
Finance (Basics)

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Structure of lectures

- 1.Introduction to finance - ok
 - 2.Financial markets - ok
 - 3.Banks and bank systems - now
 - 4.Other financial institutions;
 - 5.Current value of money;
 - 6.Private finance;
 - 7.Investments;
 - 8.Corporate finance;
 - 9.International finance;
 - 10.International financial system;
 - 11.Macroekonomic and financial indicators and information;
 - 12.History of financial science;
 - 13.Latest trends on financial markets.
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Banks (and other financial institutions)

- Banks are financial institutions that accept deposits and make loans.
 - Included under the term banks are companies such as commercial banks, savings and loan associations, mutual savings banks and credit unions.
 - Banks are the financial intermediaries that the average person average with most frequently.
 - A person who needs a loan to buy a house or a car usually obtains it from a local bank.
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Banks

- Banks are the largest financial intermediaries in our economy, they deserve the most careful study.
 - However, banks are not the only important financial institutions.
 - In recent years other financial institutions such as insurance companies, finance companies, pension funds, mutual funds, and investment banks have been growing at the expense of banks, and so we need to study them as well.
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Banking and the management of financial institutions

- Because banking play such a major role in channeling funds to borrowers with productive investment opportunities, this financial activity is important in ensuring that the financial system and the economy run smoothly and efficiently.
 - Banks provide loans to businesses, help with financing college education or the purchase of a new car or home, and provide us with services such as checking and savings accounts.
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The Bank Balance Sheet

- Balance sheet = a list of the bank's assets and liabilities.
 - Total assets = total liabilities + capital
 - A bank's balance sheet lists sources of bank funds (liabilities) and uses to which they are put (assets)
 - Banks obtain funds by borrowing and by issuing other liabilities such as deposits
 - Then use this funds to acquire assets such as securities and loans.
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The Bank Balance Sheet (liabilities and assets)

■ Liabilities

- ❑ Checkable deposits...are bank accounts that allow the owner of the account to write checks to third parties
- ❑ Non-transaction deposits...are the primary source of bank funds (60% of bank liabilities)
- ❑ Borrowings...bank obtain funds by borrowing from FED (US), other banks, and corporations.
- ❑ Bank capital...the final category on the liabilities side of the balance sheet, which equals the difference between total assets and liabilities(10%).

■ Assets

The Bank Balance Sheet (liabilities and assets) II.

- Liabilities

- Assets

- Reserves (reserve funds)...all banks hold some of the funds they acquire as deposits in an account.
 - Cash items in Process of collection (suppose that a check written on an account at another bank is deposited in your bank and the funds for this check have not yet been received from the other bank)
 - Deposits at Other Banks (many small banks hold deposits in larger banks in exchange for a variety of services, including check collection, foreign exchange transactions, and help with securities purchases)
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The Bank Balance Sheet (liabilities and assets) III.

- Liabilities

- Assets

- ...

- ...

- Securities...a bank's holdings of securities are an important income-earning assets (25% of bank assets and they provide commercial banks with about 10% of their revenue)

- Loans...banks make their profits primarily by issuing loans (60% of bank assets are in the form of loans and produce generally more than half of bank revenues)

- Other assets...the physical capital (buildings, computers, and other equipment) owned by the banks is included in this category

Capital Adequacy Management

- ROA (Return on Assets)
 - A basic measure of bank profitability is the return on assets (ROA), the net profit after taxes per CZK (USD,..) of assets.
 - $ROA = \text{net profit after taxes} / \text{assets}$
- ROE (Return on Equity)
 - Basic measure of bank profitability, the return on equity (ROE), the net profit after taxes per CZK of equity (bank) capital.
 - $ROE = \text{net profit after taxes} / \text{equity capital}$
- EM (Equity multiplier)
 - There is direct relationship between ROE and ROA. This relationship is determined by the so-called equity multiplier, which is the amount of assets per CZK of equity capital.
 - $EM = \text{assets} / \text{equity capital}$
 - $ROE = ROA \times EM$

Summary

- The balance sheet of commercial banks can be thought of as a list of the sources and uses of bank funds. The bank's liabilities are its sources of fund, which include checkable deposits, time deposits, discount loans, borrowings from other banks and corporations, and bank capital. The bank's assets are its uses of funds, which include reserves, cash items in process of collection, deposits at other banks, securities, loans and other assets.
- Banks make profits through the process of asset transformation: They borrow short (accept deposits) and lend long (make loans). When a bank takes in additional deposits, it gains an equal amount of reserves; when it pays out deposits, it loses an equal amount of reserves.
- Off-balance-sheet activities consist of trading financial instruments and generating income from fees and loan sales, all of which affect bank profits but are not visible on bank balance sheets. Because these off-balance-sheet activities expose banks to increased risk, bank management must pay particular attention to risk assessment procedures and internal controls to restrict employees from taking on too much risk.
- Question:
 - Rank the following bank assets from most to least liquid: Commercial loans, securities, reserves, physical capital

