

Level: master one

## 21

## Financial institutions

Lesson 05

## A

## Types of financial institution

These are a student's notes from a lecture about banking.

For most of the 20th century, most banks operated in one country only (in the US, in one state only). Different kinds of banks did specialized kinds of financial business:

- Retail banks or commercial banks worked with individuals and small companies:
  - received deposits
  - made loans. (See Unit 20)
- Investment banks worked with big companies:
  - gave financial advice
  - raised capital – increased the amount of money companies had by issuing stocks or shares and bonds
  - organized mergers and takeover bids.
- Insurance companies
  - provided life insurance and pensions.
- Building societies
  - specialized in mortgages. Many have now become normal commercial banks.

**bonds:** debts that pay interest and are repaid at a fixed future date (see Unit 33)

**merger:** when two or more companies join together (see Unit 39)

**takeover bid:** when one company offers to acquire or buy another one (see Unit 39)

**stocks or shares:** certificates representing one unit of ownership of a company (see Unit 29)

BrE: merchant bank; AmE: investment bank

BrE: retail bank, commercial bank, High Street bank; AmE: retail bank, commercial bank

BrE: building societies; AmE: savings and loans associations

## B

## Deregulation

The financial industry changed radically in 1980s and 90s when it was deregulated.

- Before **deregulation:** rules and regulations in the US, Britain and Japan prevented commercial banks doing investment banking business. Some other countries (Germany, Switzerland) already had universal banks doing all kinds of financial business.
- Today: many large international **conglomerates** offer a complete range of financial services. Individuals and companies can use a single financial institution for all their financial needs.

**deregulated:** there are now fewer restrictions and regulations than before

**conglomerates:** companies formed by mergers and takeovers (see Unit 40)

## C

## Specialized banks

Other types of banks still have specialized functions:

- **central banks** issue currency and carry out the government's financial policy
- **private banks** manage the assets of rich people or **high net worth individuals**
- **clearing banks** pass cheques and other payments through the banking system
- **non-bank financial intermediaries** such as car manufacturers, food retailers and department stores now offer products like personal loans, credit cards and insurance.

21.1 Find words in A and B opposite with the following meanings.

- 1 a company offering financial services
- 2 the money a company uses, raised by way of shares and bonds
- 3 when two formerly separate companies agree to join together
- 4 a company formed by the merger or takeover of several other companies
- 5 the ending of some rules and restrictions
- 6 when a company offers to buy the shares of another company to gain control of it

21.2 Before financial deregulation, which types of financial institutions did these types of business? Look at A opposite to help you.

- 1 arranging mergers
- 2 offering life insurance
- 3 issuing shares and bonds
- 4 providing mortgages
- 5 receiving deposits and making loans to individuals and small companies
- 6 giving financial advice to companies
- 7 organizing (or defending against) takeover bids
- 8 providing pensions

21.3 The extracts below are from websites. Which types of banks do the websites belong to? Look at A and C opposite to help you.

- 1 The Federal Reserve was founded by Congress in 1913 to provide the nation with a safer, more flexible, and more stable monetary and financial system.
- 2 We provide a full range of products and services, including advising on corporate strategy and structure, and raising capital in equity and debt markets.
- 3 How can we help you? We can:  
Build a long-term, one-to-one relationship with your banker.  
Manage your family's diverse business and personal assets.  
Build a portfolio tailored to your family's unique needs.  
Play an active role in managing your assets.
- 4 Nearly twelve million cheques and credits pass through the system each working day. Cheque volumes reached a peak in 1990 but usage has fallen since then, mainly owing to increased use of plastic cards and direct debits by personal customers.
- 5 Why bank with us? Because we offer:
  - a comprehensive range of accounts and services
  - over 1,600 branches, many with Saturday opening
  - free withdrawals from over 31,000 cash machines
  - online and telephone banking for round-the-clock access to your accounts

**Over to you**



Does your company use more than one bank? Do you? Why?

