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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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— This paper was written while the author was a Visiting Scholar at the Board of Governors. Ed Green, Russel Cooper, two anonymous referees, and seminar participants at Chicago and the 1986 Summer Econometric Society meetings provided many helpful comments, but bear no responsibility for the remaining errors. The views expressed here do not necessarily represent the position of the Federal Reserve System.

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