basel framework were prepared in parallel negotiations and adopted in 2006.[3] The EU also extended the Basel II framework to small banks that do not have international operations, demonstrating a regulatory harmonization project that far exceeds that of the Accords. In the French context, the leeway that might still exist was again further reduced by the interpretations of the banking supervisor. The Commission Bancaire[4] had indeed clearly hinted to major French banks, including the UBM group of which the BM is a member, that they expected them to ensure that all their institutions apply the "most advanced" internal risk control methods as soon as the official transition to "Basel II" took place on 31 December 2007.

as key intermediary actors, find themselves in the position of having to disseminate the financialized management standards to the businesses that are their customers even more effectively since their customers are dependent on the credit facilities they distribute. These credits consist of both loans (medium and long term credit) and liquidity facilities (overdraft or short-term credit), and indeed there is no small organization that is not concerned by this at some point or another of its existence. Because of the consequences of the regulations, and not because of the pressure of financial investors who have invested in its capital, the BM has thus found itself obliged to adopt more financialized methods of management that then transform the forms of financial discipline which it imposes on its member-customers' businesses. This is the two-fold process that we propose to document here.

2. Until 2009, the Committee's composition was similar to that of the G8, and it is now closer to that of the G20. The Committee's member countries are represented by their central banks and by the institutions responsible for the supervision of banks if this is not provided directly by central banks. France is represented by representatives of the Banque de France delegated to the French Banking Supervisor (Commission Bancaire at the time of Basel II negotiations).

3 Adoption of Directives 2006/48/EC2 and 2006/49/EC3 on June 14, 2006 for application on 31 December 2006. Graduated transition to the new system from 2007. Application to all credit institutions in the European Union from 1 January 2008.

4. The Commission Bancaire was merged into a new prudential control authority (ACPR) created in January 2010.

After specifying our framework and working methods and explaining specifically how the regulatory change studied here relates to the financialization process, we follow its repercussions in terms of the practices of assessment and supervision of loans to SMEs in the bank and then unpick their consequences for its relations with these SMEs.

## Studying financialization through credit risk management tools

### *An approach*

The method we have used to conduct this survey was to focus the analysis on the management tools used by enterprises (Chiapello and Gilbert 2013). These are not separate from the prescriptions of general validity (good practices, standards, software packages, regulation, etc.) that circulate on a broad national or even international basis, and are translated, or "edited" (Sahlin and Wedlin 2008), into contextualised tools specific to an organization and its internal context. Most tools thus exist in at least a "circulating" form and in many specific "inscribed" states that are variations of the initial normative form (Chiapello and Gilbert 2013, p. 248 ff.). In the case studied here, the regulations of the Basel Accords must, if they are to become effective, be transposed at national level and incorporated into the management tools used by BM such as credit analysis files, credit rating systems, methods of setting rates, and delegation procedures. It is this process of conversion of statutory requirements into management tools that we have sought to document in order to understand how the implementation of regulatory requirements transforms organizational practices to the point where they affect other organizations, as in this case the customers of the transformed organization itself.

This approach, which involves tracking management tools in different arenas (Burchell *et al*. 1985) to reflect both how they incorporate collective rules of regulation and how they contribute to the day to day organization of economic activities, allows us to address capitalism and its changes (in this case, its financialization) in another way: rather than studying capitalism as a global system, we examine it from the perspective of how businesses operate and their management tools. In many ways, such a reversal is similar to that proposed by Michel Foucault, when he moves from the study of the state to that of governmentality,[5] which has recently extensively fertilized research on public policy in political science (Lascoumes and Le Gales 2004, Le Gales and Scott 2008; Halpern *et al* 2014).

Although some studies have been able to emphasize the importance of normative texts such as accounting standards (Capron 2005; Chiapello 2005; Zhang and Andrew 2014; Müller 2014) in the maintenance of the dynamics of financialization on a global scale, the impact of changing regulatory frameworks is rarely followed up to the organizational level, let alone pursued as far as inter-organizational relationships. Meanwhile, economic sociology has shown that market interactions

5. *Security, Territory, Population* and *The Birth of Biopolitics*, lectures at the Collège de France 1977–1978 and 1978–1979, published in English in 2009 and 2010 by MacMillan.

were largely structured by technical tools and systems that revealed that beneath the "invisible hand" of the classical economists was the visible hand of management (Chandler 1977; Cochoy 1999; Quellier Dubuisson 1999). We know the importance of technical equipment in manufacturing prices (Muniesa 2005; Callon *et al*. 2007). Although the role of tools in the equipment of market interactions has been widely described, the relationship that these instruments have with regulatory frameworks and public policy remains poorly explored.

This approach via the tools being used may also allow us to understand the room for manoeuvre and interpretation actors have when it comes to inscribing these normative frameworks in their daily operation. The selected organization is interesting in this perspective because the BM differs from the model of the bank which regulators have used to design the Accords, which—as we will show—also negates its cooperative goals. The BM was initially actively engaged in movements that sought to change the regulatory plan. However, once the outlines of the reform were definitively fixed, it could do no more than try to negotiate the best form of local implementation. The BM appears to be an ideal setting for observing the feasibility of a purely "ceremonial" adoption of the Basel framework and the possibility of a decoupling from routine operation (Meyer and Rowan 1977).

The second version of the Basel Accords carries the same liberal representations of financial markets (Baud 2013a) as the ones that fuelled the reforms that were the source of financialization in the United States (Krippner 2011). As we show in the next section, it is also marked in the writing of the rules by a recourse to an instrumentation (methods to review problems, techniques of calculation and decision-making) that is specific to modern financial discipline. Because these elements belong to a specific body of knowledge, they are involved in financialization in the sense that they speak a language that carries with it certain assumptions, methods of decision-making and sociopolitical conventions (Desrosières 2008) that are favourable to investors and that they tend to expand and reproduce (Chiapello 2015).

## *"Basel II" and the financialization of credit management*

The many documents available on the Basel Committee's website make it possible to analyze the debates surrounding the reform of the Accords and its evolutions from one preparation report to another and thus to document the progressive financialization of the thinking about credit and the norms for managing risks that accompanied the transition from "Basel I" to "Basel II" (Baud 2013b). Since the first Accord in 1998, the main tool of the Basel framework is a minimum capitalization norm that makes sure that banks have enough funds in the form of capital to absorb losses they might suffer in the course of their business. The aim is to limit the risk of bankruptcy and thus contribute to the stability of the financial system.[6]

6. Initially, only credit activity related risks gave rise to the establishment of capital requirements, and then other risks have gradually been taken into account, such as market risks (through an amendment to the "Basel I" accords adopted in 1996) and operational risk (i.e., "the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events" (BCBS 2006, §644, p. 144)) with "Basel II" in 2004. The credit risk requirements are however both older and quantitatively the most important. Credit risk accounts for more than two thirds of the capital requirements of banks (against 9.5% for market risk and 7.3% for operational risk) and over three quarters of their variance (BCBS 2013).

