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The Economic Institutions of Corporate Governance: A Comparative Study between Bank-based and Market-based Systems

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The institutions of corporate governance which can roughly be categorized into two distinct forms--market-based or arm's length and bank-based or relationship system--differ greatly in various respects such as financing pattern, corporate and individual risk taking behavior, regulatory and governance mechanisms. The effectiveness of those systems, therefore, depends greatly on how complementary institutions support the systems. This paper attempts to examine the systemic advantage embedded with the systems for dissemination information as well as economizing transaction costs. Based on our analysis the paper finds that the integrated monitoring in the bank-based system claims an advantage over market-focused system in disseminating information and reducing transaction costs.

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1. Introduction

The seminal contribution about separation of ownership and control in Modern Corporation is due mainly to Berle and Means (1932) who state that modern corporations are run by professional managers who are unlikely to be accountable to dispersed shareholders. Moreover, managers possess enormous latitudes to maximize their benefits at the expense of owners. This problem however, becomes severe when managers acquire more firm-specific knowledge and information than shareholders do (Chowdhury, 2003). The primary objective of corporate governance therefore, is to assimilate the objectives of both shareholders and managers towards enhancing firm's competitiveness.

In the traditional agency relationship, shareholders are dispersed and they are unable to take part in the firm's day to day operations (Jensen and Meckling, 1976). As a result, managers or agents hired by shareholder run the business. This creates an opportunity for conflict of interest in that managers' interest might deviate from that of shareholders. For instance, agents might be tempted to build their own empire, or exert below optimum level of efforts towards achieving firm's objectives or they enjoy perks that reduces firm's value. At this circumstance, the critical function of a financial system is to establish some institutions in the economy so that shareholders are assured that they would get their investment back as promised with due shares of profit. The mechanism by which the task is performed is called

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corporate governance. The institutional settings for corporate governance are different in different countries which roughly can be categorized into two distinct forms (though some overlapping is common between these two systems), market-based and bank-based governance systems which are embedded with their respective financial systems. Japan, German, and other continental European countries are widely known to be the followers of bank-lead or relation-based financial system whereas the United States and the United Kingdom follow security-market lead system or so-called transaction-based system (Aoki 1995, Wenger and Kesper 1998).

There is a line of difference, at the highest level of aggregation, between corporate governance and the financial system in that financial system comprises mainly the demand for and supply of financial services and the way which they are mediated including the aspects of corporate governance (Schmidt, Hackethal, and Tyrell, 1999). However, the segregation is not always fruitful because the efficacy of corporate governance depends largely on whether it is designed in such a fashion that fits comfortably with the underlying financial systems. Therefore, the evolution of bank-dominant and market-lead practices of corporate governance is embedded with their respective financial systems.

Each system, undoubtedly, has its own mechanisms for corporate governance with some inherent advantages as well as disadvantages. For example Main Bank (a lead bank that provides major percentage of a firm's borrowing) plays the crucial role of corporate governance in Japan as does Hausbank (German version of a main bank) in Germany. During its early period of economic growth Japan succeeded tackling governance problem to a great extent through Main Bank monitoring and so did Germany with its universal banking (Aoki and Patrick 1994, Vitols, 2003). As opposed to the Anglo-Saxon separation of finance and industry, bank-based system can be characterized as having long-term ties between banks and their client firms which have often been described as a growth enhancing (Weinstein and Yafeh, 1998). Moreover, the intermediation process the system is featured with is termed to serve the needs of developing and reforming economies better than anonymous capital markets modeled after the Anglo-American financial system. Managers in those countries, in general, are monitored by a combination of banks, larger corporate shareholders and other inter-corporate relationships.

However, this system is highly criticized on the ground that this relationship-based system generates organizational inefficiency by restricting competition and increasing information impactedness. Moreover, the cozy relationship that is derived by the system may impose huge burden to the society since markets are unnerved to play its due role towards efficiency-enhancing activities (Rajan and Zingales, 2003). In contrast, it is believed that Anglo-American capital markets are liquid and company ownership is not concentrated. Managers are supposedly monitored by an external market for corporate control and by board of directors that is usually dominated by outsiders. As a result, recent debate emerges surrounding the notion that bank-based corporate governance system is converging to the more Anglo-Saxon type of system placing shareholders primacy at the center (Hackethal, Schmidt, and Tyrell 2005, Vitols 2003, Schroder and Schrader 1998). On the other, collapse of American corporate giants such as WorldCom, Enron, and others marks a sharp question about the supremacy of market-lead corporate governance.

