Asian Social Science
www.ccsenet.org/journal.html
Vol. 5, No. 8
August 2009

Comparison of Bank-Oriented or Market-Oriented Financial System and Inspiration

Shumei Wang
International Business College, Shenyang University
Shenyang 110044, China
E-mail: ttkklltt@126.com

Jingting Ma
School of Business Administration, Shenyang University
Shenyang 110044, China
E-mail: ttkklltt@126.com

Abstract

In order to get benefits from trade, financial system plays an important role. Without financial system, commodities are traded in spot market. Every family collects capitals by self resources. To collect capitals by the internal financing to build railways is just as the words said by Marx in Capital: "I am afraid of no railways till today." In present economic system, financial system has two kinds of structures, namely the market-oriented one and the bank intermediary-oriented one. By comparing the two structures, we can get useful experiences for references.

Keywords: Financial system, Market orientation, Bank orientation, Complement

After the South Sea Bubble and Mississippi Scheme, different treatments result in sharply different financial system structures: the stock market-oriented Anglo-Saxon model and the bank-oriented Europe continent model. At present lots of countries, including developed countries and developing countries adopt the two kinds of financial systems.

1. The classification of financial system

Today, the financial system is vital for resource allocation. Through the financial system, household deposits flows in enterprises and capitals distribute among different enterprises. According to market and bank's different effects on financial resource allocation, the financial system can be sorted into the market-oriented financial system and the bank intermediary-oriented financial system.

A defect of the market-oriented financial system is that the market is incomplete. To build market needs fixed costs. Only when reach the critical minimum scale, can it match up with costs. Therefore, many small markets fail to survive. Information asymmetry, moral risks, and other reasons also contribute to the failure of markets. The intermediary-oriented financial system can overcome these problems by making up risks sharing contracts. Furthermore, because the price fluctuation of assets may have less or no relation with the basic value of assets, incomplete market brings about higher risks to individual investors and enterprises. As a matter of fact, without market, the financial institution may offer a risk- smoothing service that could not be realized by market. Finally, because the benefits from market differ from the benefits from institutions that devote themselves to supplying risks sharing chances in nature, market competition may ruin institutions' function of risks sharing, what will cause disintermediation that can barrier the coexistence of market and institutions in competition. Therefore, it deserves to be balanced carefully between financial market's afterwards efficiency and financial intermediary's risks sharing function.

Surely, the competitiveness of market-oriented financial system and the stability of bank-oriented financial system are not in harmony. Banks compete for market shares, what will inevitably lead to severe competition between banks, what may lead to excessive risks sharing behaviors. If a bank suffers from certain strike, it may make bank's creditors worry about that. As a result, the chain effect happens, affecting other banks in positive conditions. It makes banks fall in an embarrassing situation. Market competition determines the existence of amounts of banks, what will cause financial infection.

However, all these things centers on information. Market and intermediary process information differently. Market is an effective mechanism for summarizing information. Intermediary, as the appointed supervisor, can help to save costs of collecting information. For market and intermediary, which one is more efficient, that is determined by the type of information. As everyone agrees on what information needs to be collected and how to process, intermediary is maybe more efficient, in reducing the repetitiveness of information collection and process. If everyone expresses their opinions and has specific intentions, competitive market is better, in processing this type of information.

2. The comparison of countries with different typical financial system respectively

Different responses to the frangibility of financial market lead to two kinds of financial systems. The first is market-oriented, such as America. The other is bank-oriented, such as Germany.

To compare different kinds of financial systems is complicated. And the answer is not simple. In analyzing the financial system, the most important is to balance the functions of different financial systems. Table 1 displays the financial systems in some countries. Financial systems in America and Germany are regarded as two typical financial systems. America has the extreme competitive market- oriented financial system. It has the inclination of instability in nature. The pervasion of considerable information causes the "free rider" problem, which is not good for people collecting information. Meanwhile, it enhances unnecessary external restrictions on corporate governance. Germany has the other extreme financial system. Concentrative bank-oriented financial system guarantees stability, without the "free rider" problem. Individuals have strong motivations for collecting information.

