KIATNAKIN PHATRA

Discussion on:

Bank Size and Economic Growth

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Overview of the paper

Research question

- How does bank size affect the level of capital accumulation, and hence economic growth?

Methodology

- A theoretical model following Cetorelli and Peretto (2012)
  - **Two banks** (Big and Small) choosing how much to lend and the portion of 'relationship' lending
  - **Firms** borrowing from banks, at interest rate R_t, to invest with a probability of success θ
  - **Household** deciding how much to save at interest rate r_t

Key findings

- Bigger bank ➔ More lending (with less borrowing) ➔ Higher capital accumulation ➔ Higher output

Contribution

- Modify the dynamic general equilibrium model of Cetorelli and Peretto (2012) to investigate another aspect of banking market structure, namely, the size of banks, in influencing aggregate output

Discussion: Model setup and key assumptions

1. Bank size: Big and Small banks' endowment: $e_0 + \delta$ and $e_0 - \delta$

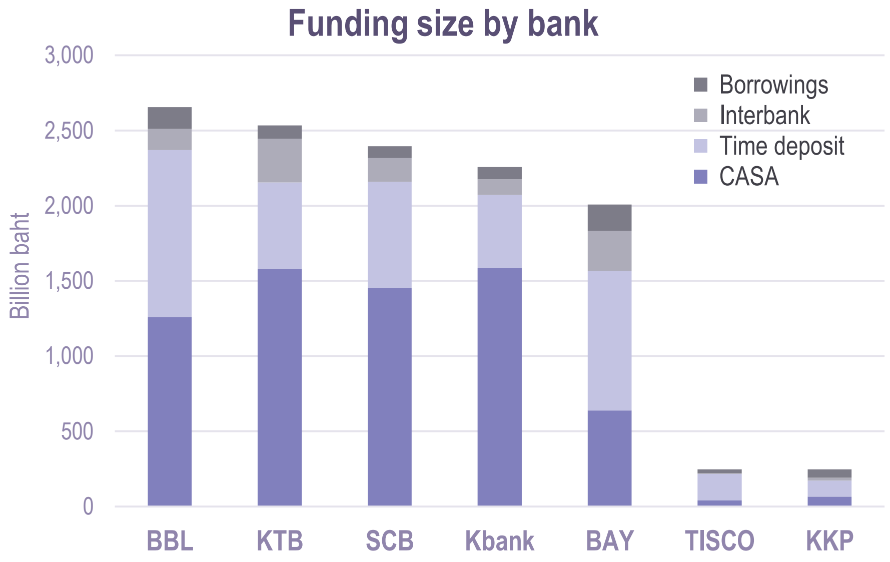
Key result: $$big\ bank\ borrows\ less\ than\ small\ bank:\ x^{b^*} < x^{s^*}$$

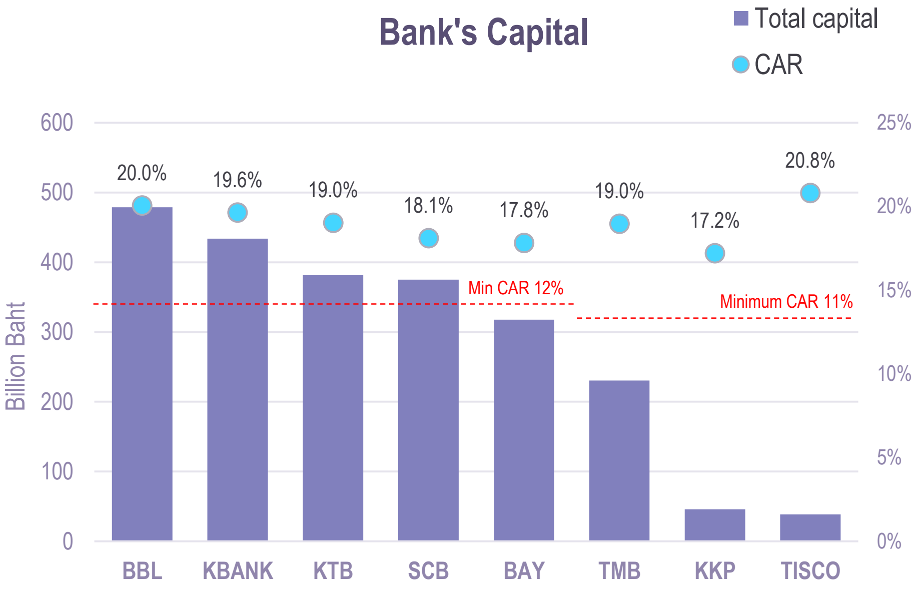
$$big\ bank\ lends\ more\ than\ small\ bank:\ x^{b^*} + e_0 + \delta > x^{s^*} + e_0 - \delta$$

