Bank lending during the COVID-19 pandemic: Do alliances and digital strategies matter?

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Abstract

Purpose – This paper investigates the joint impact of COVID-19, alliances, and digital strategies on bank lending. Additionally, this study examines whether the effect of COVID-19, alliances, and digital strategies on bank loans depends on the types of banks.
Design/methodology/approach – Using a sample of 92 commercial banks in Indonesia from March 2020 to September 2021, a fixed-effects model (FEM) was used to analyze data.
Findings – This study provides robust results regarding the negative impact of the COVID-19 pandemic on bank loans in Indonesian banking. Furthermore, it reveals that collaboration between banks and FinTech does not substantially influence bank lending, despite the rise in proven cases tending to reduce loan expansion. It emphasizes the importance of the development of mobile banking as part of digitalization in boosting loan bank expansion, and this finding is more noticeable in private and small banks.
Practical implications – This study highlights some policy recommendations to improve bank lending during the COVID-19 period, particularly the role of new alliances and digital strategy in involving COVID-19 pandemic mitigation within a novel financial ecosystem.
Originality – This study offers a significant contribution to the empirical literature that specifically explores the joint impact of the COVID-19 pandemic, alliances, and digital strategies on bank lending in banking.

Keywords COVID-19, Alliance Strategy, Digital Strategy, Bank Lending.
Paper type: Research paper

Introduction

The COVID-19 pandemic and the large-scale social distancing policy have resulted a decline in economic activity. According to Baldwin & Di Mauro (2020), the outbreak has reduced global productivity due to the imposition of social restrictions. Fernandes (2020) reported that GDP growth forecasts could fall by 3-5% depending on the country. The COVID-19 pandemic also has an impact on small and medium enterprises (Lestari et al., 2021) Therefore, the great uncertainty and economic losses associated with the pandemic have made markets highly volatile and unpredictable, leading to higher bank loan risk (Wu et al., 2020). Banks are expected to take part in counter cycling and absorbing the shock of the pandemic to support the economy by supplying funds (Borro, 2020). Lending during economic downturns has been the topic of intensive examination, with common wisdom claiming that financial crises disturb the credit allocation mechanism, resulting in restricted loan supply and increased borrowing costs (Bernanke, 1983). However, the significance of banking sector dynamics during the pandemic is significantly less understood.

At the same time, digitalization plays an essential role as a driver of loan expansion. Digitalization has benefited society in dealing with the COVID-19 disruption (Faraj et al., 2021). As a result, banks have invested heavily in digitizing their financial services, such as mobile banking, pushing consumers to use them instead of traditional banking services, and changing market orientation (Barrett et al., 2015; Haapio et al. 2021). However, the banking industry has been confronted with the new digital innovations developed by financial technology (FinTech) companies (Navaretti et al., 2017; Ozili, 2018; Hornuf et al., 2021). Meanwhile, Iman (2020) demonstrates that FinTech is a vast, multifaceted, and diverse phenomena that may materialize in a variety of ways. Facing this condition, banks and Fintech companies develop alliance strategy to get mutually beneficial transactions (Hornuf et al. 2021).

This paper analyzes the impact of COVID-19 on bank loan expansion. This paper also examines the role of collaboration between banks and financial technology companies as an alliance strategy for encouraging loan growth. Furthermore, this paper explores the critical role of bank digitization, specifically in the development of mobile banking, in promoting loan expansion. More precisely, this paper observes the joint impact of the COVID-19 pandemic, alliance, and digitalization on bank lending. Additionally, this paper examines whether the effect of COVID-19, alliance, and digitalization on bank loans depends on the types of banks.

Using monthly financial reports of 92 commercial banks, this paper focuses on investigating the link between the COVID-19 pandemic, alliance, and digital strategies on bank lending from March 2020 to September 2021. This paper provides robust results regarding the negative impact of the COVID-19 pandemic and bank loans in Indonesian banking. This paper also discovers that banks collaborating with Fintech do not significantly impact bank lending, even though the increase in confirmed COVID-19 cases tends to decrease loan expansion. Furthermore, this paper emphasizes the importance of the development of mobile banking as part of digitalization in boosting loan bank expansion during the COVID-19 pandemic particularly in private and small banks.

