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A Study of the Theoretical Approaches to the Banking Financial Intermediation and its Development Trends

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Abstract: The article describes modern approaches to the theory of financial intermediation and its development presented by foreign and home specialists which must be taken into consideration in the process of institutional development of bank intermediation in financial sector of national economy. The conclusion is made that modified theory of financial intermediation which appeared as a response to financial innovations and universalization of the activity of financial intermediaries is rather up-to-date for modern Russia.

Key words: Financial and bank intermediation · Transactional and informational approach · Traditional and improved theory of intermediation · Intermediaries

INTRODUCTION

The essence of financial intermediation is a key point of modern economic theories. The founders of financial intermediation theory were G. Akerlof, J. Benston, V. Diamond and many others. They used common methodological approach which is perception of financial intermediation as combination of institutions, tools and markets satisfying needs of different economic entities.

In modern home and foreign literature financial intermediation are viewed as combination of financial institutions (banks, insurance companies, credit associations, pension funds etc.) whose functions are to accumulate money of citizens and legal entities and then give it to borrowers on commercial conditions.

Such description is supported by foreign authors. Financial intermediaries, in their opinion are banks, insurance companies, investment fund and credit association accumulating people's and legal entity's money and investing them into the economy [1].

The interpretation of financial intermediation given by W. Sharp, G. Alexander and J. Beily should be mentioned as well: in their opinion. "financial intermediaries, or financial institutes are organizations which issue financial obligations and sell them for money as assets. The money which they obtained from these sales are used for buying financial assets of other companies" [2].

Russian economic literature, in our opinion, does not provide comprehensive description of the character of institutional category "financial intermediary". Some Russian scientists connect this phenomenon with participation in re-distributing processes (function) of financial intermediaries, the others concentrate attention on the securities turnover function or restrict the intermediation process to accumulation and organization of cash flows. All these descriptions, in our opinion, are biased and do not describe particularities of modern money market in full.

In the same time we believe that description of "financial intermediary" category given by E. Glushchenko, L. Drozdovskaya and Yu. Rozhkov is very appropriate and convincing: an institution acting on the base of economic trust directly assisting market entities in transformation of their accumulated cash into investments (through financial market) thus turning their idle money into investments without agreement

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of these entities, on their own accord, taking all risks (through credit market), acting as an agent, including money clearing (payments) by the order of their customers [3].

Research of the theory of bank financial intermediation and its genesis was made in full by Ukrainian scientists V. Vishnevsky, A. Matyushkin and I. Annenkov who proved that it is a modification of the traditional theory which described functioning of banks through the prism of quality, quantity and temporal transformation of asserts: this modification was a response to financial innovations and universalization of activity of financial intermediaries in post-industrial countries, diversification of banking activity, stronger competition in financial sector of economy [4].

The theory of bank financial intermediation in the middle of 70s of the last century was based on so called transaction and information approaches.

Information approach in the theory of financial intermediation was founded on studying of the phenomenon of asymmetry of information as exemplified by relationship "creditor bank" and "borrower bank" and originates from 70s of the last century in the works of leading theorist of “information economy” George A. Akerlof who showed universality of information asymmetry phenomenon, its presence at many markets [5].

Significant contribution into development of information approach was made by Duglas V. Diamond who in the beginning of 1980s developed the concept of financial intermediation as delegated monitoring based on the principle of minimizing costs which are necessary for production of information necessary for solution of the problem of stimulation of borrower’s behaviour in creditor's interests. This author considered activity of financial intermediary as an agent of many investors (depositors) who hand over to the intermediary their money for crediting entrepreneurs and delegate to it expensive authorities on monitoring of credit contracts. Such activity has some advantages for creditors because otherwise they had spent their efforts on monitoring and wasted restricted resources. So, it is profitable for creditors to use an intermediary which can save their money spent on monitoring in comparison with direct financing [6].

