

Study on the Behaviors of Commercial Banks Based on Bank Particularities

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Abstract

Through analysis of the particularities possessed by commercial banks comparing with general industrial and commercial enterprises, this article put forward four particularities including the high risk, the particularity of the credit market, the particularity of bank product and the particularity of the bank industry. Based on these particularities, we should not follow the common enterprise theory in the industrial organization theory when we analyze the functions and behaviors of commercial banks, and we must understand the optimal selections of commercial banks according to their particularities and limit conditions.

Keywords: Commercial banks, Particularity, High risk, Credit market

The function of commercial bank is to make a mickle by many a little and utilize its own financial agency function to translate family savings into the investment of enterprise and realize the trans-position and trans-term deployment of the resource. The agency function of commercial bank is that the bank possesses the predominance of information asymmetry of both capital supplier and demander and utilizes its own supervisory function to solve the problem of agency. The commercial bank possesses the particularity of enterprise, but it is obviously different to other industrial and commercial enterprises, which particularities are presented in following aspects.

1. The high risk of commercial banks

The nuclear function of commercial bank is its function of risk management, but the commercial bank still has higher risk itself, and its risk is presented in following characters.

(1) The capital of commercial bank is less and the financial lever is higher. Under the theoretical frame of M-M, the behavior of enterprise is independent of its capital structure. However, the real world is the world that both trading sides have incomplete and asymmetry information, which will induce the trading costs, therefore, the ideal ambit of M-M without frictions is still an ideal analysis model. Comparing with other industrial and commercial enterprises, the capital assess ratio of commercial bank is much less. According to the requirements of Basel Concordat, the capital adequacy ratio of commercial bank should achieve 8%, which means the assets to debt ratio of commercial bank will achieve 90%. Therefore, the financial lever of commercial bank is much higher than common industrial and commercial enterprise. Excessively higher assets to debt ratio must means larger financial risk, and just as that the capital chain rupture of other industrial and commercial enterprises will induce the bankruptcy of these enterprises, the bank will induce bankruptcy in the financial panic. To prevent the deficiency of fluidity, the commercial bank will keep some repertories to fulfill depositors' withdrawals, and it will also save corresponding reserve requirements in People's Bank of China to deal with unexpected situations. To prevent the payment conjunctures of commercial banks, many countries will implement deposit insurances or offer national visible or invisible guarantee for commercial banks. As viewed from the characters of banks, their character of large sized debt management decides their character of loan, i.e. their most customers are mature enterprises, not middle and small sized enterprises.

(2) After the bank is bankrupted, the government will generally save it because of its large exterior character. The anticipations of "too big to fail" and the government invisible guarantee exist in the interior of the bank. Because of the existence of salvation example, the superior managers of the bank will come forth the problem of moral risk because they will anticipate the possible behaviors of the government, i.e. they will ignore the risk prevention of the operations engaged by the bank or implement investments with high risk. But when the bank bankrupts, the government usually rejects salvation. The behavior of the bank has strong exterior character. On the one hand, the bank solves the problem of trans-term deployment of the capital through the agency, and realizes the optimization of the resource, so it has strong positive exterior character. On the other hand, when the bank bankrupts, it may harm many enterprises and families, even induce the bank crisis and economic crisis, so relative to the bankruptcy of enterprise, the negative exterior character of the bank bankruptcy is much larger. After the risk and the crisis of the

bank occurs, to avoid large negative exterior character, most risks are assumed by the government and the society, and the final losses are the benefits of the depositors and the government, and the losses of the enterprise bankruptcy are mainly assumed by shareholders.

(3) The regulations assumed by enterprises are less in the management activities. Because the commercial bank is mainly engaged in the capital operation of the currency, and a great deal posts and employees contact with the money directly or indirectly and more face the seductiveness of the money, so the moral risk and the operation risk faced by the commercial bank are very prominent, and the very strict system and management are necessary. The bank will face more supervision. For example, except for the banking regulatory commission, if the enterprise comes into the market, it is also regulated by the securities regulatory commission, and if it comes into the market in foreign countries, it will so be regulated by foreign corresponding supervisory laws and regulations. For enterprises, there is no coherent arrangement, but the Basel Concordat required the capital adequacy ratio to the global bank industry. The creditors of the commercial bank are relatively dispersive, and because of the limitation of the costs, the bank is hard to supervise these creditors, and the bank may adopt the hitchhiking behavior. Under this situation, to prevent large exterior character, the country usually will supervise the common products.

