



## The Research on the Behavioral in Domestic Commercial Bank Governance Model and Enlightenment Based on Behavioral Theory

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### Abstract

Through analysis of the particularities possessed by commercial banks comparing with general industrial and commercial enterprises, this article put forward four particularities including the high risk, the particularity of the credit market, the particularity of bank product and the particularity of the bank industry. By comparing the typical governance models of different countries, we can find some principles and ways for our state-owned commercial bank to establish effective corporation governance model.

**Key words:** Commercial bank; Finance; Behavioral biases; Governance model

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### INTRODUCTION

#### (a) The Conception of Behavioral Theory

Because psychology systematically explores human judgment, behavior, and well-being, it can teach us important facts about how humans differ from traditional economic assumptions. In this essay I discuss a selection of psychological findings relevant to economics. There are two basic components of the standard economics model of the individual: That she has stable, well-defined preferences, and that she rationally maximizes

those preferences. Given some choice set X, a person is assumed to “Max  $x \in X U(x)$ ”. Psychological research can be roughly categorized by how radically I challenge this model, and by the nature of the modifications implied.

#### (b) The Conception of Governance Model

Corporation governance is one of the most important concepts in the modern enterprise system. Corporation governance is the system arrangement, which can harmonize the relation among shareholders, directors and managers and assort with some related people (employee, clients, suppliers, creditors, the public and the government). It contains exterior governance model and interior governance model. With corporation governance, we can keep all the level in the enterprise in order and in controllable state, and in the end we will have the transparent and effective governance effect. In all, corporation governance is one of the most critical problems confronted with the enterprises.

Corporation governance of commercial bank is a system, which can guarantee steady operation and persistent development of the commercial bank. Board of the director and high-level managers make use of this system to deal with affairs in the bank or out of the bank, such as establishing development strategy, protecting the benefits of depositors, shareholders and stakeholders, and ensuring most of the operation activities in good order and most of the governance function in a safe and healthy way.

### 1. THE COMPARE OF THE GOVERNANCE MODEL IN DOMESTIC COMMERCIAL BANK AND OTHERS

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### **1.1 State Type of the Governance Model in Commercial Bank**

After the bank is bankrupted, the government will generally save it because of its large exterior character. The anticipations of “too big to fail” and the government invisible guarantee exist in the interior of the bank. Because of the existence of salvation example, the superior managers of the bank will come forth the problem of moral risk because they will anticipate the possible behaviors of the government, i.e. they will ignore the risk prevention of the operations engaged by the bank or implement investments with high risk. But when the bank bankrupts, the government usually rejects salvation. The behavior of the bank has strong exterior character. On the one hand, the bank solves the problem of trans-term deployment of the capital through the agency, and realizes the optimization of the resource, so it has strong positive exterior character. On the other hand, when the bank bankrupts, it may harm many enterprises and families, even induce the bank crisis and economic crisis, so relative to the bankruptcy of enterprise, the negative exterior character of the bank bankruptcy is much larger. After the risk and the crisis of the bank occurs, to avoid large negative exterior character, most risks are assumed by the government and the society, and the final losses are the benefits of the depositors and the government, and the losses of the enterprise bankruptcy are mainly assumed by shareholders.

### **1.2 The Marketization of Governance Model in Commercial Bank**

In the product market, most products realize the marketization. But in the market of commercial bank, many developing countries have not realized the marketization such as the marketization of the interest rate, and large numbers of financial restriction and policies exist, and the resource is deployed by the rent transfer or the redistribution of the rent. Therefore, the regulation of lending rate will also induce the price distortion and popular dear money, or the bank breaches the regulation through the innovation of the product.

Under the condition of incomplete symmetry contract, the benefit conflict exists between both debit and credit sides. The consigner’s and attorney’s benefits are abhorrent. Because of the existences of incomplete information and asymmetry information, debit customer can not identify loaner, and when the debit customer falls across the excessive demand of capital, if the loaner hastily enhances the interest rate, he will compel the debit customer with low risk to quit the market, and leave the debit customer with high risk, and the conversely selective problem will occur. Under this condition, the debit customer usually will give up utilizing the interest means to fulfill the excessive demands, and implement the

credit distribution by other means in order to minimize the risks of converse selection and moral risk in the loan. The credit distribution is a sort of special contract relationship in the capital market.