### Box 2.—*The changing rules for calculating regulatory capital requirements related to credit risk*

Under "Basel I," the calculation of regulatory capital used simple rules based on the type of borrower. Regulatory capital should amount to 8% of outstanding loans, but weightings could be used to bring this down. Some loans only required 4% of capital (mortgage loans secured by real estate), others 1.6% (loans to OECD banks) or even no capital protection, in other words 0% (loans to OECD states). The system therefore included fairly coarse judgments on risk (no risk for OECD states) but could be easily calculated. These terms were totally overhauled in "Basel II," in particular so as to weight risks by methods presented as being "conceptually sound" (BCBS 2006, §5, p. 2). Banks could now use two methods: the "standard method" and the "internal ratings-based approach" (The IRB method).

In the standard approach, capital requirements depend primarily on financial ratings ("external" ratings) assigned to borrowers by accredited rating agencies.[7] In the IRB approach, it is the ratings assigned by the bank itself to its borrowers ("internal" ratings) that are used. Each internal rating is supposed to reflect a specific "level of risk," that the loan is in default in the coming year, expressed as a probability called the probability of default. The calculation of capital requirements is then performed by applying a financial mathematics model, the ASRF model (Asymptotic Single Risk Factor), to the probability of default established by the bank.[8] Theoretically, the heart of the ASRF model is the Vasicek (1987) formula, which can be considered as a by-product of the model of R. C. Merton (1974), one of the main pillars of modern finance (MacKenzie 2003). The calculation method is in fact based on the conversion of theoretical models developed in the 1970s for securities traded on financial markets for credit operations with individuals, non-listed companies or non-profit organizations. In these models, it is considered that the future position of a company can be represented by a random variable following a normal distribution whose parameters[9] can be estimated from information provided by the financial markets and, in particular, from share prices.

The minimum capital required depends on the loan portfolio structure, the underlying rationale being that 'riskier' loans generate stronger capital requirements.

The first significant change focused on the methods of calculating these regulatory requirements, with a change of loan differentiation criteria in the portfolio (Box 2). The calculative conventions which were openly relying on the legal or political qualities of borrowers have shifted in favour of risk "ratings" provided by the financial operators themselves (whether credit rating agencies in the case of the "standard method," or the banks themselves in the case of the "internal ratings method" (IRB approach)). The capital required to cover the risks taken by banks depends in this case on what they themselves believe to be their risk, the criteria of the regulator fading away behind the supposed expertise of the actors it seeks to regulate. This shift is the sign of a first form of financialization linked to the increased power given to the financial sector.

7. Three private rating agencies that make up the dominant worldwide oligopoly (Moody's, Standard & Poor's and Fitch Ratings) received worldwide approval. To these must be added locally accredited ratings agencies. In France these are the COFACE and the Banque de France.

8. In an advanced version of the IRB method, the bank may also consider another important internal parameter: the rate of loss given default (LGD).

9. The average expected return and the risk, defined as the dispersion of returns around the mean.

The change in risk assessment criteria has been accompanied by the adoption of quantification models that come directly from the dominant theories of market finance now being written into the regulations (Box 2). As a result, financial theory sees that law now offers a powerful vehicle for it to deploy its performative power (MacKenzie *et al*. 2008). This is another form of financialization: that of the quantification instrument. Note that this adoption also assumes a very particular representation of credit risk defined entirely in terms of statistics such as credit scoring techniques (Lazarus 2012b), which means a generalization of these approaches to cases far removed from those where it has traditionally been applied for many years (loans to individuals). It also involves the adoption of an important valuation convention of financial theory that models must be probabilistic (Chiapello 2015) since the implementation of the IRB approach requires banks to build a rating system to determine the probability of default associated with each rating, a system they are obliged to calibrate statistically from large data samples.

Not content with changing the method of calculation of regulatory capital, "Basel II," unlike "Basel I," also stipulated a number of business requirements. In addition to capital requirements (so-called "Pillar I") some guiding principles of the prudential banking authorities in their supervisory duties ("Pillar II") were added to them, whose objective is to ensure that banks build risk management systems tailored to the complexity of their activities which are consistent with how regulatory capital is calculated.[10] Thus for the right to use the IRB method (which is less costly in terms of capital than the standard method), banks must pass a "use test," which aims to prove that they have not designed their rating system for purposes of "regulatory optimization" (to save capital), but that they also use it on an everyday basis to make decisions about approval and pricing of loans.

Regarding the latter, the Basel Committee also has a fairly definite idea of how the cost of risk should be distributed among clients and capital providers. Firstly, according to a dominant idea in market finance, capital must be used to cover variations in losses around the average (and not the whole risk) and be paid at the rates prevailing on the financial markets. It follows that it is the borrowers' responsibility to cover the cost of average risk and the cost of capital covering the variations around this average. Secondly, it is assumed that borrowers must participate up to the amount of what is believed to be their individual risk. Therefore, the pricing of each loan must depend on the rating of the borrower and provide compensation at the rate required by the markets for the capital used by the bank. Under these principles, banks are required to analyze the profitability of their loans by allotting to each of them the cost of the equity capital it requires. Again, this risk-based pricing is clearly a form of financialization as the new scheme protects and legitimates shareholder interests at the expense of other stakeholders (in this case the customers),[11] and moves towards an individualization of risk and its pricing at marginal cost, at the expense for example of solidarity-based approaches that promote the mutualization of risk and its support on a collective basis among borrowers. We see clearly how the theoretical construction that is part of financial reasoning (in this case pricing based on the principle of profitability related to risk) articulates with the interests

10. It also adds obligations for publication of information by banks ("Pillar III").

11. This recalls Lordon's (2000) analysis of EVA except that EVA is a non-binding instrument and in addition rarely used (see end of article) while the system we are discussing was imposed on all banks in the EU and is the global framework of reference.

of shareholders, and therefore the way in which the financialization of calculation systems articulates with financialization conceived as the increased power of capital providers.

## *A survey*

We have sought to understand the ways in which changes identified at the regulatory framework level have led to changes within the bank. Because of the European decision, and although it is not an international bank, the BM had to apply the Basel Accords. However, it had in theory a choice between two options: the standard method (external ratings) or the IRB approach. Nothing *a priori* meant that it must adopt the latter. Firstly, it did not have the technical means to do so because it did not practice "internal rating." Furthermore, by requiring risk-based pricing, this approach is contrary to the mutualist principles on which the bank was founded. Finally, being well endowed with capital and largely independent of the ratings of financial markets and capital profitability maximization objectives, the BM had no reason *a priori* to want at all costs to benefit from the lower capital requirements offered by the IRB approach. These issues have been widely debated by the board of directors (*conseil d'administration*): during one of its meetings the Director of Risk referred to the "serious consequences for the management of banks," and explained that the process goes "far beyond" a change in capital requirement, and that it affects "the determination of credit risk policy, delegations of authority based on ratings, the definition of boundaries, for example by industrial sector, […] pricing, etc." [Minutes of the Board of 14 December 2006]. Despite everything the BM still ended up by adopting the IRB approach, the most financialized one in the Basel framework, under pressure from the French bank supervisor (Commission Bancaire) who is in charge, within "Pillar II," of choosing the risk management system that he considers suitable for the activities of a bank. As the Director of the BM explained, "choosing the method is a misnomer. The context is binding. BM being a major institution of the UBM group, the Commission Bancaire has refused use of the standard method in the BM" [Proceedings of the Risk Committee 2008].