(4) The credit market is not a balanced market. The product market usually can achieve the balance of the supply and demand. But in the credit market, the credit distribution always exists. Comparing with the product market, the credit market generally is not a completely competitive market, but a market with oligarch monopolization or oligarch competition. Therefore, the demand of the loan is larger and the supply of the loan is smaller, and the price confirmed by the commercial bank is always higher than the market price under the complete competition, but the loan amount of the supply is always lower than the loan quantity under the complete competition. The loan price among banks is not confirmed by the auction principle of the product market and the service market, i.e. the principle that the buyer with higher price gets the loan, so the profit of the bank is based on the security, and to avoid the converse selective behavior under the asymmetry of information, the loan price confirmed by the bank is lower than the price of auction. There is only limited competition among banks, and the market behaviors are financially regulated by many aspects, and its normality is the monopolization market or the oligarch market, and the credit market is usually in the unbalanced state. But the enterprise generally suffers less regulation, and the product market is in the completely competitive state, so it is usually balanced.

(5) Under the condition of incomplete symmetry contract, the benefit conflict exists between both debit and credit sides. The consigner's and attorney's benefits are abhorrent. Because of the existences of incomplete information and asymmetry information, debit customer can not identify loaner, and when the debit customer falls across the excessive demand of capital, if the loaner hastily enhances the interest rate, he will compel the debit customer with low risk to quit the market, and leave the debit customer with high risk, and the conversely selective problem will occur. Under this condition, the debit customer usually will give up utilizing the interest means to fulfill the excessive demands, and implement the credit distribution by other means in order to minimize the risks of converse selection and moral risk in the loan. The credit distribution is a sort of special contract relationship in the capital market.

(6) In the product market, most products realize the marketization. But in the market of commercial bank, many developing countries have not realized the marketization such as the marketization of the interest rate, and large numbers of financial restriction and policies exist, and the resource is deployed by the rent transfer or the redistribution of the rent. Therefore, the regulation of lending rate will also induce the price distortion and popular dear money, or the bank breaches the regulation through the innovation of the product.

2. The particularity of the product offered by bank

The bank offers the deposit product and the loan product and implements the functions of payment agency, coin creation and policy conduction, and the products offered by the bank and other visible products and service products have the aspect of the particularity.

(1) General enterprises have the upper course and the lower course in the industrial chain, so they are easily integrated, and the routes of the integration include transverse integration and lengthways integration. But the products of the bank possess high homogeneity, so most integrations of the bank are transverse integration, and at the same time, the products of the bank are easily simulated. The product of commercial bank is contract. And through the combination of the products, the bank can implement diversiform investments to reduce the risks of the investments. But the products of enterprise are relatively limited, so the diversification of the product is limited.

(2) The product transaction charge of the bank is relatively low. Because of the development of modern computer technology and network technology, it is very conveniently to implement transactions such as payment and balance through the product of the bank, which is very different to the regionality that other products or services are limited

in, and other industrial and commercial products have large transaction costs induced by the transformation of time and space, but the products of the bank can be traded in 24 hours and in the whole world.

(3) As a sort of financial product, the loan is different to the visible commodity which is the timely transaction through bargaining between supplier and demander, and it is a sort of spot transactions in most situations, and after the transaction, the ownership and the using right change simultaneously. But for the loan, only the using rights change after the transaction happens, and the ownership is not really transferred. The demander should return interests monthly and return corpus at the end of the term of the contract, which not only includes the time value of the capital, but embodies a sort of idea of long-term contract. So the pricing of the loan is to price the using value in certain term considering the risk. Under fixed risk, the using value in certain term is higher, its price is higher.

(4) Except for on-balance-sheet operation of indebted assets, the commercial bank also has large off-balance-sheet operations. So comparing with other enterprises, the balance sheet of commercial bank is more easily faked, especially the income share of off-balance-sheet operation is higher and higher, the behaviors of the commercial bank which utilize the off-balance-sheet operation to implement the investments with high risk (such as futures options and hedge transactions) are more and more difficultly supervised, for example, the British hundreds years' shop Barings Bank was closed down by large of transactions of derivative financial instruments.