Banking Industry: Structure and Competition

- The operations of individual banks (how they acquire, use, and manage funds to make a profit) are roughly similar throughout the world.
 - In all countries, banks are financial intermediaries in the business of earning profits.
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Historical Development of The Banking system (US)

- The modern commercial banking industry in the United States began when the bank of North America was chartered in Philadelphia in 1782.
 - With the success of this bank, other banks opened for business, and the American banking industry was off and running.
 - Figure
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Figure: Historical Development

Bank of North America
is chartered

Bank of the United
States is chartered

Bank of the United States
charter is allowed to lapse

Andrew Jackson vetoes rechartering
of Second Bank of the United States;
charter lapses in 1836

1782

1791

1811

1816

1832

1863

1913

1933

Second Bank of United
States is chartered

Federal Reserve Act of 1913
creates Federal Reserve System

National Bank Act of 1863
establishes national banks
and Office of the Comptroller
of the Currency

Banking Act of 1933
creates Federal Deposit
Insurance (FDIC) and
separates banking and
securities industries

Bank – credit and debit cards

- In the Czech Republic we have three types of cards- credit, debit, charge
 - Charge card
 - Credit card
 - Debit card
 - Electronic banking...lower the cost of bank transactions by having the customer interact with an electronic banking facility rather than with a human being.
 - One important form of an e-banking facility is the ATM (automated teller machine), an electronic machine that allows customers to get cash, make deposits, transfer funds from one account to another, and check balances.
 - 24 hours a day
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Investment Banks

- Investment banks are best known as intermediaries that help corporations raise funds
 - Investment bank...is not a financial intermediary that takes in deposits and then lends them out
 - In addition to underwriting the initial sale of stocks and bonds, investment banks, also play a pivotal role as deal makers in the mergers and acquisition area, as intermediaries in buying and selling of companies, and as private brokers to the very wealthy.
 - Well-known...Morgan Stanley, Merrill Lynch, Goldman Sachs
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Investment Banks II.

- One feature of investment banks that distinguishes them from stockbrokers and dealers is that they usually earn their income from fees charged to clients rather than from commissions on stock trades.
 - These fees are often set as a fixed percentage of the dollar size of the deal being worked.
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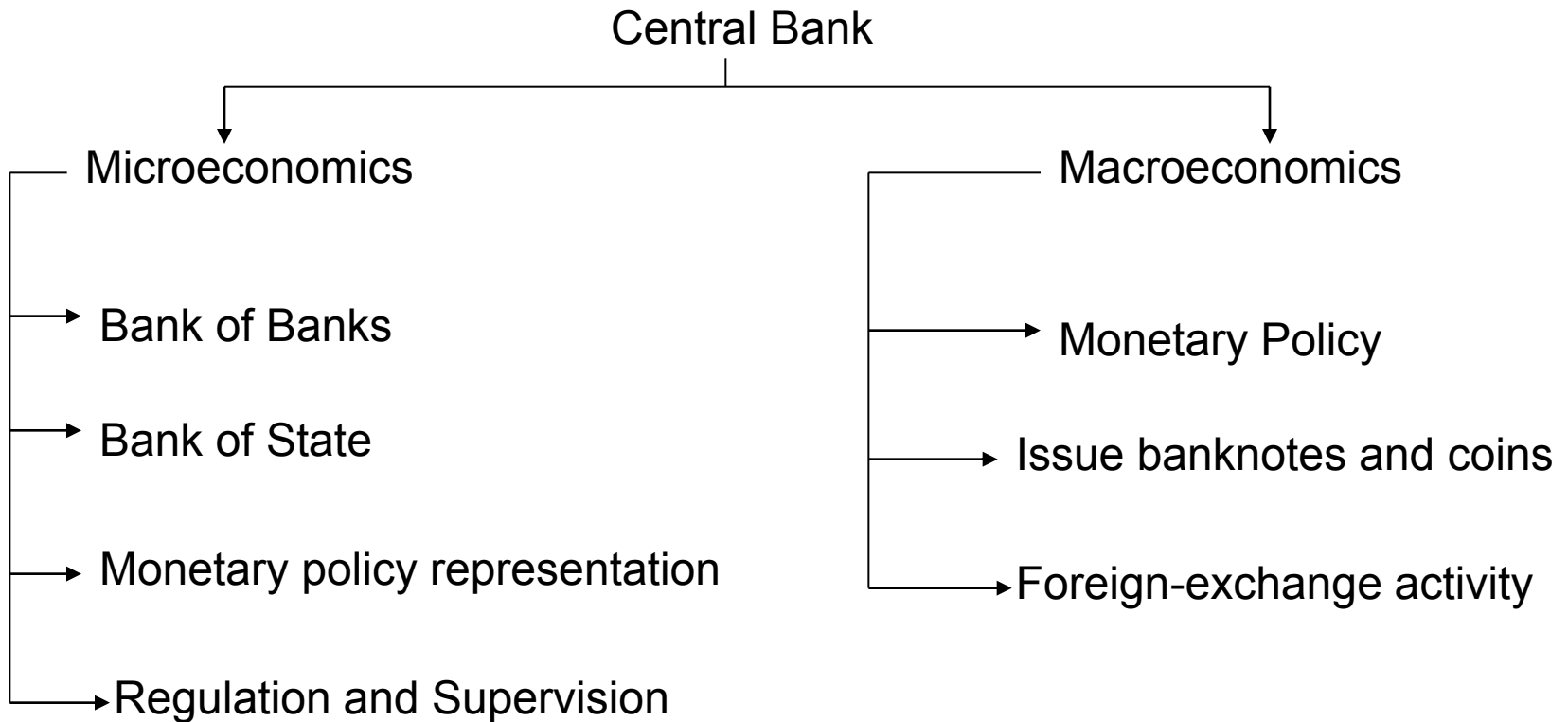
Banking System Classification