The justification of the evolution of intermediaries either in the form of market or bank can be attributed to the suffused existence of asymmetry of information in financial system without which they cease to exist (Leland and Pyle, 1977). Those intermediaries lessen the magnitude of information asymmetry between fund users and suppliers. Accordingly, a careful examination of corporate scandals across countries reveals that information asymmetry is at the centre with which corporate governance is preoccupied. Dispersed shareholders lack information about manager’s activities and future prospects of the firms which very often functions as obstacles of proper monitoring. Furthermore, monitoring is costly which sometimes does not justify many shareholders to undertake monitoring activities except large and concentrated holders. From this vantage point, it can be said that corporate governance purpose is best served when the system disseminates information among the interested parties as well as reduces monitoring costs or transaction costs.

In light of these two important parameters, the paper aims to examine the systemic advantages and disadvantages each system is part with. Although there are some researches available in the existing literature however, no significant study can be found which focuses on identifying systemic advantage of corporate governance comparing between bank-based and market-based system particularly focusing on the theoretical framework discussed in the paper. In this sense, the research has can contribute to the body of knowledge to the existing literature. The structure of this paper is: a theoretical framework is drawn in section two; section three discusses the methodology of the paper. Section four focuses on national characteristics of corporate governance in both banks based and market based system whereas section five examines the systemic advantage of those systems which is followed by a brief conclusion.

2. Theoretical Framework

2.1 Asymmetry of Information

The acquisitions and use of information properly is the supreme functions of every financial system (Allen and Gale, 2001). Nonetheless the centre-stage of the corporate governance is preoccupied with the theory of information asymmetry which implies that the information held by managers regarding the prospects of a firm, for example, is significantly higher than information held by principals who are the owners of a company. Shareholders are dispersed and a modern corporation is run by professional managers who are unlikely to be accountable to those shareholders (Berle and Means, 1932). However, the decisions undertaken by the former affects greatly the interest of the latter. It is however, not surprising that managers hold more information about the company than the shareholders. But this simple rule bears severe consequences when the persisting information gap is extensive along with managers increased tendency to utilize the opportunity of that information for maximizing their wealth at the expense of shareowners.

Stiglitz (1994) and Akerlof (1970) epitomize the theory of asymmetric information. Agents on one side of the market have much better information than principals which undermines Pareto optimality and efficient market hypothesis. Borrowers know more than the lenders about their repayment prospects that ultimately leads to adverse selection. CEO and the board know more than the shareholders about the profitability of the firm which is the core of agency problem. Policyholders know more than the insurance company about their accident risk which relates to moral hazard problems. Therefore, the symmetry of information in every sphere of transaction is perverse. Used car market and the market for “Lemon” which have been symbolized for assessing the problems of asymmetric information are widely known facts to the economists. Akerlof (1970) –who exemplifies those notions –introduces the first formal analysis of markets with the informational problem known as *adverse selection* and analyses a market for a good where the seller has more information than the buyer regarding the quality of the product. He argues that the information problem can either cause an entire market to collapse or contract it into an adverse selection of low-quality products. A key insight in his "lemon paper" is that economic agents may have strong incentives to offset the adverse effects of information problems on market efficiency.

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This information gap between two interested groups where decision taken by one greatly affects the interest of others is not equally likely in all financial systems and the effectiveness of the corporate governance mechanisms vary depending on the institutions that shape the rule of game. Market based financial system depends for information mainly on the market for corporate control since market is the reliable source of mediating the hidden information. This implicitly assumes that share price promptly reacts as soon as information is released and it seems no individual can gain abnormal profit for a long period of time by any private information. On the other hand, information flow from corporation to the stakeholders takes place through the large lenders such as banks or other institutional investors in the bank-based system because banks are presumably the large stakeholder.