### **1.3 The Compare of Supervision of Commercial Bank in Governance Model**

The regulations assumed by enterprises are less in the management activities. Because the commercial bank is mainly engaged in the capital operation of the currency, and a great deal posts and employees contact with the money directly or indirectly and more face the seductiveness of the money, so the moral risk and the operation risk faced by the commercial bank are very prominent, and the very strict system and management are necessary. The bank will face more supervision. For example, except for the banking regulatory commission, if the enterprise comes into the market, it is also regulated by the securities regulatory commission, and if it comes into the market in foreign countries, it will so be regulated by foreign corresponding supervisory laws and regulations. For enterprises, there is no coherent arrangement, but the Basel Concordat required the capital adequacy ratio to the global bank industry. The creditors of the commercial bank are relatively dispersive, and because of the limitation of the costs, the bank is hard to supervise these creditors, and the bank may adopt the hitchhiking behavior. Under this situation, to prevent large exterior character, the country usually will supervise the common products.

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## **2. THE PROBLEMS OF IN DOMESTIC COMMERCIAL BANK GOVERNANCE MODEL DEVELOPMENT**

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### **2.1 Lack of the Internationalization Operation Commercial Bank Governance Model**

The internationalization operation of enterprise and that of bank is interdependent and develops along with each other: enterprise’s internationalization development need the support from the sufficient development of that of bank; and bank’s internationalization degree and scale, to some extent, dominate the level of enterprise’s overseas expansion; while transnational enterprise is the major customer of the internationalized bank. As to transnational bank, compared with those customers with scrapes of business, transnational enterprise has not only the advantage of quantity, but also brings comparatively less risk.

In this way, on one hand, it brings about remarkable economic benefits for transnational bank, and on the other hand will also bring along the development of other bank service. According to the general law of socialized production and the international experience, enterprises’ internationalization process will generally undergo three phases: independent exportation, overseas

direct investment and transnational management. At present, in general, domestic enterprises are in the first or the second stage. Although there are some enterprises that have succeed in overseas operation, compared with some large-scale transnational enterprises, they still lack competitive power. And funds-raising is especially a prominent problem that restricts enterprise's development in the process of overseas operation. On one hand, it's difficult for transnational-operated enterprises to get the funds-aid from the financial organization of host country, so they need the help from the overseas branches of domestic banks. And on the other hand, domestic banks are deficient in overseas customers, failing to give effective support to domestic enterprise's transnational operation. Under this situation, both the development of transnational enterprises and domestic banks are hindered to some extent.

## **2.2 The Constrains of Policy on Customers in Commercial Bank Governance Model**

The insufficient effective demand by customer households for services offered by official financial institutions leads to the demand-related financial constraints. Currently, there is an insufficient demand for financing by customer households. On one hand, there is insufficient natural demand which is mainly determined by the low interests and long term of investment which have reduced the commercial demand by customer households for funds. On the other hand, stimulation of demand is insufficient and this is the main cause of demand-related financial constraints. In turn, this is the result of policy limiting the development of rural finance institutions.

Firstly, as the provision of consumer credit services by official institutions is lagging, the demand by customer households for such credit is weak. Currently, it is difficult to activate the bank-renting market in this respect, partly due to low interest for bank renting. However, when customer of commercial bank withdraw saving to build houses, buy durable consumer goods, educate their children, or hold weddings or funerals, it is generally difficult for them to obtain loans from official financial institutions. This forces customers to transfer the demand for consumer credit to unofficial financial institutions and, as a result, the demand for funds from official financial institutions is reduced.

Secondly, risks in investment and devaluation of saving have reduced investment demand by households. As unstable interest frequently occurs in China, the risks of devaluation are high. But insurance is backward. At the same time, because of the low degree of market development, the risks and costs for obtaining information and technology, as well as market transactions costs, are high for peasant households. Due to such risks and a lack of correlative policy tools, the majority of households can only choose to operate within traditional industries instead of entering into other businesses. This restricts

their channels for investment and reduces their demand for borrowing capital from official financial institutions.

Thirdly, loans from official financial institutions are difficult to access which inhibits demand for investment by households. Investment loans from official financial institutions are difficult for households, mainly because of the lack of collateral, guarantees are difficult and formalities complex. The creativity is inadequate for lacking of the divided financial product. So far, the loan business in country bank is almost alike with community business. Because of the scale finance, the credit ability is far weaker than credit community, thus, the existence of country bank is in question, and for its function is almost the same with credit community.