- Banks are financial institutions that accept deposits and make loans
 - Banking system presents complex of all banks in one country and relationships between them
 - You can differentiate between the one-tier and the two-tier banking system
 - A hierarchical, subordinate relationship when the central bank occupies the first tier and the others (commercial banks, pension funds, building societies) are on the second tier (one-tier or two-tier?)
 - You can differentiate between universal banking system and specialized banking system
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Banking System

- Banks are financial institutions that accept deposits and make loans
 - Deposit...the liability owed by the bank to its depositor; money given in advance to show intention to complete the purchase of a property; to put money in a bank, as for safekeeping or to earn interest
 - Loan...an arrangement about lending money when the customer agrees to pay the money back after a certain period of time, with some interest
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Central Bank and its function



Central Bank and its Function

- Control and formulate monetary and fiscal policy
 - Issue banknotes and coins (sole right)
 - Store reserves
 - Handle government borrowing
 - Act as the other banks' bank (lender of last resort)
 - Set and control interest and exchange rates
 - Do business with international institutions (e.g. IMF)
 - Conduct money transfer to other countries
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CNB (Czech National Bank)

- The CNB is the central bank of the Czech Republic and the supervisor of the Czech financial market.
 - It is established under the Constitution of the Czech Republic.
 - Under Article 98 of the Constitution of the Czech Republic and Act No. 6/1993 Coll., on the Czech National Bank, as amended, the primary objective of the CNB is to maintain price stability.
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CNB...its mission

- To maintain low and stable inflation
 - To ensure smooth circulation of money and smooth payments
 - To oversee the stability of the financial system
 - To support the balanced and smooth development of the Czech financial market
 - Through monetary policy CNB seeks to achieve price stability and thereby maintain confidence in the value of money and the exchange rate of the Czech koruna
 - By supervising the financial market, issuing prudential rules and conducting financial market operations we care for the stability and development of the financial system and protect its clients
 - By managing the clearing system and issuing banknotes and coins we ensure smooth payments and cash flows
 - They administer the foreign exchange reserves of the Czech states
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The types of the financial institutions

- Commercial banks (clearing)
 - Merchant banks
 - Building societies (US: Thrifts)
 - Pension funds
 - Insurance companies
 - Credit Unions
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- Commercial banks accept deposits, make loans and provide services both to the members of the public and to the corporate clients while
 - Merchant banks only cater for the corporate clients with the same services
 - Building societies take mortgage loans and deposits by offering current accounts to members
 - Pension funds earn interests and dividends from the accumulated funds and sometimes part of banks or
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- Insurance companies...loan out funds and invest in government securities or shares
 - Credit unions...co-operatively owned by members who are given loans, chequebooks, life assurance etc.
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Nonbank finance

- Banking is not the only type of financial intermediation you are likely to experience.
 - You might decide to purchase insurance, take out installment loan from a finance company, or buy a share of stock.
 - Insurance
 - Pension
 - Mutual funds
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- Thank you for your attention
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