2.2. Transaction Cost

The notion of transaction cost can be traced back as early as 1930s when Ronald Coase put forward the notion in his breakthrough and widely accepted article “the nature of the firm” (1937). Later this concept has been developed and widen to several branch of economics and finance. North (1990) and Williamson (1985) can be credited for advancing and developing the concept of transaction cost and bringing it for mainstream discussion as a unit of analysis. Though economists define organizations from various dimensions, for instance firm as a black box, production function, and nexus of contract, transaction cost economies however, considers firm as a governance process (Willimason, 1985). He states, “an accurate assessment of the economic institutions of capitalism cannot be reached if the central importance of transaction cost economizing is denied” (1985 pp.17). The mode of governance process for economizing transaction costs vastly depends on the state of the nature of transaction the firm is organizing and the nature of its underlying investment. The following table summarizes various state of nature that might exist in contract agreement for accomplishing a transaction.

Table 1: Attributes of the Contracting Process

Behavioral Assumption		Assets Specificity	Implied Contracting Process
Bounded Rationality	Opportunism		
No	Yes	Yes	Planning
Yes	No	Yes	Promise
Yes	Yes	No	Competition
Yes	***Yes***	***Yes***	***Governance***

Adapted from Williamson (1985)

In the first case when assets are specific (the invested assets which are specific to that transaction and their redeployable capacity is very insignificant) and agents are opportunistic (self-interest seeking with guile) but human beings are not constrained with bounded rationality, contingencies involved with the contract are settled in ex-ante and the contract execution problems thus never arise and planning is the necessary form to economize transaction cost. Therefore, no governance is necessary. Assuming a situation where economic agents possess bounded cognitive reasoning power –contract cannot encompass all contingencies ex-ante as a result –and transactions are supported by specific assets, but agents are not opportunistic, promise by the contracting parties can solve the ex-post conflict. Where assets specificity does not exist but agents are opportunists and under bounded rationality, competition can solve the governance problems. However, each of this system fails when agents are subject to bounded rationality, suffering from opportunism and asset specificity arises. This is the state of governance and the world with which transaction cost economies is concerned (Williamson, 1985).

Human bounded rationality concept is highlighted in the work of Herbert Simon who concludes that human behavior is “intendedly rational, but only limitedly so” (1961 p xxiv). Cognitive power that each individual possesses is obviously limited to a great extent, therefore, the neo-classical behavioral assumption about human cognitive ability is rarely held in reality. Simon (1961) clearly refutes the notion and establishes limitation of human calculative and imaginative power assumption. On the other hand, many scholars have already contemplated agent’s opportunistic behavior in the contract and logically proved it from different viewpoints (Jensen and Meckling, 1976). Another landmark work of Williamson makes the notion clear. He states “the possibilities that economic agents will lie, cheat and steal are admitted. The possibility that an economic agent will conform to the letter but violate the spirit of an agreement is admitted. The possibility that economic agents will deliberately induce breach of contract and will engage in other forms of strategic behavior is admitted” (1993, p 101).

Another element of governing variables is asset specificity. Regarding this aspect, Alchian (1984 pp.38-39) postulates “the whole rationale for the employer-employee status, and even for the existence of firms, rests on assets specificity; without it there is no known reason for firms to exist.” Therefore, the basic assumptions on which transaction cost economics relies on are met in reality. However, the possibility that every individual is not continuously or even largely subject to opportunism is carefully noted in the literature of transaction costs. In the existing literature there are some controversies regarding what comprises the transaction cost. For example, neoclassical economists are preoccupied with the assumption that transaction costs are part of total production costs (North, 1990). Accordingly, Arrow (1974) defines transaction cost as the cost of running an economy, which is seemingly very vague. In contrast, Williamson (1985) opines that transaction costs are to be distinguished from production costs which he classified as *ex-ante* and *ex-post*. *Ex-ante* costs involve with searching for the potential counterparts, negotiating and finalizing the contract. On the other hand, *ex-post* costs include cost of overseeing and monitoring in every step of contract execution and resolving conflicts arising from any breach of terms and conditions. Even if this seemingly definition of transaction cost is from economic parlance, this however, resembles to the notion of corporate governance. Here essential cost includes mostly *ex-post* type of cost.

There exists a vast array of literature which focuses on a comparative study between bank-based system and the market-based system of monitoring and governance. The current study however, differs from the existing study in that the existing research performs the comparative analysis from the perspective of new institutional economics specially it attempts to analyse comparative advantage each system possesses in terms of economizing on transaction cost by reducing asymmetry of information. Despite the paper has attempted to cover literature and data from most influential countries covering market-based and bank-based system, the research mainly focuses on Japan-German as an example of bank-based system and England and USA as examples of market-based system. However, there are other countries which also follow either of the system but differ characteristically little bit from the mainstream analysis of both systems. These differences are not taken into account in this paper. That is a major limitation of the research. However, since their influence on the respective system of monitoring and governance is very little, the inference drawn in this study based on the analyses are therefore not affected.

