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FINANCIAL INTERMEDIATION AND DELEGATED MENTORING

Abstract:

In this dynamic relationship lending model, a bank acquires information on borrowers and on the profitability of sectors by lending. The bank uses this information to screen borrowers, direct loans between sectors and mentor borrowers to leave declining sectors and relocate their businesses to booming sectors. Mentoring generates a novel reason for bank formation and a new source of scale economics in banking. The learning by lending effect provides an established bank with an information advantage over other banks and its old borrowers. The bank can misuse this advantage and exploit the borrowers. To eliminate the exploitation, it is optimal to lend without outside collateral.

Keywords:

Banking, Financial intermediation, Relationship lending, Collateral.

JEL Classification: G21