



International Financial System

- Different designs of financial systems are found in different countries
- **Structure of economy, its pattern of evolution, political, technical, and cultural difference** affect the design (type) of financial system
- **The two extremes: bank based financial system and market based financial system**
- Bank based financial system (Germany) – a few large banks play a dominant role and the stock market is not important
- Market based financial system (USA) – financial markets play an important role and banking industry is much less concentrated
- Other major industrial countries fall within these two extremes
- The two systems explained:
 - **Market based financial system:**
 - Securities markets share **central stage**
 - Banks simply mobilise society's savings for firms, exerting corporate control, and easing risk management
 - **Bank based financial system:**
 - Banks play a vital role in mobilising savings, allocating capital, and overseeing the investment decisions of corporate managers; providing risk management facilities
 - Tend to be stronger in countries where government have a direct hand in industrial development (like **India** where the nationalisation of banks, an administered interest rate regime, and the government policy of favouring banks led to the pre-dominance of a bank – based system)

Countries	<u>USA</u>	<u>UK</u>	<u>Japan</u>	<u>France</u>	<u>Germany</u>
Financial Markets	Central	Central	Developed	Fairly important	Unimportant
Banks	Less important				Highly important
Trade-offs	Financial Markets				Financial Institutions
	Competition				Insurance
	Efficiency				Stability
	Public information				Private information
	External control				Autonomy
	Free riding				No free riding

Type of FS (down) / Characteristics (right)	Advantages	Disadvantages
Market Based	Provides attractive terms to both investors and borrowers	Prone to instability
	Facilitates diversification	Exposure to market risk
	Allows risk sharing	Free rider problem
	Allows financing of new technologies	
Bank Based	Close relationship with parties	Retards innovation and growth
	Provides tailor made contracts	
	Efficient inter-temporal risk sharing	Impedes competition
	No free rider problem	