3. Methodology

The research is a theoretical study which relies on the existing study. Or on other words, the research is a survey based study on the existing literature. As a theoretical framework, the research describes institutional economics with particular attention on asymmetry of information and transaction cost economics. In so doing, the research extensively focuses on literature of transaction cost theory including the pioneering works of Ronal Coase, Douglass North, and Oliver Williamson. Review of this theory helps identify the elements and economic drivers of transaction costs and how they affect the national financial system in general and corporation governance in particular. At the same time, the research carefully reviews the literature on asymmetry of information. The epoch making work of Jospeh Stiglitz and George Akerlof are carefully reviewed to examine the nature and causes of asymmetry of information and their associated problems. Based on this theoretical framework, the research first identifies the characteristics of institutions for corporate governance widely practices in developed countries bifurcating into bank-based system and market-based system. It then discusses the comparative advantages of these institutions in attenuating asymmetry of information problem and reducing transaction costs.

4. Mechanisms of Corporate Governance

The financial system is viewed as a set of institutions at the center of the monetary economy that mediates the savings and investment between non-financial sectors of the economy. Banks and markets thus, compete with one another as alternatives for mediating that flow of funds (Vitols, 2003). Postwar German and Japan represented distinctive versions of non-liberal capitalism embedded in, and managed through, their respective national institutional settings. Although differing from one another in numerous ways, German and Japanese capitalism also differ substantially from the Anglo-American model of capitalist economy and seemingly violates core prescriptions of neo-classical economic theory. One of the key features of the system that differs fundamentally from that of Anglo-Saxon model of corporate finance is that the supreme power to mediate funds rests on banks. However, in the market-based system, banks dominating role toward the non-financial firms are likely to be absent and market will fill the gap instead.

It is evident from Table 2 that Japan and German financial systems are categorized as credit-based because banks are given enormous latitudes to undertake the corporate governance role. For example, the universal bank or *hausbank* in German and main bank in Japan can be known as the largest outside fund providers with a large share of long-term loans at fixed interest rate. They are the prime sources of corporate finance not only as major lenders but also large shareowners or block-holders in the form of *Keiretsu* (Japanese term which means corporate industrial group) in Japan and pyramidal conglomerate holding companies in Germany (Jackson, 2003). However, the role played by dispersed shareowners, where applicable, is not clear but believe to be insignificant because corporate shareholdings by a single individual shareholder is too limited to justify any major initiatives undertaken by that particular individual to bring the managerial discretion in a corrective manner. Therefore, dissemination of information from the corporation is undertaken by banks.

Table 2: Major institutional arrangements

		Japan	German	USA
Financial system	Major allocation mechanism	Credit-based	Credit-based	Capital market-based
	Regulation	(Formerly)Strict separation	Universal banks	(Lenient)Separation
Corporate governance	Major mechanism	Keiretsu, Main banks, Government guidance	Hausbank system, strong banks and insurer	Active shareholders, investment banks etc.
Labor/Industrial relations	Allocation mechanism	Internal labor market	External and internal labor market	External labor market

Adapted from Pascha, 2004

These corporate characteristics are seemingly lacking in the Anglo-American market-based financial system where each individual is assumed to exercise power towards corporation since they are the major shareowners and bank-lending is relatively insignificant to non-financial firms compared to the bank-based economies. Moreover, institutional arrangements are such that each individual shareowner is encouraged and empowered by law to instigate any corrective measures against managers and therefore, minority interest is highly protected. These traits of the market economy ensure liquidity of the security markets; consequently market for corporate control is supposed to perform substantial corporate governance role.

