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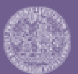

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Cross-Border Risk Transmission by a Multinational Bank

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Abstract: A model of international banking, with a stress on manager human-capital (borrower monitoring) and majority-shareholder human capital (manager auditing) is constructed to study the impact of exogenous shocks in one country on credit creation in another. I show that the presence of the two cited categories of non-transferable skills in banking technology reduces the role of the standard portfolio-diversification motive in the cross-border transmission of disturbances. At the same time, this bank-specific market friction creates a separate channel of shock propagation, a function of bank shareholder and manager incentives. It can even happen that the impact of an exogenous shock on credit has a different sign in the “relationship” as opposed to the “arm’s-length” banking environment. This phenomenon, caused by the marginal effect of the human-capital management in the bank operation, is present in those bank branches with relatively small loan volumes. When the loan volume is large, the direction of the reaction of the manager-auditing bank to shocks abroad is the same as that of an arm’s-length lender.

JEL classification: F37, G21, G28, G31

Keywords: multinational bank, managerial effort, audit, credit, foreign shock

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