The study of the effects of this new prudential framework on the BM will allow us to understand how the bank has financialized itself through the adoption of new tools for the assessment and control of risk and how these changes are transforming its credit relationships and affecting its SME clients. The empirical evidence presented is taken from a survey conducted in 2009–2010 as part of a doctoral thesis (Baud 2013a). A first study period of seven weeks at the bank's headquarters was followed by a second within five bank branches (one to two weeks of observation by branch). The work of bankers and daily use of the bank's information systems were observed directly during these periods. In the course of the survey, the BM was just finishing the implementation of the requirements of "Basel II." The accounts of different actors at headquarters and in branches on the implementation of the new system were thus collected (53 interviews).[12] Finally, a large documentary resource [13]

12. The interview quotes used in this article describe the position of the person in parentheses (CC = branch loan officer or *chargés de crédits*) and if necessary the location of their post.

13. Internal BM documents are referenced in squared brackets.

including notes of procedures, minutes of meetings and a sample of 80 credit records was also assembled.

## The financialization of credit risk management tools

The operation of the BM is far from close to the dominant model of the "modern" centralized banking industry in which the segmentation of offers and product standardization makes it possible to separate sales activities, performed locally by relatively unskilled agents, from those in the design of products and control, which are centrally exercised and form the heart of the expertise of the bank. BM is one of the French banks marked by their mutualist heritage, where the banking relationship demonstrates a commitment to supporting customers in their borrowing goals within an educational perspective (Moulévrier 2012). This is reinforced in the BM by the fact that its clientele is overwhelmingly made up of small or very small organizations, whose diversity makes mass processing very difficult. Providing services with a good quality/price ratio for widely varying customers whose businesses are often poorly understood by the conventional financial banking sector makes it necessary to acquire a detailed knowledge of their business, while controlling costs. To achieve this, the BM was structured as a decentralized organization of "field-based" professionals[14] with some degree of autonomy and initiative and where the selection and control of risk requires above all the experience and accountability of bankers. Their autonomy is, however, always supervised and any action must be fully documented and justified in order to meet control requirements.

We will now describe the practices that are used to document and evaluate loan applications in order to measure and select risks before showing how this traditional system has evolved with the implementation of "Basel II." Then we show how risk assessment methods have also evolved. We provide these descriptions, according to our approach, on the basis of the tools used by banking professionals themselves.

### *Assessment and selection of risk before "Basel II" rating*

Two management tools support the work of assessing requests at the BM: the loan application file and the customer risk scoring system. Opening a loan application file is, however, the culmination of a first filtering of the risk carried out closer to ground and traces of it do not necessarily remain in the bank's information systems. In this first phase, an understanding of the economic dynamics of the customer is at a premium.

> So, how is risk assessed, in real life? I'll tell you one thing, on risk there are […] two ideas, I think […]. In the short term, it's a little bit "old France," the important thing is […] Is there a reason for short-term credit needs? We try to sort out the puzzle. Then, over the medium-long term, there again, we try to go back over things, so finally, I try never to depart from: will the investment be the creator of added value, and, if so, how, and how much? I think we really should, before thinking about the rates, guarantees, trade opportunities, try

14. Loan officers make regular visits to customers and actively participate in their institutional life (general meetings, important events) and the local networks and groups to which they are attached (occupational, trade, professional and community associations, etc.).

### Box 3.—*"Financial" analysis and "economic" analysis: The case of the Aluminium B loan file*

Aluminium B is a small aluminium foundry whose operations were taken over two years ago, following a judicial liquidation, by Mr. B. The company has applied for short-term loans (60,000 euros) and overdraft facilities (20,000 euros).

A financial analysis of the accounting documents of the company shows that it is experiencing strong growth (increase in turnover of almost 40%), and that although its profitability has decreased during the past year, it remains clearly profitable (net income represents 2.5% of revenues against 4.5% the previous year). Profitable and growing, Aluminium B is also well capitalized (capital represents 20% of total assets) and has no debt. It is consequently particularly solvent.

However, we understand from reading the file that, in the eyes of the banker, this is not enough. In order to be able to agree this financing, he tries to understand the business model behind the new needs and assess sustainability. We then read that Mr. B has tried and succeeded in "acquiring premium customers" who will certainly demand increased volumes but whose future demand will be more stable (examples are provided). To meet this increased demand, the company has had to move, which "disturbed the end of the accounting year, with a total production shutdown for almost ten days" and helps explain the decline in profitability. The file also explains that "the move went smoothly and that the growth of the business immediately recovered." Moreover, "business is expected to stabilize next year, because Mr. B now wants above all to have a clear margin." The bank concludes that the growth of aluminium B is a strategic choice for the long term and that Mr. B has "harmoniously developed his business." The loan application is accepted.

> to understand the need. These are not empty phrases. That is to say, we try to see roughly what it will bring in, what is this loan going to be the answer to? (Manager, Branch 3).

However, closeness to customers can affect the level of risk being taken.[15] The completion of the loan application file thus aims at acquiring some perspective on situations, by requiring bankers to structure their analysis by following a series of "mandatory steps"[16] and then to provide reasons for their opinion or decision. The files also lead to carefully argued justifications, confirming the idea that the credit report is based on an understanding of the customer's business model and of the viability of the loan, and not on a financial assessment made by reference to external standards of solvency or profitability[17]. The case of the Aluminium B business (Box 3) provides a good illustration of what differentiates this "economic" approach from a more formal "financial" approach focused on the analysis of the accounts.

15. "Sometimes it's more difficult when you've known a customer for years, and you know they've managed to set things straight once, twice, three times … So the fourth time, one says to oneself that it will get better, it's going to go well. But in times of hardship, are we going to have enough covered?" (Manager, Branch 1).

16. Any loan application file thus contains a description of the activity of the company and the "need" for which the loan is required, a financial and predictive analysis aiming to assess the borrower's ability to repay, the justification for the request (i.e., whether it is reasonable in view of the applicant's business model), a risk analysis of the transaction to the bank, and finally the presentation of written conclusions.

17. This point, emphasized by the actors themselves, is supported by the analysis of loan applications. In our sample of 80 cases, there was in fact only one where the analysis and conclusions had not been carefully drafted. It was for the renewal of a short-term credit line (overdraft facilities).