Another contrasting feature of market based-financial system as opposed to the bank-based system is the ownership structure of listed firms. In the case of Germany, the blockholder-ownership structure of German firms used to overlap with relations to banks, suppliers, and sometimes even customers. Thomsen at el (2006) show that the average level of blockholder ownership in German firms between 1990 and 1998 was 58 percent which was 5 times higher than the 12 percent blockholder ownership prevalent in US firms at the same time. The typical corporate governance in Germany is that supervisory board oversights the activities executed by the management board for all publicly listed companies. German banks usually have power to select members for seats in the supervisory board since they are the major stakeholders. Moreover the proxy voting arrangement that empowers banks besides their direct shareholdings give them adequate leeway to overly dominate in the supervisory board and company decisions are allegedly made in favor of banks. Somewhat similar features of corporate governance are common to Japanese firms. Corporate decisions are typically influenced by Main Bank. Moreover, *keirtesu* networking is seemingly stable that hinders market to function properly. Consequently hostile takeovers and other market mechanisms are absent as means of corporate governance in those countries.

However, hostile takeovers and other market-driven forces are very apparent in Anglo-Saxon countries and stock market plays extremely important roles (Schroder and Schrader, 1998). From this vintage point, standard economic theory considers the market for corporate control as the most important remedy. Because when a firm's management deviates too far from the value maximizing principles, some outside investors can gain control over the firms and replace incumbent management. Market type of organization, moreover, is acclaimed because of its greater possibilities of ensuring proper and adequate level of competition and henceforth ensures free flow of information. However, this severe competition for superior performance allegedly makes managers myopic and short-sighted and they intend to maximize short-term benefits sacrificing firm's long-term prospects. O‟Sullivan (2000) contends that US corporate managers have proclaimed that the prime responsibility of the corporation is to increase the value for shareholders. Managers in return for maximizing shareholders wealth receive ample amount that sometimes are "exorbitant" rewards whereas most other corporate employees experience lower earnings and employment instability.

This predominant feature of corporate behavior along with extensive role of the stock market for mediating information and hence corporate finance characterize market oriented US system of corporate governance. Bank-based system, on the other hand, seemingly assures long-term prospects of the firm since the nature of financing and business activities are such that managers are more prone to secure long-term gains for the stakeholders in contrast to the Anglo-Saxon shareholders profit maximization objectives.

5. The Systemic Advantage

Each and every system, undoubtedly, claims its uniqueness and deserves some merits that make it viable for efficient conduit of funds from savers to investors. This process however, heavily requires the need for mediating information with keeping transaction costs as low as possible. Transactions involving investible funds between investors and an industrial firm undertaking a business projects entails a substantial degree of information asymmetry as well as imperfections (Aoki, 1995). Investors might not be well informed regarding firm's technological capabilities and innovation potentiality as well as marketing opportunity which define the outcome of the projects. Moreover, the funds provided to the firms for specific projects managers promised to use are under managerial discretion and the deviation of manager's efforts for their empire building is not unlikely. Thus, the supply of financial resources requires a substantial level of commitment information collection by investors before and after the actual investment as well as their participation in controlling the firms. To tackle those problems, information flows from the managers to the fund providers are extremely important.

In the case of bank-based economies, banks are the largest fund provider both in the form of lending and shareholdings. They undertake the necessary screening and monitoring functions to ensure the proper utilization of the funds, consequently, it is crucial for those banks to collect important information about the firm's prospect and potential future risks to increase the likelihood of their money get back. Banks information collection through direct intervention in Germany and Japan seems to be quite effective on the ground that a clear and committed relationship between banks and their client firms is highly likely by their continuous interactions in the transaction process. As the largest creditors and shareholders, the main bank has definite interest in assuring sound management of the company through their mutual interactions that eases main banks to collect information of the firms on a regular basis which, therefore, enables them to carryout effective monitoring of its management. In Japan, Aoki (1994) terms this kind of banks monitoring as integrated system because three-stage monitoring – ex-ante, interim and ex-post – is performed by main banks in their lending and screening process. This integrated monitoring cedes banks extra advantage over the situation when each and every stage of monitoring is performed by several different bodies

Table 3: Three stages of monitoring

Stage of monitoring	Function	Associated problems	Market-based monitoring	Bank-based monitoring
Ex-ante	Project evaluation, credit analysis	Adverse selection, co-ordination failure	Investment banks, Venture capital. Commercial banks	Integrated monitoring by banks
Interim	Watching the management operation of the firm	Moral hazard	Rating agency, board of directors,	
Ex-post	Verification of financial statements and apply punitive and corrective action	Commitment	Law, market for corporate control	

Adapted from Aoki, 1994.