Transaction approach is related to study of the phenomenon of transaction costs in economy and their impact on organization and conducting of economic and financial activity. One of the first works which investigated the connection between the functions of financial intermediation in economy and existence of transaction costs was written by G.J. Benston and C.W. Smith where the authors described the main reason of existence of financial intermediation: it was market friction in the form of information and transaction costs because of imperfection of market [7].

These authors ague that the function of financial intermediation in market economy is to satisfy financial needs of depositors and investors with relatively low for them transaction costs by means of realization of specific financial products and services which allow depositors to invest any cash for any appropriate for them period of time to get good income. Besides that intermediaries provide savers with high liquidity of their investments giving them opportunity of current consumption and borrowers-with liquid assets in demanded amounts and for necessary terms with minimum transaction costs. So, important feature of financial intermediation is its ability to satisfy financial needs of savers and investors upon more flexible terms and with less costs (or consumer's transaction costs, in comparison with direct financing).

Further development of post-industrial economy in developed countries led to new trends in functioning of their financial-credit systems determined, first of all, by intense growth of corporative credit securities market, securitization of assets and sale of loans which led to formation of secondary market of bank credits and development of mortgage markets etc. But the categories of transaction costs and information. asymmetry on which traditional theory of financial intermediation is based did not provide the answers to these questions. That is why existing at that time theoretical foundation demanded modification.

In modern studies the theory of financial intermediation is formed mainly by 2 concepts: the concept of liquidity provision based on the model of Diamond-Dybvig [8] and the concept of risk management based on theory of Wharton school of Pennsylvania university [9].

The concept of liquidity provision accentuates both sides of balance: taking deposits and giving credits. By authors opinion the banks do not just get resources from clients with the purpose of their further distribution between borrowers but perform a more complex function: they allow both categories of clients to get cash, provide their liquidity on conditions of short-term notification, or both variants of activity of banks are two kinds of the same function of provision with liquidity upon the request.

Provision borrowers with liquidity by banks differs from their competitors in credit sphere, such as, for example, financial companies which can provide customers with longer credits: only banks can guarantee

return of money to their clients upon their request. Such specific character of bank business explains the transition of banks to providing credit lines, credit obligations and widely used on practice financial products impossible for the market of direct bank crediting.

The concept of risk management developed by scientists of Wharton school accentuates on study of cardinal changes in bank activity caused by fundamental changes and development of national financial systems which required from the banks more active participation in financial innovations.

Historically such changes took place in the USA and Great Britain first where market-oriented financial systems appeared. The banks of these countries were forced to become more active innovative players in traditional and new financial markets - provide underwriting and insurance services, manage assets and develop new products. In conditions of stronger competition in financial markets they were able to endure thanks to their agent function in regard to their customers and carrying out of new profitable activities.

Changes in bank activity coincided with changes in investors' behaviour which started to use complex risk management tools. So called symbiotic relations have formed between financial intermediaries and financial markets when every participator of financial market is necessary to the others. Such symbiotic movement was called by American scientists Robert Merton and Zvie Bodie a financial innovative spiral [10].

Analysis of the theories of financial intermediation allows to conclude that risk management concept in conditions of intense financial innovations is one of the fundamental theoretical concepts of financial intermediation, known as modified theory. Today risks are assessed not only on the level of company but also on macro-economic level. Risks assessment has become central issue in banking service.

So, study of financial intermediation theory allows to conclude that it has evolved from traditional theory which described functioning of banks through the prism of quality, quantity and temporal transformation of asserts: this modification was a response to financial innovations and universalization of activity of financial intermediaries in post-industrial countries, diversification of banking activity, stronger competition in financial sector of economy.

Russia of today has all necessary elements of modern financial system and is ready to perform main set of functions attributed to mature economies. In our opinion, modified theory of financial intermediation which was a response to financial innovations and universalization of financial intermediaries' activity, expansion of bank activity through consultancy, investment and insurance services is rather urgent and up-to-date for Russia.

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