

Raju J. Sing. 1992. An imperfect information approach to the structure of the financial system. UNCATD discussion paper 46 (July).

---

Bank-based systems are better at dealing with uncertainty arising from asymmetric information with respect to borrowers interest and projects, because:

- facilitates the gathering and analysis of information;
- reduces the scope for speculative use of financial resources, as the bank may pursue a lending policy associated with longer-term investment strategies;
- banks become linked with the non-financial firms.

The pitfalls of the system are:

- cartelisation, which may lead to averse selection of borrowers and a bias towards large economic corporations and groups, as well as limited competition;
- reduced incentives to invest in new firms that do not result from investment decisions undertaken by the existing cartel or economic group;
- reduced credibility on the ability and willingness of the bank to cut off credit if projects are not successful. This may lead to moral hazard from the investors because they may not take the necessary precautions as they think that the associated bank will always provide finance and bail out debts and bad loans.