in bank capital and the supply of loanable funds.[115] Rising stock markets increase the capital base of Japanese banks, and hence their supply of loanable funds. Similarly, falling stock markets decrease the supply of loanable funds. While the issue of bank ownership of commercial firms, and vice-versa, arises periodically, especially in the U.S., where the Japanese system is held up as a model by those who favour direct linkages between banking and commerce, the relationship between stock prices and bank capital tends to be ignored.[116] Anyone prescribing a closer banking-commerce link must carefully consider the effects on bank capital and loanable funds of movements in the stock market.

In addition, allowing banks to hold equity increases the risk that they bear, especially if their holdings are not well diversified.[117] The increased risk of bank failure is enhanced by the presence of a deposit insurance system. Even though Japan has never had a bank failure, bank equity links in other countries could lead to excessive risk taking, depending on the banks' abilities to manage their portfolios.[118]

A benefit attached to the corporate ownership structure and banking relationships in Japan is the reduced costs of financial distress.[119] For a firm experiencing financial difficulty, other companies within the *keiretsu* often assist

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[115] See R.W. Wright, "Japanese Financial Flows to Canada", in *Japanese Finance in Transition: Implications for Canada,* The Canada-Japan Trade Council, Ottawa, 1993, pp. 36-7; Bank for International Settlements, *op. cit.*, p. 91; and S.B. Kim and R. Moreno, "Stock Prices and Bank Lending Behaviour in Japan", in *Economic Review,* No. 1, Federal Reserve Bank of San Francisco, San Francisco, CA, 1994, pp. 31-42.

[116] See, for example, R.J. Pozdena, "Why Banks Need Commercial Powers", in *Economic Review,* No. 3, Federal Reserve Bank of San Francisco, San Francisco CA, 1991, pp. 18-31; and L.J. Mester, "Banking and Commerce: A Dangerous Liaison?", in *Business Review,* Federal Reserve Bank of Philadelphia, Philadelphia, PA, May-June 1992, pp. 17-29.

[117] For a full discussion, see A.B. Frankel and J.D. Montgomery, *op. cit.*, pp. 293-4.

[118] Although Japan has never had a bank failure, bank regulators have overseen the transfer of deposits, including those exceeding the maximum coverage limit of deposit insurance, from failing banks to other banks. See H.S. Scott and S. Iwahara, *In Search of a Level Playing Field: The Implementation of the Basle Capital Accord in Japan and the United States,* Occasional Paper No. 46, Group of Thirty, Washington, D.C., 1994, p. 8.

[119] See, for example, W.C. Kester, *op. cit.*, p. 7; A.B. Frankel and J.D. Montgomery, *op. cit.*, p. 287; and J.B. Treece and K.L. Miller, "If the Japanese Were Running G.M.", in *Business Week,* McGraw-Hill Inc., New York, NY, January 27, 1992, p. 32.