It is likely that information necessary for interim monitoring is substantially influenced by the information already collected for ex-ante monitoring and the resultant interdependence between interim and ex-post is inevitable corollary because of intertwined nature of information. Therefore, when this three-stage monitoring is performed as integrated system, obviously the screening and monitoring process will be more competitive especially in respect of information collection as compare to the market-system where one stage of information and monitoring does not necessarily facilitates later-stage information gathering process. Aoki (1994) argues that integrated monitoring might reduce incentives for the firm to conceal or misrepresent information to the main banks, particularly at the interim stage. The main bank has the option of imposing weak or heavy penalties on management depending upon the magnitude of the fraud. Consequently, firms become fair in respect of their information disclosure to the main banks because they are likely to rescue at firms financial distress.

As has been described above, the level of interaction between shareholders and managers in the bank-based system is much more intense than it is in the market-based financial system. This intense interaction or called “complex web” of relationship-capitalism generates a free, constant, and heavy flow of information. Moreover the investment horizon of this relationship capitalism is longer than the short-sighted market capitalism since selling shares to the market means the impairment of relationship and trust. Where the dominant shareholders have a long-term horizon, they are however, less interested in short-term dividend signals as a source of information since any asymmetric information will eventually be revealed regardless of the firm’s dividend policy. This arguments is supported by Dewenter and Warther (1998) who contend that lower level of information asymmetry and agency conflict in Japanese firms suggest that dividends do not act as a signal of information or as a disciplinary mechanism, and that Japanese managers need not to fear adjusting dividends in response to signal the firms current and future earnings. They further argue that analysis of the frequency of the dividend changes indicates that Japanese managers initiate and omit dividend more frequently than their US counterparts. Therefore, the functioning of dividend policy as a crucial measure for information disclosure in market-dominant financial system implies that information asymmetry is more pronounced.

In the same token, conclusion can be drawn that German bank representation on company supervisory boards is arguably mediate more information from the firms to the banks and reduce asymmetry of information. However, the lead banking system in Germany like the main bank in Japan means that banks understand the business and personnel of the firms to which a particular bank is leading (Edwards and Fischer, 1994). Accordingly, Baums (1994) affirms that German banks are seen as being much more closely involved with the firms they supply funds to than banks are in market oriented systems. He further argues that financiers typically have less information about firms than the entrepreneurs and managers. In German lead-bank system, where banks hold both equity and debt furnishes those banks with means to control the behavior of a borrower and its management more effectively than is possible as being mere creditors.

Most of the literatures on the importance of asymmetric information are preoccupied with the reaction of financing pattern of the firms. For example, information asymmetry determines the cost and mode of financing, *ceteris peribus,* such as whether the firms should seek for bank fiancé, from new security issues, or from internal finance. When information symmetry is very severe, because not only that information flow is uneven but also the nature of information is such that individual is hard to understand specially when it is knowledge specific project, certain classes of borrowers may find it prohibitively expensive to obtain financing by directly issuing new equity in the open market. Moreover bank finance is also unlikely in that circumstance because no matter how lofty the borrowing rate, banks are strongly unwilling to disburse loans to borrowers whose business information is unclear to them. Therefore, in the presence of asymmetry of information, it can be concluded that internal finance is more common than external source of funds.

Despite some strong criticism against bank-lead governance system such as lack of competition and relation-specific financing, the advantage the system possesses is more pronounced and obvious specially resolving information asymmetric problem. However, the fact is that the suffused publicly available information released by market mechanism is, perhaps, less prevalent in the bank-based system, but for private information banks are able to acquire considerable amounts more than released to the markets (Allen and Gale, 2001). In contrast, bank-based system disseminates information through the stock market and increase efficiency by ensuring fierce competition among the players. Moreover, the strong ties allegedly inherent with the bank-lead governance is presumably absent in that arrangement because market is quite efficient justifying the notion “survival for the fittest” through the Adam Smith’s invisible hands. Therefore, any attempt to rescue moribund firms at the cost of nation is unlikely. No individual has seemingly dominant power over the market occupied with private information and shareholders are very active in corporate governance activities since independent directors elected by shareholders dominate in the boards instead of banks supervisory authority followed in the bank-based system. Such an arrangement is ensured by rules and institutions. Allen and Gale (2001) argues that market system where there are large number of publicly listed firms with strict disclosure requirements implies that enormous information about firm's activities is released with much of this released information is reflected in the stock prices.