The analysis is focused on the Indonesian context for three significant reasons. First, according to the Banking Digital Transformation Blueprint Indonesia 2020-2025, Indonesia is accelerating banking digital transformation to maintain banking performance in prudent, safe, and sound banking conditions. This prompted 14 banks to be shifted from traditional to digital banking to deal with the COVID-19 pandemic and FinTech companies. The collaboration between FinTech and banks is also on the rise. Second, in recent years, the funding gap has been filled not only by lending and performance. In addition, pre-crisis IT investment pushed banks to be more expansive and resilient. Core & De Marco (2021) demonstrated that banks' digitalization level affected the provision of government-guaranteed loans. Branzoli et al. (2021) stated the deployment of innovative loan risk assessment technology-aided loan expansion. Kwan et al. (2021) showed that banks' adoption of digital technology for remote or virtual labor and online communication increased small company loan supply. Meanwhile, Girmaye (2018) discovered that investments in IT had not generated a positive return.

Typically, there is a drop in bank loan supply during the crisis. Caballero and Simsek (2009) showed that the global financial crisis has a contagious impact. Aldasoro et al. (2020) noted that COVID-19 produces a complex and varied set of consequences for banks and threatens the banking system's stability. Many studies showed different impacts of the global financial crisis depending on government-owned and private banks (Bertay et al., 2012; Brei and Schclarek, 2013; Cortes et al., 2019; Gambacorta et al., 2011; Tran, 2020).

COVID-19's expansion and associated government lockdowns resulted in a significant surge in the rate of finance app downloads. Numerous banks are digitizing to serve their customers better (Dadoukis et al., 2021; Core and De Marco, 2021; Branzoli et al., 2021; and Kwan et al., 2021). However, several research showed that digitalization depends on the type of bank. Government-owned banks are likely to be slower to adopt and implement technological innovations, owing to a bureaucratic culture (Troshani et al., 2011), budgetary constraints, political environment (Caudle et al., 1991), and management quality (Mishra et al., 2021). Scott et al. (2017) showed that small banks adapt to internal and external changes in their operations due to legacy systems that require significant adjustment. However, small banks often lack sufficient funding to invest in information technology (Dick, 2007).

Data and Methodology

Sample and data sources

This research obtained data on bank-specific variables from 92 commercial banks' monthly financial reports between March 2020 and September 2021. According to Çolak and Şenol (2020), monthly loan growth (GLOAN) is the dependent variable. Meanwhile, the macroeconomic data are collected from the Central Bureau of Statistics and Ministry of Finance of The Republic Of Indonesia. The government policy responses index (GPR) was collected from the Oxford Coronavirus Government Response Tracker (OxCGRT).

Variables

COVID-19 is the independent variable in terms of explanatory variables, and it is measured by the monthly increase in confirmed cases. Previous research also employed this indicator, although the duration of the outbreak in each country differs based on when the first case was confirmed (Gong et al., 2020; Al-Awadhi et al., 2020; Maria et al., 2022, Riadi et al., 2022). The outbreak began in Indonesia when the first case was confirmed on 2 March 2020 by the Ministry of Health.

This study takes into account independent variables such as alliance strategy (ALS) and digital strategy (DIG). Following Hornuf et al. (2021) and Klus, et al. (2019), any contractual or financial contract between a bank and a fintech with the goal of partnering is defined as an alliance. If the bank has collaborated with at least one fintech, the binary variable will be 1 and 0 otherwise. Data were gathered from The Indonesian Joint Funding Fintech Association (AFPI), bank websites, and annual reports.

government-owned banks. Meanwhile, digital strategy had a significant positive impact on loan growth, particularly in private banks. For the interaction of COVID19 and digital strategy (COVID19*DIG), there is a significant positive relationship between bank lending in private banks. These findings regarding the benefits of digitalization in enhancing the beneficial effect of the interaction between COVID-19 and strategic digital are somewhat consistent with the literature, which emphasizes the critical role of mobile banking as a component of digitalization in accelerating the expansion of loan banks, particularly private banks, during the COVID-19 pandemic.