Comment: Bank's capital ('endowment') should not be treated as funding

- The bigger the bank the larger capital, the more lending it could *afford* by regulatory requirement
- But this does not mean the less deposit funding it needs (in fact, the bigger the bank, the larger deposit funding)

Suggestion: Is it possible to make optimal choices depend on 'interest rate' and 'rate of return' rather than the *absolute* amount of costs and profits?





Source: Commercial banks (ธพ 1.1), KKP Research

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Discussion: Model setup and key assumptions

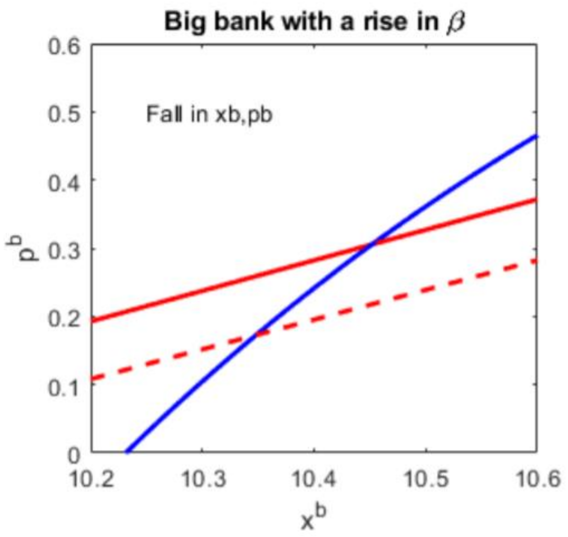
2. Type of lending

Interpretation: "Relationship" lending = More screening/monitoring (more costly, less risky)

"Standard" lending = Lax screening/monitoring (smaller cost, but riskier)

Suggestion:

- Can there be two layers of uncertainty of project success? (1) intrinsic uncertainty in the economy and (2) varying uncertainty depending on the type of loan
- So that can compare two cases (eg. two countries) where intrinsic uncertainty is *high* and where it is *low* ➔ making monitoring and lending decision also depend on different fundamentals



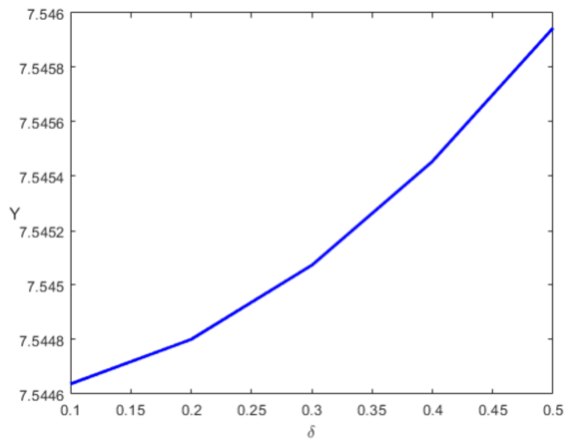
3. Bank size, Credit efficiency, Capital accumulation, Aggregate output

Result: The model predicts non-diminishing credit efficiency, capital accumulation ➔ increasing aggregate output with bigger bank size

Implication: One single bank (absolute monopoly) is best for economy!!?

