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Financial intermediation: Delegated monitoring and long-term relationships

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Abstract

This paper considers the consequences of enduring relationships for bank structure and policy in an information-based banking model. Adding a richer time dimension allows repeated lending between the intermediary and borrower. This contract lets a bank produce information and enforce compliance more easily than direct monitoring of the borrower's organization. This implies an asymmetric banking structure: banks enter long-term relationships with borrowers, but not with depositors. Next, it shows how enduring relationships solve problems with loan participations and security underwriting by commercial banks.

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