## **3. THE ENLIGHTENS OF COMMERCIAL BANK GOVERNANCE MODEL**

As financial enterprises, commercial banks also aim at capital appreciation and getting the maximum profit. Therefore, the motivation for commercial banks' internationalization is to realize the maximum profit, to pursue the increase of proceeds and decrease in operation cost.

### **3.1 To Realize the Internalization Advantage and Scale Economy**

First of all, the internalization is one of the effective ways for banks to save cost and increase profit and banks can realize the optimization allocation of the internal resources through the easy-to-control internalized trade. Banks' internalization operation is a favorable way to realize the internalization advantage. If commercial banks set up overseas branches, when launching overseas business, they can turn to their own branches to deal with the transaction through pre-formulated procedure, and thus can save the time and reduce the cost for business transaction.

Then, the scale economy can help to realize banks' pursue of profit enlargement. As the scale advantage of the bank is quite prominent, it can reduce the cost recovery rate and increase the capital reciprocation rate through large scale extension. For example, the findings of the survey on America's 50 big banks reveal that, after consolidation, the banks' average capital reciprocation rate has increased from 1% to 1.29%, and the general capital reciprocation from 13.6% to 15.9%, which gives sufficient evidence to show the advantage of scale economy. And banks' scale advantage is not only reflected by the scale of its network, but also by the rational distribution of the network all over the world. The rational distribution of the network all over the world enables commercial banks to raise funds from the international market in a convenient way, reduce the funds-raising cost, improve the ability for international clearance, gain market information in a more convenient way, and thus reach the aim of saving cost and increasing profit.

### 3.2 To Stabilize and Enlarge the Customers Groups of Commercial Bank

Customer resources are the lifeline for commercial banks' survival and development. Along with the pouring-in of foreign banks, customers have become the competition focus of the banks both at home and abroad. And as the cultural fusion has become more and more prominent, as well as the day-by-day more frequent participation in international activities of domestic enterprises and citizens, foreign banks that can offer international service will occupy the favorable position in competition and many high-quality customers will move to those foreign banks providing international, systematic financial service from domestic commercial banks. According to bank field's "Two-Eight" theory, that is, bank's main profit flows from high-quality customers, so domestic commercial banks should stabilize and enlarge the customer groups through the realization of internationalization operation, thus to struggle for development in the competition over customers.

### 3.3 To Improve the Overall Management Level of the Commercial Banks

To an internationalized bank, the crucial point for its survival and development is to gain the possibly maximum profit through effective management. And at present, most of the international commercial bank are equipped with scientific management and operation mechanism, and, they are built up based on the good business management and in general, they all comply with the principle of "Benefits Dominate", and aim at "To Gain the Maximum Profit". While the commonly used mechanism in the world is "Capital Balance Proportion" management, that is, along with the change in the operation environment, banks coordinate various capital and liabilities contradiction in the field of interest deadline and structure, and try to realize the rational allocation and optimized arrangement at the aspects of risk and circulation, thus pursue the combination of security, good circulation and profit-making. If domestic commercial banks set up branches in developed countries, they can learn the advanced experience from their financial market, such as the treatment of unhealthy assets, the management pattern, and business processing flow. And at the same

time, they can transplant the experience to domestic and other markets to improve the level of management. In addition, there is sufficient financial products line in their financial market, from which domestic banks will learn a lot. Also, the financial market of these developed countries especially that of America, serves as the test field for new products, where the transnational banks often exercise financial innovation

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## CONCLUSION

Above analysis discussed the compare of commercial bank in governance model, the imbalance of credit market, the particularity of bank product and the particularity of bank industry, and we can more fully understand the function and the behavior of commercial bank. And because of the limitation of the particularities, the optimal selection of commercial bank in governance model is different to the optimal selection of enterprise. Therefore, the method to explain the behavior of commercial bank according to the common enterprise theory in the industrial organization theory has large limitations. The comparative analysis of different corporation governance in some typical countries offer us some valuable experience, meantime, we must have a clear understanding that it doesn't come true until we lead a way agreed to the situation of our country. Therefore, we expect further research in order to find a develop route for our commercial bank, that's a method which can bring us system and efficiency in a harmonious and uniform way.

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