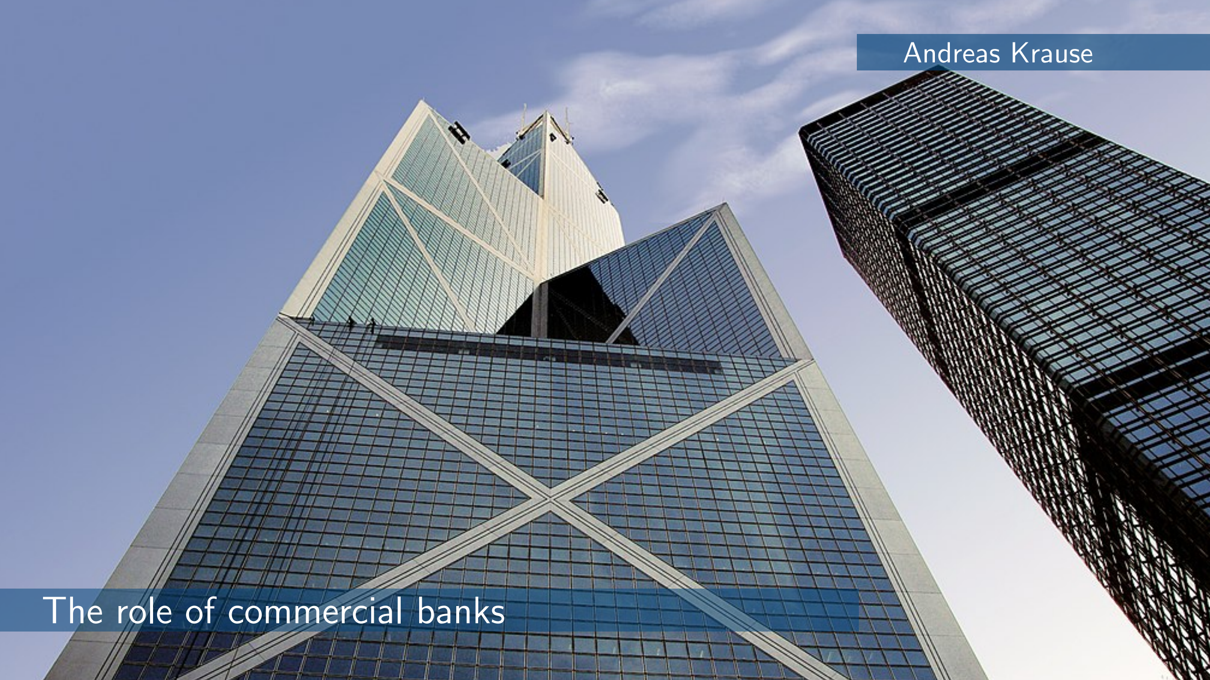


The role of commercial banks

Andreas Krause

Banks as intermediaries

- Banks can be seen as a 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'

Negotiating with banks

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

Chapter 2.1

Negotiation costs

Andreas Krause

Discussion of model results

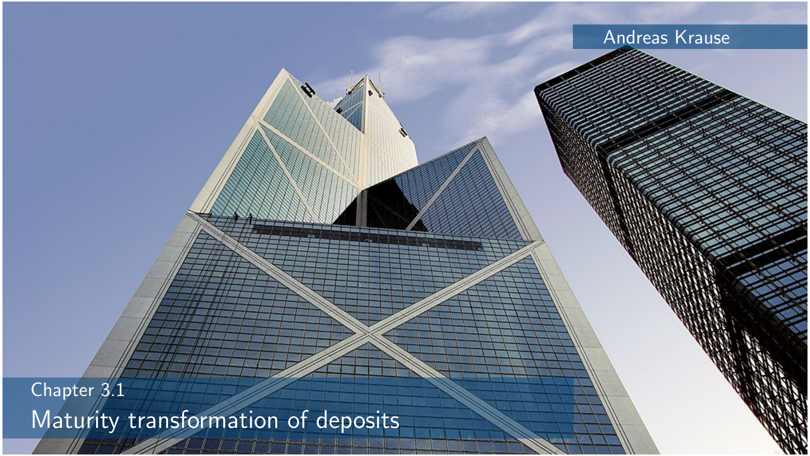
- Bank lending will dominate due to the lower negotiation costs of banks
- Direct lending can be sustained only in narrow ranges where the returns to borrowers are of intermediate value

? 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

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 beforehand
- Banks can overcome this uncertainty by offering short-term deposits while giving 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

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 extend than ordinary intermediaries

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