Once it has been written, the file is then a medium of exchange between the banker and his manager in the branch or at head office.

> So, the decision maker will ask questions because we all have our hobby-horses … or our experience, because the hobby-horse is experience. I've got 5 opticians around here that have short-term credit. At headquarters, they know about 50 of them, so they tell me, "Yes, but in some other cases they are not paying or are 6 months late," and they'll draw my attention to things I had not seen." (CC 2 Branch 3).

Thus it is on the expertise of the banker and the experience of his manager that the validation of the diagnosis is ultimately reliant.

> Lending, in all humility, is all about the accumulation of experience. There are no excellent young credit-men. There are bad old ones but there are no outstanding young. It's only if we have a lot of experience that we can say: "We need to pay attention to that." You have to have analyzed the problems we've encountered. (Manager, Branch 5).

The assessment and selection of risks therefore operate at the BM in a professional mode aimed at a disciplinary type of objectivity (Porter 1995),[18] thus having the advantage of adapting to the situations being encountered. However, this mode makes it difficult to compare risks, to aggregate them or even to get a rapid idea of what they are. To this end, the BM has established a complementary system called the "credit scoring system," which was originally intended to disappear with the arrival of "Basel II" rating.

The score is intended to reflect a summary "personal" opinion of the actors about the quality of a customer from the point of view of risk [Principles and description of the rating system, June 1999]. It is even stated in the scoring rules that non-quantifiable and qualitative elements will play a "very important" role. The score goes from A to E, A being "very good" B "good," the C "to monitor," the D "excessive" and E "troubled case." This is initially a judgement coordination tool (Batifoulier 2001), which provides a consensus on the assessment of a situation within the BM. Indeed, the scores provided by the branch in charge of the account are systematically reviewed and possibly amended by the Loan Department at headquarters, which generally does not do so without prior discussion with the actors in the branch. The score then supplies a synthetic indicator reflecting changes in the situation of a customer. Thus any loan file records the historical list of scores as well as the proposed score carried out by the branch, and then the score chosen by headquarters. Finally, the score is used to identify cases that may result in losses (a rating of E). The customer is then classified as a "troubled case" and listed as "excluded from the branch network": all powers of delegation of the branches are suspended and all actions concerning these files must first be approved by headquarters.

In this system, although the experience accumulated by the decision maker and the perspective available to the assessors is important, the assessment is always based on local information and reported by the loan officer through the files, which contrasts sharply with the operation of the system that is set up with "Basel II."

18. Theodore M. Porter (1995) sets up an opposition between a "disciplinary objectivity," based on the expertise of professionals patiently built up during a career of experience shared with peers, and a "mechanical objectivity" that is based on the application of reproducible methods and independent of any particular human judgment. Mechanical objectivity is ideally the result of the application of standardized methods and calculations organized so as to lead to automatic decisions.

### *The introduction of financialized methods for risk assessment*

As part of "Basel II," risk assessment is carried out by an internal rating system that actually takes the form of a dedicated computer application, called the "risk rating engine," which assigns each customer a mark from 1 (for the "best") to 16 (for "most risky").[19] For most SMEs, the rating provided by the engine may in no case be changed manually since the regulation requires "bulk" treatment of customers whose turnover is less than 5 million euros and bank commitments of less than 1 million euros (the so-called "*retail*" segment).[20] The development of such a system presupposes that sufficiently numerous and standardized information is recorded in the bank's information systems to form statistically representative cohorts, which are necessary to validate the rating engine by statistically demonstrating its ability to discriminate between borrowers and predict their default. It follows that the factors taken into account by the "engine" (Box 4) are in practice very few in number and mostly far removed from the daily work of the business, and are usually based on formal representations of organizations, rather than the knowledge of their customers, their situations and their plans acquired by bankers.

BOX 4.—***Information used by the "risk rating engine"***

Items that could be considered are:

1) Identity information: country, industry, turnover, amounts outstanding at the BM, date of the last financial statements, etc.

2) External ratings, when available: COFACE and Banque de France ratings.

3) Financial information from the financial statements.

4) Variables in behaviour or accounts: current account balance, average of maximum lending balance, savings amount, length of the banking relationship, presence of overruns of overdraft or unpaid bills, etc.

The daily business of the company is therefore only very indirectly considered as, at best, only the industrial sector can induce differentiation. Moreover, apart from data on banking behaviour, almost all information is public information often acquired externally (externally purchased financial statements, COFACE and Banque de France ratings, etc.) and therefore do not use the knowledge acquired by the banker about their clients. Note also that the data collected are overwhelmingly about the past situation and behaviour of the business (accounting documents describe a situation observed two to fourteen months earlier). The prospects and goals are not taken into account. Finally, the rating engine operates from a relatively small number of factors that are further reduced in practice (frequent absence of external ratings or financial statements).

19. Furthermore, additional categories (D and C) make it possible to distinguish customers "in default" (late payment or overdraft excess lasting more than 90 days, regardless of the amount involved) and those in litigation.

20. Nearly two-thirds of the customers of the BM with outstanding long-term loans are in this case. For companies whose commitments exceed EUR 1 million or whose turnover exceeds EUR 5 million (the "corporate" segment) rating adjustments may be proposed by the loan officers and eventually incorporated by risk managers. Nevertheless, the costs for bankers of justifying these rating changes strongly discourages use of this possibility.

The rating system also generates a transformation of the relationship to the information BM has available on a business (e.g. the average time delay in paying suppliers). These are not used directly for understanding its particular situation but indirectly to feed a calculation in which only the result—the rating—is considered relevant. In this system, the link between the data and the risk of default is also purely formal: they are variables whose evolution was correlated in the samples that were used to build the model. But this correlation does not presume anything about causality. Some factors are even quite counter-intuitive.

> Statisticians have a historical database, that they watch and they test. And they arrive at some quite funny things. For example, for me, it's never been that the sum of net credit transactions on an account was predictive of a default … There are things that are really, really amazing. (Chief analyst, Risk Management Department)

This form of rating, automatically operated remotely from organizations and based on formal representations of them has the advantage—according to its promoters—of providing estimates whose "objectivity" is guaranteed by the low degree of discretion left to local actors. The rating process is also opaque to them. The engine provides a score but the data, criteria and weightings used are not mentioned, and there is nothing available from which to understand what could cause an improvement or degradation of the estimate. This poses no problem when the estimate provided by the engine largely converges with the estimates of loan officers, which occurs fairly frequently.[21]

However the latter are far from having a clear understanding of what the score is supposed to mean, which would help them to know if it "really" corresponds with their own perception of risk.

> Where the score is out of 16, I don't know what the difference is between 8 and 9. (CC 2 Branch 4).

> Does it mean a lot to go from 1 to 4? No, I don't believe so, I don't know. (CC 4 Branch 2).