From a split sample of large and small banks, Table 6 documents that the impact of COVID-19 on bank lending is negative and significant. This finding is in line with Dursun-de Neef and Schandlbauer (2021), Çolak and Öztekin (2021), Gong et al. (2020), and Hasan et al. (2020), who show the negative impact of the COVID-19 pandemic on bank loans. This finding is more pronounced in large banks. This result is consistent with the notion that small banks with a weaker core capital position more strongly during the crisis period (Gambacorta et al., 2011). This paper also finds that strategic digital had a large beneficial effect on loan growth, especially in small banks. This finding corroborates those of Dadoukis et al. (2021) and Branzoli et al. (2021), who examine the relationship between information technology use in banking and loan expansion during the COVID19 pandemic. This finding is more obvious in small banks because small banks are likely to be more adaptable to technological innovations and quicker to implement them than large banks (Scott et al., 2017). Regarding the impact of the interaction between the COVID-19 pandemic and digital strategy on bank lending, this study also finds that banks with digital strategy tend to expand loan banks, although, with the increase in confirmed COVID-19 cases. This result suggests that digitalization can help make the positive effects of COVID-19 and strategic digital even better. These results are somewhat in line with the literature, which emphasizes the importance of digitalization for small loan banks during the COVID-19 pandemic.

Robustness checks

To ensure accurate and stable results, several additional tests were conducted. First, this paper re-estimates the impact of the COVID-19 pandemic on bank lending using alternative measures of the COVID-19 pandemic. Following Al-Awadhi, et al. (2020), this study uses the monthly growth in COVID-19 death cases (GDEATH) as the independent variable, as documented in Table A1. Second, following Dursun-de Neef & Schandlbauer (2021), this study first replaces the dependent variable with alternative bank lending measures, as reported in Table A2. Third, this study specifically includes listed banks as control variables (see, Table A3). Listed banks quickly raise funding from the public to increase their growth opportunity, making them take more risks (Samet et al., 2018). Overall, the impact of the COVID-19 pandemic, alliances, and digital stretegies on bank lending remain unchanged.

Conclusion

This paper studies the influence of the COVID-19 pandemic, alliances, and digital strategies on bank lending using panel data on 92 commercial banks operating in Indonesia for March 2020 and September 2021. This paper establishes an empirical relationship between the COVID-19 pandemic – bank lending literature, strategic alliances – bank lending literature, and digital strategy – bank lending literature by investigating the joint impact of the COVID-19 pandemic, alliance strategy, and digital strategy on bank lending in banking. Moreover, I explore whether the impact of COVID19, alliance strategy, and digital strategy on bank lending depends on the types of banks.

This study provides robust outcomes regarding the negative impact of the COVID-19 pandemic and bank lending in Indonesian banking. This study also finds that banks collaborating with Fintech (strategic alliances) do not significantly impact bank lending. However, when interacting between COVID-19 and the alliance strategy, this study finds a negative and significant coefficient on bank lending. These results indicate that the alliance strategy between banks and Fintech is not boosting loan expansion during the COVID-19 pandemic. One possible explanation is that FinTech experienced decreased performance during the COVID19 pandemic. Moreover, digital strategy (DIG) seems to have a positive and significant relationship with loan growth. In line with the increase in COVID-19 cases, banks with digital strategies are becoming more expansive than those that do not adopt digital strategies.

Additionally, this study documents that COVID-19 is negatively linked to bank lending. This finding is more definite in private banks and large banks. This study also finds a negative and significant coefficient of the interaction term between COVID-19 and alliance strategy on bank lending in government-owned banks, while the interaction of COVID-19 and strategic digital, shows a significant positive relationship on bank lending in private and small banks. These findings regarding the benefits of digitalization in enhancing the beneficial effect of the interaction between COVID-19 and digital strategy are somewhat consistent with the literature, which emphasizes the critical role of mobile banking as a component of digitalization in accelerating the expansion of loan banks, particularly private and small banks during the COVID-19 pandemic.

Finally, this study highlights policy recommendations to improve bank lending during the COVID-19 period. First, this paper highlights the significance of digitalization in boosting the expansion of loan banks throughout the COVID-19 pandemic. Second, this paper emphasizes the importance of banks rebuilding new strategic alliances involving COVID-19 pandemic mitigation within a novel financial ecosystem. Future research should consider whether digital investment by banks contributes to lower borrowing costs, and loan expansion may provide more insight into countercyclical and absorbing the shock of the COVID-19 pandemic.

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