Insert Table 1 about here

Furthermore, from Table 2 we notice that conditions in America and Germany are typical and extreme. Banks are not so important in America. Banks loans are only equal to 73% of GDP, almost being half of the percentage in Germany, namely 132%. Meanwhile, the market value of American stock market is about 127% of GDP, being three times of Germany, namely 45%.

Insert Table 2 about here

In all countries, the financial system turns household deposits into funds for corporate investment. But effects of financial market and financial intermediary have different importance. Families possess different types of assets, what is shown in Table 3. In America, families hold securities that have changeable prices along with the development of market. German financial system depends more on banks and other intermediary institutions. Families usually hold financial institutions' fixed bonds. Therefore, the risks caused by changeable assets hold by families in the two countries are different. But at least the two countries have one common ground: internal financial preference. In other words, corporate investments are more from retained earnings rather than external financing, which is in accordance with world popular theory of capital structure: The sequence of corporate financing is internal financing, bond financing, and stock financing.

Insert Table 3 about here

Note: American total household financial assets are 327% of GDP. The percentage in German is 194%. The two percentages do not mean German are poor but indicate that in German the household wealth in form of financial assets is less than that in America.

Insert Table 4 about here

Next, we compare the national income per capita in America and Germany, respectively as the representative of the market-oriented financial system and the bank-oriented financial system.

Insert Table 5 about here

From Table 5, we notice that the relative margin of Germany and America is only 16.7%. The difference is small or even we can regard them as be equal. Two different financial systems respectively in the two countries promote the effective distribution of resources. A further analysis of relevant data in other three countries in Table 1 and more developed countries shows that two systems have their advantages and disadvantages respectively. The empirical study does not support the market- oriented opinion or the bank-oriented opinion. Therefore, we can not determine what it is the market- oriented financial system or the bank-oriented financial system carries out the function of financial system better. Different financial systems mean financial system transforms deposits into investments by different ways, and different corporate governance structure and methods.

3. Inspiration

Based on analyses above, we know that both financial market and bank intermediary has defects. But we should make it clear that financial intermediary has a driving effect on market operation. One of main functions of intermediary is to support the operation of market. That inspires us a lot undoubtedly. Market deserves praises as an invention. Market requires that some investors must possess professional techniques. As investors pay too much for collecting information, the sub-prime resolution may turn into an alternative. Besides, at present in China the bank-oriented financial system can promote economic growth effectively. It is irrational to force intermediary-oriented financial system to turn into market-oriented financial system. Intermediary and market are all useful methods for solving the information costs issue and other barriers. The relationship between market and intermediary is not opposite but complement.

The optimization of financial system is to make financial system exert its functions completely by choosing the proper financial system structure model. In fact, it is to make a balance and improvement for the market-oriented financial system and the bank-oriented financial system, driving the sustainable development of finance. The development of science and technology, and the characteristics of China's financial structure serve as favorable conditions for the effective integration of bank intermediary- oriented financial system and market-oriented financial system.

The general characteristics of China's financial structure supply conditions for the complementation of two financial structures. Firstly, the bank financing dominates the financing structure and the distribution of banks scales is imbalance. Secondly, the financial market grows fast in recent years. Its importance is rising gradually. Thirdly, the general development of financial system in China is at a lower level with low efficiency. And the exterior institutional environment is imperfect.

Progresses of information technology reduces the information asymmetry in financial market and relieves the adverse selection and moral risk issues, changing the financial market more or less, and ensuring the feasibility of two financial system structures' complementation. Firstly, the debt market becomes larger. More and more tools for debts can be traded. Secondly, the derivatives market develops. The market risks costs for enterprises in transactions are reduced. Thirdly, the payment system develops electrically, reducing the requirements for families saving wealth in banks.

Therefore, after comparing and analyzing the conditions in the two typical countries, considering China's conditions, we should pay attention to these points as follow in order to build and perfect a financial system in China.