Suggestion: Introducing non-linearity or frictions with bank size? eg. Another term to represent market power, thus interest rate does not necessarily fall as bank size becomes bigger

Bank size and Aggregate output



Beyond the theory: Reality is much more complex

Issue 1: All bank loans for corporate lending are 'relationship' lending

- *Relationship-based lending*
- *Collateral-based lending*
- *Feasibility-based lending*

Issue 2: Firm size matters (a lot) too

Issue 3: Other types of loans become more important

- Growing bank size does not always translate into more investment
- Market segmentation differs by bank

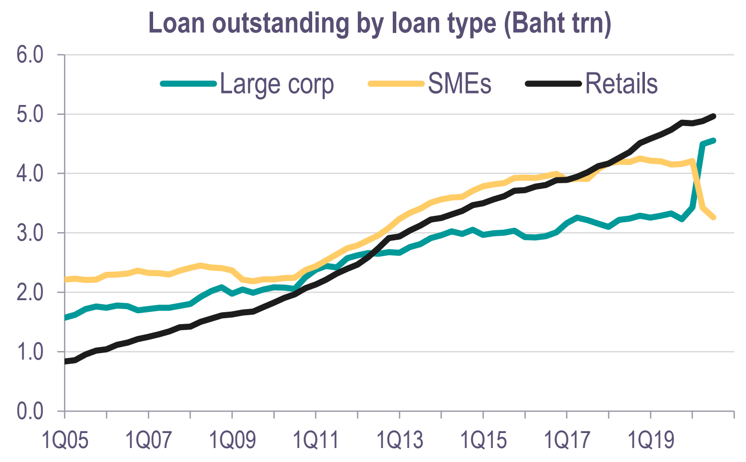
Issue 4: A bigger bank does not always imply more efficiency

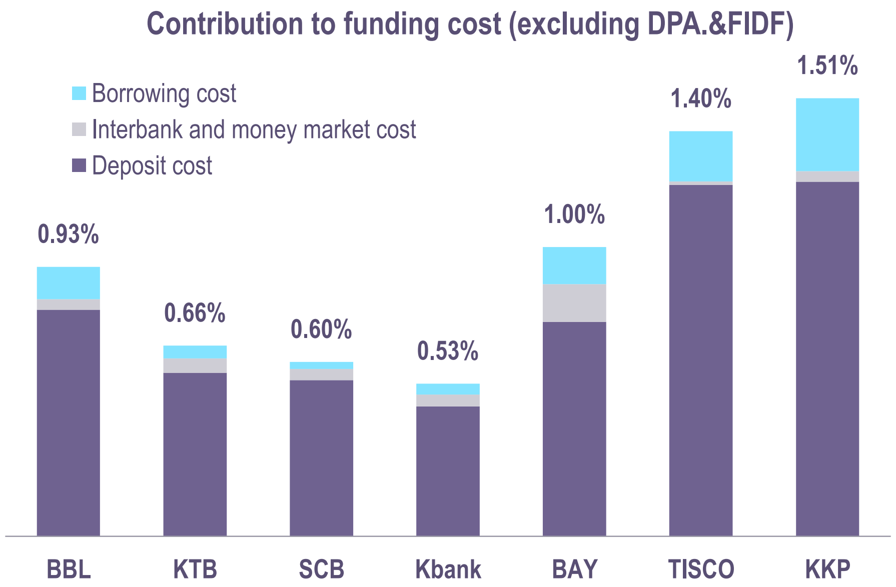
Old world:

- Scale (branches) is important for reducing funding costs (deposit mobilization)
- Capital is a constraint on extending corporate lending

Today's world:

- Technology/digitalization diminishes the importance of scale
- Corporate lending is not growing; having large capital is less beneficial





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Beyond the Theory: Bank size and economic growth

Issue 5: Is it the bank size or the *banking sector size* that matters?