Only the "plausibility" of the figure is ultimately checked, thus constituting a fairly loose constraint when one does not know the difference between a 1 and a 4.

The rating is therefore in sharp contrast with the traditional method of risk assessment which started from analyses made "as close to the ground" as possible and co-constructed in dialogue with the hierarchy. Although the new automatic rating system was not in the end substituted for the old scoring system but was added to it, the obligation to operate it has already become a change that is all the more remarkable because it concerns a customer segment, the SMEs, whose risk is conventionally considered difficult to objectify remotely through established financial criteria, therefore leaving a role for a "social assessment" of risk (Ferrary 1999). Automatic assessment by an engine without any recourse to human judgment is even more problematic, especially as all the information available to run it is often lacking (Box 4). This explains the resistance of traditional intermediation techniques in a number of banks, even while the statistical assessment of risk was growing for lending to individuals. BM's practices therefore were not really exceptional in this

21. "We have the financial statements, we know the customer, so there is bound to be a difference, but in general, it's reliable." (CC 1 Branch 5).

regard. Thus it was really the regulation that was binding on these banks that pushed them down this slope.

We will now show that the same type of movement promoting impersonal and distanced judgments is also at work regarding the organization of risk control. Obliged to adopt the IRB approach, the BM also had to meet the criteria of the "use test" as defined by "Basel II."

### *Introduction of financialized methods for risk control*

Risk control aims both to ensure that people who take lending decisions do it correctly and are authorized to do so, and on the other hand to organize a tracking of loans that makes it possible to identify problems and, if necessary, to intervene in order to manage them. The management of loans and their risks was traditionally performed at the BM within a single department, the Loans Department (Direction des Crédits), organized by geographical area. Each member of its management was responsible for all of the lending-related activities of the branches in a region. Their role was to authorize the granting of loans exceeding the authority of branch managers, to monitor compliance with procedures for granting loans and to follow up the files classified as "troubled cases" (category E). The Director of the former Loans Department explains:

> It was a comprehensive view. The loans officer at headquarters was the sole contact on all matters related to the lending of a bank manager or a loan officer at a branch. So there was this overall approach and finally a sense, when a loans officer at headquarters went to see to a branch, of what the branch is, what its business is, etc. An overall view of the business and its credit risks. (Former Director of Loans).

It was also the Loans Department which provided the reporting of information relating to commitments and their risk to the senior management, who could monitor the business of the Loans Department through its Inspectorate (Inspection Générale). To achieve all of its tasks, the Loans Department used the customer credit files and credit scores, which were an opportunity for hierarchical exchanges, with the views of the higher echelons taking precedence over that of local staff. This system was completed by a default management device that was kept in place under "Basel II." Each loans officer received fortnightly an exhaustive statement of the accounts in his or her portfolio listing all overdraft limit overruns or unpaid items. The loans officer had then to explain in writing, account by account, the origin of these anomalies and specify the actions undertaken to regularize the situation. These comments were then forwarded to the branch manager who could intervene, and then sent to the manager at headquarters who had responsibility for the branch in question. He or she could still modify the decisions taken by the branch, and classify the customer as a "troubled case" (category E) in order to "exclude him from the branch network" and take control of the file.

Under "Basel II," it was no longer possible to maintain this "comprehensive and integrated" approach to credit and its control because it violates the principle of segregation between control and decision-making functions imposed by the Accords (Box 5).

In practical terms the implementation of "Basel II" involved creating a Risk Management department on the basis of and adjacent to the former Loans Department. The Loans Department is now only responsible for "first level" control. The Risk

### Box 5.—*Risk control under "Basel II"*

To be approved for the IRB approach, banks must organize the internal control of their risks according to very specific principles themselves based on the dominant financial doctrine that postulates opportunistic actors that need to be monitored and controlled by independent actors (Jensen and Meckling 1976). The standard is that of a nesting of controls on four layers, where each layer is controlled in turn by another one considered more "independent." The *first layer* of control corresponds to the direct control by loan officers and their reporting lines (called "self-control"). The *second layer* (called "*internal control*") is primarily intended to check compliance with the standards and procedures at the first level, and to monitor and ratify the decisions taken there. The Committee requires that the internal control units are "functionally independent from the personnel and management functions responsible for originating exposures" (BCBS 2006, §441, p. 98). The independence of internal control is not sufficient to ensure the integrity of control: since controllers are integrated into the organizational structure of the bank, they might be under pressure from some managers for example, to minimize, procrastinate over or not reveal existing flaws in the risk control or assessment processes. It is therefore necessary to control the controllers. It is the role of the "internal audit" teams, which constitute the *third layer* of control. These teams regularly assess the existing control procedures and quantification systems. Here too the Basel Committee stresses the need for independence of such teams. In practice, this means their direct attachment to the bank's Chairman and Board of Directors. It is the latter which is, in the final analysis, the head of risk management that sits within the *fourth level*—that is moreover also controlled because the banking supervisory authorities must ensure that the system meets their quality requirements. They can lead inquiries or commission external audits in order to verify it.

Management Department is responsible for "second level" control. All decisions relating to loans are thus inserted into a dual system: they are taken in within the loans sector, which in order to do this has to follow the procedures established by the Risk Management Department, and they are then controlled and monitored within the Risk Management Department. An Internal Audit Department was created from its predecessor, the Inspectorate (which then disappeared) to take over control at the "third level." Finally, the "fourth level" of control is managed by a risk management committee created within the board of directors. Thus, control and supervision of credit risk management were disembedded from the rest of the organizational structure in order to be able to impose their own requirements and procedures on the entities in charge of decisions on and management of loans.

The mistrust institutionalized by the new monitoring scheme finds echoes in both the preferred mechanical objectivity of credit rating, intended to prevent as much as possible the human intervention which is always suspected of being subject to conflicts of interest, and its opacity for loans advisors, all of which are consequences of the opportunistic behaviour postulate of the financial theory that has informed the whole of the regulatory mechanism. New risk indicators based on a statistical picture have begun to have a formal existence, accompanied by a legitimating discourse highlighting their "precision" and "modernity."[22] A new organization has

22. Thus, the general training document on the reform used in the BM makes it clear that the new system: "is not meant to increase the capital requirements of banks, but to adapt them to actual levels of risk and improve monitoring practices and risk measurement." [McDonough: "Issues" (internal presentation for training support) p. 8].

also been set up, tending to weaken the forms of cooperation between loan officers and their superiors about the collective assessment of loan applications in favour of an increase in the monitoring relationship. At the time of our survey,[23] these changes were not accompanied by a change in the skills and qualifications of personnel in the branches or a reorganization of the latter. The changes were concerned mainly with the management tools used in the work and the monitoring procedures concerning this work, which had to incorporate forms of thought and action inspired by financial theory. The aim of the last part of this article is thus to show what these instrumental changes in the credit relationship with SMEs have done.