(1) Present financial development system should take the coordinative development mode with bank financial intermediary institutions and capital market. The development of banks and non-bank financial institutions and the development of capital market are more complement rather than competitive. High-effective capital market should be supported by healthy intermediary financial institutions as payment and liquidity system. And the trade in capital market and the development can not be realized independently without the support of financial intermediary. Therefore, to promote the reform of commercial banks, break the monopoly, form a positive competitive pattern, and enhance financial institutions' capabilities is extremely important. To release the entrance barrier of banking industry can help to deepen the financial reform. But the process is step by step. And the encouragement to competition should be proper. As a matter of fact, it is to seek for a balance between economic efficiency and economic stability.

(2) To improve the right protection mechanism for depositors can benefit both lenders and potential borrowers. To issue laws and regulations about protecting investors is vital for the development of capital market, especially the perfect of auditing, accounting, and relevant information releasing system. China has always emphasized on the constitution of laws but neglect the execution in the capital market. And the construction of morals is also ignored. We must change these conditions and strengthen the construction of moral system, forming a complement mode of laws and morals concerning the protection for investors.

(3) Government's regulation and supervision over financial institutions are necessary and should not be neglected. The financial system has its internal vulnerability. The scientific and powerful supervision of government can help to form and perfect relevant institutions.

(4) Perfect the information disclosure system and release more information effectively. To disclose necessary information and publicize the facts of employees abusing rights can protect the interests of small shareholders, restraining banks and other institutions' capability of controlling the market, and driving the financial development. To perfect the information infrastructure can drive small borrowers to enter the market. Improve the management innovation and business operational techniques in special micro financial institutions.

References

Asli Demirguc-Kunt & Ross Levine. (2006). *Financial Structure and Economic Growth: A Cross- Country Comparison of Banks, Markets and Development*. Beijing: China Renmin University Press.

Gail Liberman & Alan Lavine. (2002). *Comparing Financial System*. Beijing: China Renmin University Press.

Wang, Banxing & Wang, Xinglong. (2006). Should China build a market- based financial system? *Finance and Economics*. No. 1.

Zou, Hongyuan. Et al. (2005). On the development direction of China's financial system from the reasons of different financial systems. *Reform of Economic Structure*. No. 2.

Table 1. Overview of financial system

	America	English	Japan	France	Germany
Financial market:	Most important	Most important	Developed	Relative unimportant	Unimportant
Competitiveness of bank:	High	→			
Concentration of banks:	Low	→			

Source: Gail Liberman & Alan Lavine. (2002). Comparing Financial System. p4.

Table 2. Compare the conditions of banks and markets respectively in America and Germany in 2003

	America	Germany
Banks loans / GDP(%)	73	132
Market value of stock / GDP(%)	127	45
Market value of private bonds / GDP(%)	73	36

Source: European Central Bank, Federal Reserve. From: Richard A. Brealey, Stewart C. Myers & Franklin Allen. Principles of Corporate Finance.

Table 3. Proportion of financial assets hold by families to GDP respectively in America and Germany in 2002 (%).

	America	Germany
Banks assets	59	70
Insurance and funds	120	68
Equities	118	36
Other	30	20

Source: European Central Bank, Federal Reserve. From: Richard A. Brealey, Stewart C. Myers & Franklin Allen. Principles of Corporate Finance.

Table 4. The proportion of financial institutions' portfolio to GDP respectively in America and Germany in 2002.

	America	Germany
Debts	45	80
Loans	38	125
Equities	26	30
Deposits and cashes	13	68
Others	56	20

Source: European Central Bank, Federal Reserve. From: Richard A. Brealey, Stewart C. Myers & Franklin Allen. Principles of Corporate Finance.

Table 5. Compare the national income per capita in America and Germany in 2006. (10,000 US dollars)

National income per capita in America	GDP per capita in Germany	Relative margin
4.2	3.5	16.7%