Stiglitz (1994) however, challenges the value of information released by the stock market and argues that information revealed by the stock market is of limited value either in the design of incentive structures or in the allocation of investment. Moreover one of the principle tasks of managers is to obtain specialized information required to make such investment decisions. It seems implausible that those who speculate in the stock market would have much to add to the information of the firm's managers. Indeed, decisions within the divisions of the firm occur without the aid of the information provided by the market (Stiglitz, 1994). It seems that relationship financing can better mediate the information from the firms that need finance to the providers of that finance than market does, especially at the catching up stages of the economy. However, this does not mean that bank-based system is superior to market-based system as a whole but better information dissemination is more pronounced in the former case.

For effective and efficient corporate governance that fits with country's existing financial system, it may rely either on pure market or in other intermediaries such as banks depending on where transaction cost economizing is highly likely. In this respect, information costs and the costs of implementing the governance system might be economized in the relationship financing because relationship generates trust among the players which keeps the system lubricated in absence of which costs might be necessary and banks integrated monitoring and screening supposedly impose less burden than if the tasks are performed through various different set of arrangements. Because once the main bank or *Hausbank* performs the screening task for a specific institution, other small organizations do not necessarily need to perform the similar jobs when they finance to the similar firms; rather they can easily rely on the lead-banks screening and hence save costs. On the other hand where individuals and institutions are supposed to do the similar job with some costs, it is not socially beneficial to mediate this transaction with this form. Consequently bank-lead system's cost savings probability is more obvious than does the market-lead transactions. Moreover, with anecdotal facts it is logical to conclude that relationship transaction generates trust that in turn thwarts opportunism.

Transaction costs of ex-ante and ex–post type can be segregated, for example, the former is the cost of drafting, negotiating, and safeguarding an agreement. This can be done with a great deal of care, in which case a complex document is drafted in which numerous contingencies are recognized and compliance with the contract by all parties is essential. Otherwise the document can be very incomplete and easy to breach the contract. However, the parties can bridge the gap as and when the contingency arises. Williamson (1985, Pp. 20) argues, "rather than contemplate all conceivable bridge crossing in advance, which is a very ambitious undertaking, only actual bridge crossing choices are addressed as event unfolds". He further contends that there are many instances that participants can devise more satisfactory solutions to their disputes than can be done by professionals applying general rules on the basis of limited knowledge of the disputes. So, the legal costs as a part of total transaction costs are seemingly more pronounced in the market type of transaction than relationship financing.

In sum, the transaction costs treat the evolution of organizational-form as strategy in the search for and success in realizing a superior technological or production regime. Specially, the theories of the firm conclude that inter-firm alliance is superior organizationally, not merely that it economizes on transaction costs but it also thwarts opportunism which also incurs substantial transaction cost. Therefore, operation of market costs something and forming an organization & alliance transaction cost can be saved

6. Conclusion

This paper, simply, attempts to explore the idea of corporate governance from two different perspective namely transaction cost economizing and information symmetry problem and finds that relationship transaction is at the core of the financial mediation in the bank-centered capitalism whereas markets undertake this basic role of mediation through the market mechanisms in the market capitalist countries. However, the relation that acts as a social lubricant derives much acclaim for information flow and lessens the opportunism that in turn reduces transaction costs of which markets are yet to cope with. This issue is critical for developing nations because financial fragility is closely related to financial contagion. When a financial system is fragile a small shock can have a big effect. The shock may be spread by contagion. A financial crisis may rage out of control and bring down the entire economic edifice. Markets might have certain advantages over banks specially ensuring competition and encouraging individual to assume risk but to make the system efficacious, perfect and competitive markets are strongly required.

However, there is a sharp critic for the bank-based system that is who will monitor the monitors? Obviously the enormous latitudes of banks power should be constrained through effective monitoring by higher authority such as ministry of finance or stronghold of central bank. In so doing, financial system can enjoy a smooth flow of funds from savers to investors offsetting some social loss generated from strong relationships by deriving merits from disseminating optimal information and economizing transaction costs. Moreover, making substantial information publicly available undermines risk sharing probabilities by various classes of investors which is very crucial when the economy is functioning at relatively lower level of development.

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