## Financialization of relations with SMEs

Despite the fact that, at the time of the survey, new credit rating does not appear as a salient factor (Boussard 2001) in the assessment of loan applications (although it is calculated and noted in the files on them), its implementation has led to a change in pricing practices and to a questioning of the mutualism hitherto supported by the BM. So even if it is not necessarily perceived by customers, the impact of credit scoring is felt from the moment the loan product is conceived. But it is especially during the lifetime of the loan and in their everyday relationships with the bank that customers are affected by this change. The establishment of credit rating indeed imposes new constraints that may tip the relationship towards management "at a distance" by headquarters and require customers to exhibit more "disciplined" financial behaviour and greater "transparency."

### *The low salience of the new indicator in the decision-making about loan requests*

In order to receive approval for the IRB method, the BM has to prove that credit rating plays a role in the decision-making about loan applications, which has led to the systematic recording of the rating in the credit files. However, during the investigation, it was clear that the credit rating was not being used by the bankers to make their decisions. Thus we never found the credit rating referred to in order to justify the decision, even when it was good, in the 80 applications we examined. When it was discussed, it was usually to be challenged, as being bad when the record seemed "good" to the loans manager. The low salience of the new indicator was striking: while loans managers were generally able to recall very precisely the majority of information in a credit application file, when we asked them the credit rating of the customer concerned, they usually could not remember what it was.[24] However, all of them knew the bank's own internal score and generally that of the Banque de France as well.

23. Our study was conducted in 2009–2010, four years after the introduction of the first version of the rating engine and one year after the official implementation of the scheme based on the "Basel II" accords.

24. They would only remember if the rating was "problematic" that is to say if it had caused an "exclusion from the branch network."

One hypothesis could be that the credit rating, unlike these other two indicators, had not long been established in the BM. But the discussion with the most recently appointed loan managers suggests that this is perhaps not the only reason. The internal rating appears to be more in touch with the customers' development.

> Already, the difference between credit rating and internal score, is that we, every time we make a loan, we will evaluate the company, while for rating, this is about a situation over the year as a whole compared with the results in 2008, for example. So already, there are these differences. (CC 3 Branch 4).

Moreover, when there are few loan commitments, internal score takes that into account whereas credit rating does not report it. So the internal score appears, in the eyes of loan officers, to be a better "snapshot" picture of the risk situation.

> —I was surprised just now, I was with XXX, your internal score was B, so quite a good record, but the credit score was a 10 out of 16. And, a priori, it is not a great rating as B is a pretty good score, so I wondered where this difference comes from.
>
> —In fact, the ratings are not necessarily consistent, so let's say that the group which you are talking about has no loan commitments. So they don't give us their financial statements every year and I guess we do not want to spend a lot of time in finding them for a customer who has no commitments to us […]. After that we know that a customer who does not have many commitments, who does not have anything reported to the Banque de France, and who is never overdrawn, is worth a B because, in a snapshot, there is no risk for this customer because he doesn't borrow anything, so there is no risk. (CC 1 Branch 5).

The low salience of credit rating appears linked to its characteristics. As a "formal" mode of assessment, it does not take into account either the specifics or of the economic goals of actors; it does not help to determine the "cause of need," nor does it assess how the borrower can actually meet his commitments, all elements deemed essential by the bankers of the BM. Also its "opacity" makes it difficult to use in a justificational approach: either the loan officer "knows" (or thinks he knows) why the credit rating is good or bad and in this case, it does not provide new evidence, or he does not "know" and cannot know. However, if the application is accepted without resorting to credit rating, the latter is still essential to determine the rate that can be offered to the customer.

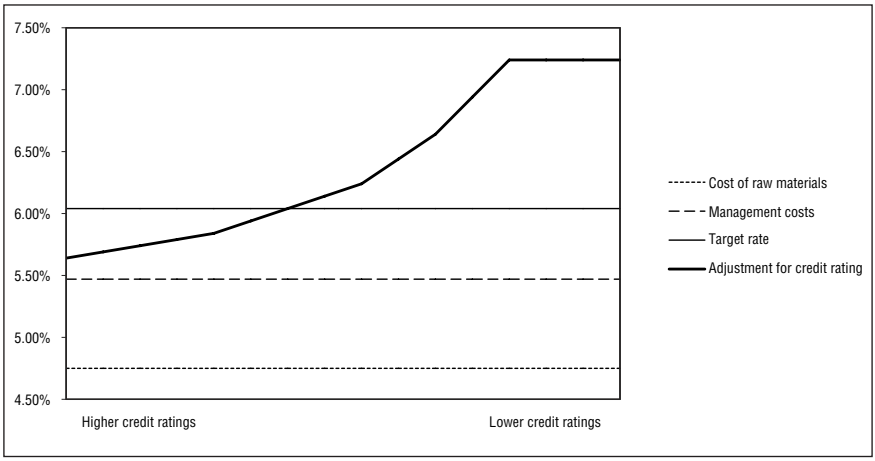
### *Pricing by rating: a questioning of mutualism?*

In accordance with regulatory requirements, credit rating is now necessary to fix the rate of interest applicable to the loan. Before the reform, pricing was not independent of the risk to the BM. But the cost of risk was estimated for each product and shared among all borrowers using the same product. Pricing grids specified a "target" price for each product, which was used as the default value in commercial offers. Decisions about how to adjust this rate either up or down could then intervene in a very strictly regulated way.

The target rate is now adjusted up or down for each loan depending on the credit-rating of the borrower. Figure 1 shows the target rate applicable to a loan with a maturity of ten years, which was 604 points (6.04%) at the time of the establishment of the new system in September 2008. Taking account of credit ratings led to it varying between 564 and 724.

The power of commercial adjustment over rate was also reduced slightly, from 70 to 50 points. In addition a new incentive system was established to guide local

FIGURE 1.—***Adjustment of the target rate by credit rating***[25]




decision-making towards support of this new pricing principle: branch remuneration for their lending activity was increased and a "premium" of 25% of this remuneration is now given if the loan is made without trade discount, by strictly applying the target rate.

The BM has thus reduced the opportunities and incentives for the branches to commercially adjust rates and opted for a pricing based on credit rating, in contravention of the principles of mutualism. This issue had also been identified within the BM from the very beginning of the negotiation of the Basel Accords, from 1998 to 2001, which was the basis of strong opposition to this framework. As the Development Director explained, in the preparatory notes made for a speech at an international meeting of cooperative banks in 2001:

> Each customer is individualised, labelled, classified in a statistical series, each series is itself examined and classified according to the history of problems experienced […]. This probabilistic statistical approach completely ignores the relations of solidarity that the Bank can advocate for taking into account the closeness that exists between borrowers which was the basis of mutual guarantee systems. This risk mutualisation technique is on the contrary considered to be an additional risk [by the regulations]. This [individualizing] technique, which is claimed to be neutral, is, from my perspective, the best weapon in the war against co-operative banks: probability against mutualism—this is now no longer a case of de-mutualisation but one of anti-mutualisation.