3. The particularity of bank industry

(1) The character of bank scale economy is obvious. With the extension of assets scale of the bank, it can deploy its assets and debts in larger range to reduce the capital costs and management costs, which presents the increase trend of scale reward. The bank industry possesses obvious character of scale economy, and in 500 largest banks in the world in 2004, the minimum capital achieved 0.64 billion dollars and the minimum assets scale achieved 20 billion dollars. Luyang (2005) had proved that the profit increase is highly positive correlative with the increase of assets scale in China stock banks, which could also explain the interior reason why the present foreign financial institutions were wild about merger and share but the direct management developed slowly. Foreign situations also proved that banks had scale effect. In 1996-2000, the capital return of community banks which assets scale was less than 0.5 billion dollars in US was 12.7%, the proportion of non-interest income was 16.8%, and the capital return of community banks which assets scale was in 0.5-1 billion dollars in US was 14.3%, the proportion of non-interest income was 21.9%, and the capital return of community banks which assets scale was above 10 billion dollars in US was 16.5%, the proportion of non-interest income was 39.8%.

(2) The commercial bank is in the industry with intensive science and technology, intensive capital and intensive technology. The information has extremely important value to the commercial bank, so the maturity and arrival time of the information is very important to the management of the commercial bank. The commercial bank adopts modern IT technology and purchases advanced equipments to create competitive predominance in the aspects of balance, payment and information communication. At the same time, because of the encouragements avoiding supervisory regulations and spread profits, the financial innovations emerge in endlessly and the whole industry embodies the character of innovation.

(3) The credit standing is the lifeline of the commercial bank. The management objective of commercial bank is the currency, and the depositors will deposit their capitals in the commercial bank because they recognize and affirm the credit of the bank. In the same way, the commercial bank will loan the capitals out because it affirms the customers' credits. Once the reputation crisis happens in the commercial bank, it will face competition even bankruptcy. When the financial panic occurs, the government will stabilize the depositors' confidences and recover depositors' credit standing to the bank.

(4) The commercial bank is not an enterprise which takes profit as the core completely. On the one hand, the management objective of commercial bank is the combination of security, fluidity and productiveness, which is different to the objective that the enterprise treats the profit. On the other hand, because of the existence of exterior character, the commercial bank can ensure the safety of financial system even the micro economy to avoid its bankruptcy. When the commercial bank pursues its security, fluidity and productiveness, it should pay attention to the social benefits and more assume social responsibilities than common enterprises. There exist more information asymmetries and more multiple agent relationships in the commercial bank. The depositors of commercial bank can not know the assets combination sheet of the bank, and the commercial bank can not fully know the loaners' information. In the same way, there exist the problems of incomplete information and information asymmetry between shareholders and managers in the commercial bank and between the managers and their underlings (such as creditor employees), which forms the multiple agent relationships among "depositor- shareholder- manager-operation personnel- loan enterprise".

(5) Based on the moral risk of middle and small sized individually-run banks and the large exterior character of the

financial industry, various countries in the world adopt the state controlling mode to the bank, or forbid private stock controlling to the bank form the legislation, which is to prevent the association transaction and interior control.

(6) Both entry and exit of the bank industry have costs. In many countries, the entry of the bank has bulwark, and the exit of the bank will also has large of costs. For example, the banking regulatory commission regulated that for the paid-up registered capital, the minimum limitation to establish the joint-stock commercial bank is 1 billion RMB, and the minimum limitation to establish the joint venture bank and exclusive capital bank is 0.3 billion RMB. If the foreign financial institution is the initiator or strategic investor of the stock commercial bank, its total assets should exceed 10 billion dollars and follow the principle of “holding shares for long terms, optimizing governance, business cooperation, and evasion of competition” and the proportion of shares should not exceed 20%. But for the enterprise industry, most enterprises can freely entry and exit and the obstacles don't exist. The competitive theory of the enterprise is not suitable for the bank. In any country, there is entry limitation for the bank, and the management permit of the bank has very high value of concession, but the enterprise basically has no entry and exit bulwarks.

4. Conclusions

Above analysis discussed the high risk of commercial bank, the imbalance of credit market, the particularity of bank product and the particularity of bank industry, and we can more fully understand the function and the behavior of commercial bank. And because of the limitation of the particularities, the optimal selection of commercial bank is different to the optimal selection of enterprise. Therefore, the method to explain the behavior of commercial bank according to the common enterprise theory in the industrial organization theory has large limitations.

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