

BA 311 – MONEY AND BANKING

WELCOME TO BA311!

Ed Barton, JD CFA CPA

Chief Financial Officer & General Counsel at Saint Martin's University & Assistant Professor – School of Business

20+ years of finance, accounting & legal experience following service as an Engineer Officer (USA, ARNG, USAR)

BBA – Finance – Notre Dame

MBA – Operations Management – Syracuse University

JD – Focus in Business and Constitutional Law – Northwestern California University

Contact Info for SMU Lacey Campus

ebarton@stmartin.edu

306-438-4534

Office Hours Tues 8:30 – 10:00 AM (OM 206) and after class

WELCOME TO BA311!

We will primarily use Moodle to communicate

Syllabus Overview

Participate/Cooperate & Graduate

Reading intensive

Writing Intensive

Focus on General Concepts

LEARNING OUTCOMES

- LO.1** Understand Key Elements of the Financial System -Including Money and Banks
- LO.2** Understand the key roles that financial institutions play in the financial system – particularly central banks

WHAT IS FINANCE?

Finance is concerned with decisions about money (cash flows)

Finance decisions deal with how money is raised and used

Everything else being equal:

- More value is preferred to less.
- The sooner cash is received, the more valuable it is.
- Less risky assets are more valuable than (preferred to) riskier assets

CONWAY'S MAXIM

“Money has a time value. Time has a money value”

-Dr. Paul Conway

GENERAL AREAS OF FINANCE

Financial Markets and Institutions

Investments

Financial Services

Managerial Finance

FINANCE IN NON-FINANCE AREAS

- All areas of business—marketing, management, accounting, production, information systems, and so forth—are affected by general finance concepts.
- All of us – business and individuals – are impacted by the money, banking and economic systems.

COMPONENTS OF THE FINANCIAL SYSTEM

There are two key components to the
Financial System:

- Financial Markets
- Banks

FINANCIAL MARKETS

Two Primary Financial Markets:

- Currency Markets
- Securities Markets

WHAT ARE SECURITIES?

- Stocks – represent ownership in a company. Also known as “equity securities”
- Bonds – represent debt. Also known as “fixed income securities”

WHAT DO FINANCIAL MARKETS DO?

- Match Savers and Investors
- Allow Risk Pooling or Risk Sharing
- Facilitate Diversification for Investors
- Create an Efficient Pricing Mechanism for Securities and Currency – Reduce Asymmetric Information

WHAT IS ASYMMETRIC INFORMATION?

Generally – One party to a transaction knows more information than the other.

Key Elements Include:

- Adverse Selection
- Moral Hazard

WHAT ARE SECURITIES MARKETS?

- Stock Markets - Domestic and Foreign
- Bond Markets – Domestic and Foreign, Sovereign, Municipal, Corporate
- Commercial Paper
- Options Markets (in some definitions)
- Private placement markets (“create a market”)

“BANKS”

Banks (or “commercial banks” or “traditional banks”) are financial institutions that have two characteristics:

- Accept Deposits
- Make Loans

Several types of “banks”

- Commercial Banks
- Savings & Loans/Thriffs
- Credit Unions

WHY DO WE HAVE BANKS (OR OTHER
FINANCIAL INTERMEDIARIES)?

Indirect Finance – Banks “transform” the deposit into capital

Direct Finance – Company accesses capital markets directly

Reduce Adverse Selection

Reduce Moral Hazard

IMPACTS OF BANKS ON THE ECONOMY - SAVINGS

Savings generally drive economic growth.

- Capital looks for returns
- High return/high NPV projects are funded
- Efficiency is gained, profits are increased, wealth is created

World Bank Study (Research Working Paper 4469 - 2008) shows a statistically significant causality between efficient and robust financial markets and economic growth.

Central Planning and Government Allocation of savings and investment tends to impact both wealth creation and wealth distribution.

WHAT IS MONEY?

Efficient means of exchanging value.

- Agreed to medium of exchange
- Easier to exchange than goods and services in a barter economy (“double coincidence of want”)
- Serves as a common unit of account
- Serves as a durable store of value

TYPES OF MONEY

Two predominant types of money?

- Commodity Money
- Fiat Money

FINANCIAL RISK AND MONEY

Why does money have any value at all?

- Because people believe it does
- When this belief fails – financial crises ensue

Some countries have given up their own money due to these concerns (Dollarization or Currency Pegs)

Other countries have banded together for a common currency (European Union) to facilitate trade, investment and stability

HOW DO WE SPEND MONEY?

The Payment System is made up of multiple elements

- Currency
- Checks
- Electronic Payments (ACH, wire)
- Stored Value Cards
- Debit Cards
- E-Money (PayPal, Bitcoin, etc)
- Credit Cards (not in the money supply – a loan)

WHO ACTS IN THE PAYMENT SYSTEM?

- Consumer
- Consumer's Bank
- Clearing mechanism (ACH, Fedwire System, Card Networks) (“the rails”)
- Seller's Bank
- Seller

HOW DO WE MEASURE MONEY IN THE ECONOMY?

The Money Supply

- M1 – Currency, checking accounts and traveler's checks (about 20% of the money supply)
- M2 – Savings accounts, small CD's, money market mutual funds (about 80% of the money supply)

HOW DO WE MEASURE MONEY IN THE ECONOMY?

The Money Supply

- M1 – Currency, checking accounts and traveler's checks (about 20% of the money supply) – most liquid (cash & cash equivalents)
- M2 – Savings accounts, small CD's, money market mutual funds (about 80% of the money supply) – less liquid (may have transaction costs to turn to M1)

WHO IS IN CHARGE OF THE BANKING
SECTOR & MONEY SUPPLY?

The Federal Reserve (US Central Banking System)

- Clear Payments
- Set Monetary Policy – amount of M1 & M2 in the system – we will talk a fair bit about this ☺
- Emergency lender for banks (and others – 2008)
- Regulation of the banking system