Although loan officers seem to be able to ignore credit-ratings in the assessment of loan applications, on the issue of the pricing rules that are central to the banking goals of the BM, resistance appears to be more difficult to organize. We had to go deeper into the technical construction of the system to identify some "compromises" with the ideal of risk pricing promoted by the regulations. They are trying to soften

25. *Sources and Methods*: Adjustment of the rate was computed based on the adjustment scale provided to account managers to set targets-rates adjusted for each rating [Pricing rules, 26/9/2008]. In practice, there are only 18 levels of adjustment (one for each "rating"). From these data, we extrapolated a continuous function to make the system more legible and to preserve data confidentiality.

the effects of the new system for certain categories of actors who are particularly poorly rated by the engine. Although the target rate is expected to increase continuously as the probability of default increases, the BM decided to cap it (Figure 1) for the riskiest category that represented approximately 10% of its customers and 4% of its outstanding loans at the end of 2007. Similarly, taking advantage of its special capital position, for most of the poorly rated loans, the BM has also chosen to limit risk pricing to the payment of the average cost of losses and not to further increase the rate by adding costs for the regulatory capital required (Baud 2013a, p. 510 ff.). BM could afford those little adjustments precisely because it had not waived, upon transition to "Basel II," its reliance on the judgments of its local bankers to take loan decisions and to get alternative risk assessments.

However significant they may be in terms of its wish not to turn its back on its history, these developments do not call into question the principle of risk-pricing that has come into the BM. Moreover, far from being displayed, these compromises are only visible when one specifically analyzes the configuration of the financial models being used. It is not certain that they will last over time, when and if the memory of another way of thinking about risk and pricing begins to fade away.

This development is all the more likely in that loan officers do not think that the more "guided" structuring of pricing that they experience is necessarily a bad thing. When questioned, they emphasize the advantages of a system that is independent from considerations about the BM's exposure to competition, even though they are not sure whether this constitutes a "fairer" system.

> In the previous system, we were only concerned about the competition. With some good quality customers, we made them pay expensive rates because they would not look around elsewhere, and some poor quality customers were so multi-banked and so concerned about the competition all the time that we were giving them an unbeatable rate. And it's true we realized this and we wondered: "But why are we doing this, when in the end this customer represents a significant risk but pays less?" We felt that this was not necessarily logical. Especially because some banks already had risk-based rating systems and we didn't. Talking with people working in other banks, they were saying: "Well, yes, when you have a poor quality customer, you must review the interest rates." But we were not doing that. […] So is that justice? I don't know. To say that a customer who is not doing well must pay more … is that right? That's the big question! Anyway, today it's like that, the customers who are doing worst are those who are paying the most. (CC 5 Branch 1).

> For customers who are not good quality ones, in general, the question is whether they can have the loan or not. So if they pay 4.5% or 5%, basically that will not change anything fundamentally. But at the same time, it doesn't help … In the end, the system is made like that and it has its rationale: inevitably, if there is more risk it's a cost to be passed on. I still find the system more logical than one where we only considered the commercial aspect. (CC 1 Branch 4).

As far as the BM's customers are concerned, they do not necessarily know what the difference is between the current rate and the rate they would have paid before. In the end, what is a very profound change in the banking model is hardly noticeable because it is borne by the management tools and imposed through regulatory compliance in the name of financial security. Yet what is happening is a great reduction of the variety of banking practices and their progressive alignment on practices that are more concerned with remunerating shareholders than serving customers and financing the economy, that is to say, a process of financialization.

The sociology of lending has highlighted that in the case of loans to individuals, two rationales are in opposition, a "social" rationale that is concerned with helping

and even educating the borrower who is not exempt from social violence[26] (Lazarus 2009) and a "commercial" rationale where the game is to sell pre-calibrated products to clients based on their "profiles" (Vézinat 2011). Coupled with a marketing approach, the development of statistical techniques has expanded the supply of credit to customer segments previously considered too risky or unprofitable (Brown 2007; Poon 2009; Lazarus 2012a) and has to some degree fed the "commercial" rationale of product placement (Lazarus 2012b). The tension between the traditional model of socially embedded credit relations on the one hand and that of the commercial relationship intermediated by an impersonal statistical tools on the other is very well documented both for individual customers and for SMEs (Ferrary 1999). It is also reflected in our case except that it does not work in the same way. The traditional lending relationship BM had with SMEs is also socially embedded, but the transformations that we describe are not directly based on a "commercial" rationale. Through a more refined attention to its tools, we have identified a "financial" rationale in the sense that the heart of the relationship is structured by the need for the bank to control the profitability of its capital by ensuring that the interest rate is constantly linked to the risk and thus to the cost of the capital required to cover it.

Although they are not necessarily visible to customers during the loan decision-making process, the requirements of the new system nevertheless show themselves clearly through pricing, and then throughout the relationship, creating new obligations, constraints and sources of cost for SMEs.

### *New constraints on everyday management*

All banks have systems governing the autonomy of decision-making by bankers, including awarding them levels of delegation. To these are added systems of exclusion that can withdraw any authority over a loan application from a branch. Thus traditionally in the BM shared professional judgment could lead to the award of an E rating that would trigger "exclusion from the branch network."

As part of the process of gaining approval for using the IRB method, credit ratings have also been included in these procedures which have therefore been changed. Levels of delegation were revised upwards for "good" loan applications (credit rated from 1 to 7), and downwards on so-called "average" loan applications (8 to 14). Some bankers regard it as the main function of the rating, which is "so synthetic it becomes useless, except to know what category—the upper or average rating—applies for a given loan application" (CC 1 Branch 2). But above all, when the rating is downgraded beyond 14,[27] exclusion from the network is automatic, knowing that this downgrading is itself automatic when certain events occur such as the recording of a payment incident (unpaid cheque, etc.) or a payment "past due" for more than 30 or 90 days,[28] regardless of the amount.[29] The allocation of these bad ratings, by

26. Some customers prefer to switch to more strictly commercial and impersonal forms of lending, such as the revolving loans offered by specialist institutions, so as not to have to put up with the paternalism of account managers (Ducourant 2009).

27. Credit rating scores 15, 16, C—for litigation (*contentieux*)—or D—for default.

28. The loan is then in default and is given a D rating.

29. A payment is regarded as "past due" from the first missing euro, whether for exceeding an authorized overdraft or not meeting a loan repayment date.

removing the decision-making autonomy of the local bank branch, thus deprives customers of a direct relationship with someone who has acquired a detailed knowledge of their situation. The credit relationship is then suddenly upset and switched—much more easily than before and without further examination—to a management "at a distance" by head office. These events are not uncommon: in the first year of operation of the system, the risk management department estimated that at one time or another during the year over 10% of the outstanding loans of small businesses had been downgraded to "exclusion from the branch network" and put into default, very often because of small excesses lasting more than 90 days of their authorised overdraft limits. It then became the responsibility of the Loans Department at head office to decide whether each of these small overruns were reflecting structural problems or only a slight and temporary lack of rigour in management.