- Financial access
- Number of banks / Bank competition
- Efficiency in allocation of funds
- Level of risk-taking in the economy

Issue 6: Profitable lending $\xrightarrow{?}$ More (productive) investment $\xrightarrow{?}$ Economic growth

Issue 7: Bigger banks and **systemic risks**

Bigger banking sector and the role of financial accelerator

Beyond banks …

A more balanced view of financial system

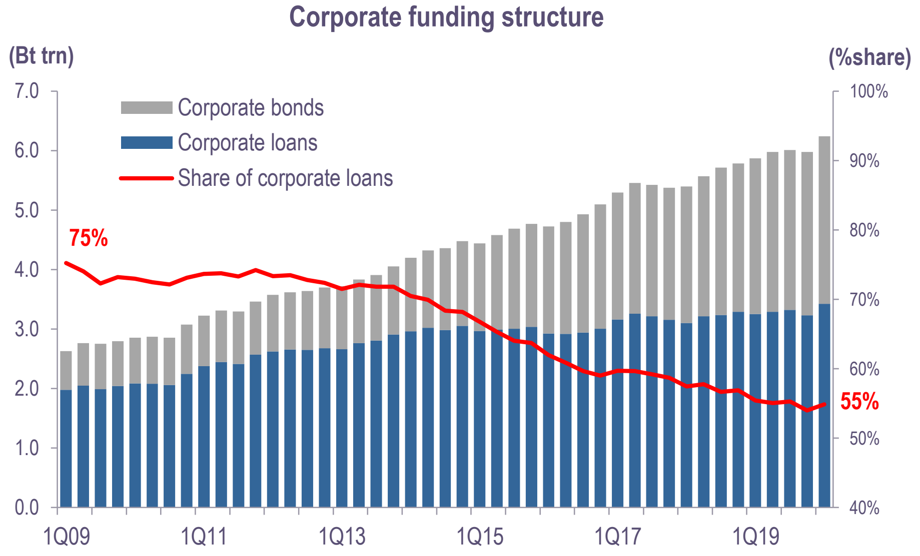
- Banking sector
- Capital markets (bonds, equity)
- Other sources of finance (non-bank, private equity)

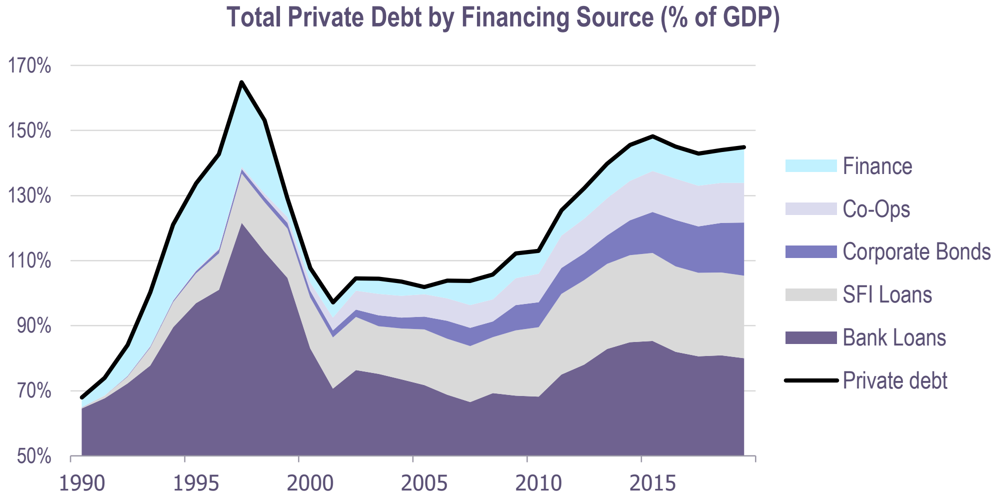
Financial disintermediation of (traditional) banks

- FinTech/ TechFin
- Digital banking / Platform economy

Future of growth and different financing needs

- Startup, Innovative projects with high risks of failure
- Banks with low risk tolerance and regulatory requirements





Source: BOT, ThaiBMA, KKP research