



Andreas Krause

The role of commercial banks

# Banks as intermediaries

- ▶ Banks can be seen as channeling excess funds, savings, in the form of deposits into loans for those that have a shortage of funds
- ▶ Using banks may be more efficient than each individual negotiating with a borrower separately
- ▶ Banks can do more than merely pass on deposits efficiently; they can transform short-term deposits into long-term loans
- ▶ This ability distinguishes banks from other intermediaries as they change the properties of the 'goods' they are 'selling'

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# Negotiating with banks

- ▶ Borrowers could obtain loans directly but would have to negotiate directly with the lender
- ▶ Alternatively, the depositor could negotiate with the bank and then the bank in turn negotiate with the borrower
- ▶ Banks have an advantage of having no negotiation costs and thus have an advantage over direct lending arrangements



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Chapter 2.1  
Negotiation costs



## Discussion of model results

- ▶ Bank lending will dominate due to the lower negotiation costs of banks
- ▶ Direct lending can be sustained only in narrow ranges where the returns to borrowers are of intermediate value
- 7 Banks have an advantage in negotiation costs; would this be only because banks are more efficient and experienced?
- ! In addition to experience and having systems set up for lending, banks are also better informed about borrowers, reducing adverse selection costs

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# Banks enabling long-term loans

- ▶ Investments are mostly long-term and require long-term funding
- ▶ Depositors often seek access to their funds at short notice, but will not know this in advance
- ▶ Banks can overcome this uncertainty by offering short-term deposits while giving out long-term loans



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Chapter 3.1  
Maturity transformation of deposits

## Discussion of model results

- ▶ Banks retain cash to repay those depositors that withdraw their deposits early and from the remainder provide long-term loans
- ▶ Having a large number of depositors allows banks to achieve this result
- ? Would banks inevitably fail if existing depositors withdraw funds in large numbers from many banks?
- ! If more depositors are withdrawn than the bank holds cash, it would fail, but often deposits get merely moved between banks and the total deposits at a bank remain steady



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## Summary of key results

- ▶ Banks are efficient in providing loans and enable the maturity transformation of deposits
- ▶ Banks are acting as ordinary intermediaries if seen as reducing transaction costs
- ▶ Banks affect the quality of the deposits if the maturity transformation is considered
- ▶ Banks are more than mere intermediaries: they affect economic outcomes to a larger extent than ordinary intermediaries



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- ▶ Banks are more than mere intermediaries: they affect economic outcomes that go beyond what ordinary intermediaries can do

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