Moreover, these "automatic" defaults also have important implications for the bank, because all credit lines held by the borrowers concerned are placed in default (the so-called "contagion" rule) and put down in the BM's accounts as having a probability of default of 100% for calculating its capital requirements. The probabilities of default are generally only a few percent, so this multiplies the capital requirements for these loans by a factor of 10, 20, or more, and may eventually weigh heavily on the overall ratio of the bank's capitalization.

It was as much the inconvenience inherent in untimely and hard to justify exclusions from the network as the ripple effects on capital requirements that prompted the BM to be much more demanding about rigour from its customers. Initially considered to be well capitalized, the bank found that the "flexibility" of its banking practices towards its customers (who could for example be content to simply make a phone call to warn it that a payment had been delayed) now generated capital requirements of an incredibly high level.

### *Customers subject to a new discipline*

Throughout the life of the loan, scrupulous respect of the repayment timetable and planned credit limits has become a goal that loan officers must comply with in order not to increase capital requirements. As the intranet site of the bank puts it, "respect for the rules, part of any sense of responsibility, is now accompanied by automatic regulatory effects that must be incorporated into daily practice."

For the customers, this means helping them not to lapse into exclusion proceedings which would worsen their credit score and thus the future interest rates that would be offered to them. Although slips in financial discipline have always led to various types of penalty, both in financial terms (additional interest, fixed charges on delayed repayments) and relational terms (harm to the trust relationship), other elements are now superimposed.

The new discipline also has major effects on the communication and form of information provided by SMEs. In the traditional model, the banker is interested in a business/entrepreneur whose financial situation and loan requirements he will assess following an *ad hoc* and collaborative approach, made up of exchanges in the form of questions and answers. Henceforth it is necessary to supply information to a credit-rating system that evaluates the creditworthiness of a particular identity, regardless of a loan application, and to continuously monitor the financial situation and the behaviour of the customer using a systematic and formal approach: the customer must send

all information likely to facilitate his (favourable) evaluation by the rating engine, even if he does not want to borrow, because he might need it someday. The customer is suspected *a priori* of wanting to benefit from the asymmetry of information and of attempting to hide bad news, so any lack of information is penalized by the algorithm. Credit officers are periodically encouraged to obtain data on "customer knowledge," procedures that are officially justified by the desire to improve customer relations.

> Why is it important to convince the customer to give us as much information as possible? The rating is based on knowledge about the customer and his environment: it should thus be recorded in our information systems. They help ensure the sustainability and quality of the customer relationship. The more detailed this knowledge is in our information systems, the more the scoring will reflect the quality of the customer and of our relationship. [Frequently Asked Questions About Credit-Rating, document available on the bank's intranet 2009].

Hence BM customers are caught within a new discipline, which involves new sources of cost. In addition to the direct cost of producing useful information for credit scoring there are the extra costs which they incur in the case of a loan application if they do not—regularly and to the standards expected—transmit them.

The new financialized discipline imposed on SMEs by the new regulatory environment is widely recognized by the public authorities. This is demonstrated by a guide published by the European Commission in 2007 (EC 2007) to help SMEs to maintain their access to finance in the new regulatory environment. This guide, developed by the McKinsey consulting firm and System Consulting Network, aims "at giving SMEs practical advice on how to adjust proactively to the ongoing changes in the so-called 'credit process' in order to benefit from the potential advantages and minimize any possible disadvantages from banks' greater focus on risk" (p. 8). One of the "key rules" is "deliver clear, complete and timely documentation" (p. 22). The idea is that the banks will increase the volume of requested information (p. 21) and that "following the logic of prudent risk management, many banks are inclined to assume the worst if any information is missing regarding a borrower's current situation. Since this might have implications for your rating—and might even be considered a 'warning signal'—it is crucial to avoid delays and omissions" (p. 22). The rule "Manage your rating actively" enjoins the SME to identify the main factors that determine the rating, to "focus" above and "endeavour to" manage them "at best" to improve its rating. The main (quantitative) factors mentioned (p. 27) are the leverage ratio, liquidity and profitability. SMEs that do not calculate these ratios are encouraged to be concerned, which may lead to a financialization of their own management.[30] The rule "make sure you hold on to your loan" points out that the rating is an "ongoing process" (p. 28) and that it is thus essential to "always try to avoid unnecessary overdrafts and make sure you pay instalments on time" and to know that "your accounts might be analysed automatically with regard to any exceptional movements" (p. 29).

The new regulation does not content itself with the financialization of banking practices. These also tend to spread a norm of financial orthodoxy throughout the economic fabric, emphasizing profitability and solvency ratios. In doing so, it calls for a new financial "self-concern" on the part of businesses.

30. By using survey questionnaires Bluhm & Martens (2009) have identified an increased use of management tools concerned with share value by German SMEs, that they connect to the changing attitudes of banks in the context of the implementation of "Basel II."

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The case of the implementation of the form of regulation produced by the "Basel II" Accords in a small mutual bank has allowed us to shed new light on the financialization process at work in contemporary capitalism. This process carries with it specific conceptions and a type of instrumentation from the world of finance that tend to transform increasingly large spaces well beyond that of those businesses having a portion of their capital in the hands of investment funds. New management techniques, inspired by financial theory, are proposed to monitor a financial sphere liberalised widely through this same theory. They are integrated into the normative frameworks mandated by law (by a European Directive) and implemented at national level by the public regulatory authorities. In doing so, the public authority contributes to the dissemination of financial standards throughout the economy well beyond the spaces that the financial market participants themselves can reach. In the case of the BM, the implementation of the new prudential provisions had the effect of introducing a new way of thinking about, assessing and managing risk contributing to changing the banking business and to financializing it. Thus, banking more fully integrates the prescriptions inscribed in the financial theory it consequently contributes to perform (MacKenzie *et al*. 2008; Muniesa and Callon [2009] 2013) and it is now especially marked by a commitment to minimizing the regulatory capital cost, which is also that of increasing equity performance. The bank's SME clients are also taken into a new disciplinary system that commits them to communicate standardized information more frequently, to greater financial discipline and to be concerned more actively about how to manage their financial ratios. This progressive transmission of financialized norms of the regulatory framework to the bank's SME clients is done through multiple translation within tools and procedures, affecting a variety of issues (assessment of loan applications, the manufacturing of pricing, delegation and control systems within the bank, management of payment incidents, or even the collection of information on customers), which are all areas where past practices are redefined to incorporate the principles and provisions of regulation and where the BM tries, but often with limited success, to cushion their effects for its member-customers.

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