## A

## The money markets

The **money markets** consist of a network of corporations, financial institutions, investors and governments, which need to borrow or invest **short-term** capital (up to 12 months). For example, a business or government that needs cash for a few weeks only can use the money market. So can a bank that wants to invest money that depositors could withdraw at any time. Through the money markets, borrowers can find short-term **liquidity** by turning assets into cash. They can also deal with irregular **cash flows** – in-comings and out-goings of money – more cheaply than borrowing from a commercial bank. Similarly, investors can make short-term deposits with investment companies at **competitive** interest rates: higher ones than they would get from a bank. Borrowers and lenders in the money markets use banks and **investment companies** whose business is trading **financial instruments** such as stocks, bonds, short-term loans and debts, rather than lending money.

## B

## Common money market instruments

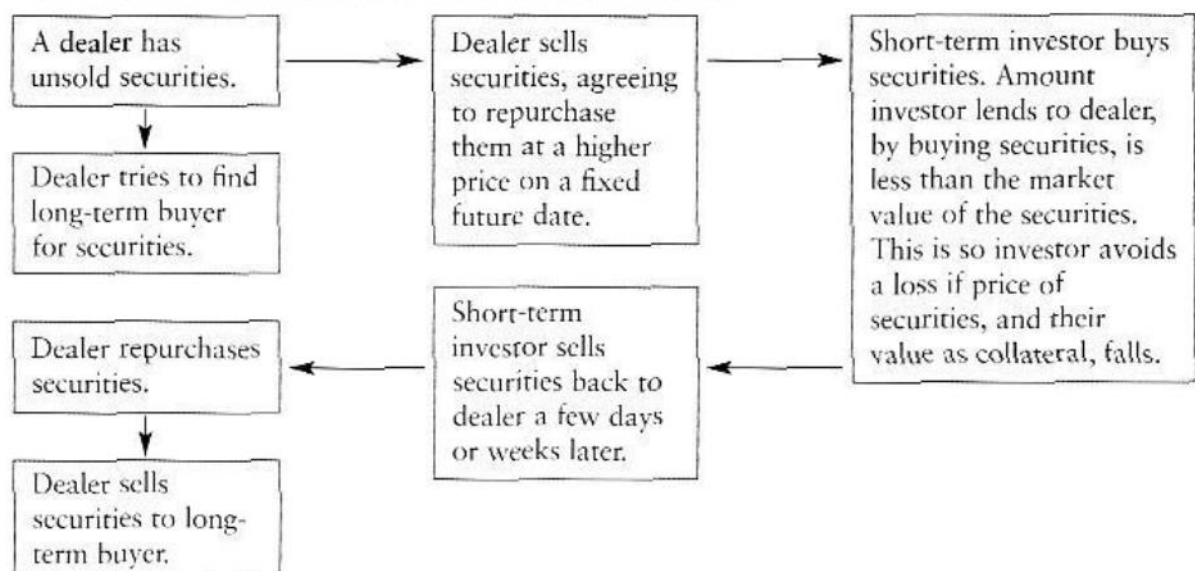
- **Treasury bills** (or T-bills) are bonds issued by governments. The most common **maturity** – the length of time before a bond becomes repayable – is three months, although they can have a maturity of up to one year. T-bills in a country's own currency are generally the safest possible investment. They are usually sold at a **discount** from their **nominal value** – the value written on them – rather than paying interest. For example, a T-bill can be sold at 99% of the value written on it, and **redeemed** or paid back at 100% at maturity, three months later.
- **Commercial paper** is a short-term loan issued by major companies, also sold at a discount. It is **unsecured**, which means it is not guaranteed by the company's assets.
- **Certificates of deposit** (or CDs) are short- or medium-term, interest-paying **debt instruments** – written promises to repay a debt. They are issued by banks to large depositors who can then trade them in the short-term money markets. They are known as **time deposits**, because the holder agrees to lend the money – by buying the certificate – for a specified amount of time.

Note: **Nominal value** is also called **par value** or **face value**.

## C

## Repos

Another very common form of financial contract is a **repurchase agreement** (or **repo**). A repo is a combination of two transactions, as shown below. The dealer hopes to find a long-term buyer for the securities before repurchasing them.



25.1 Are the following statements true or false? Find reasons for your answers in A and B opposite.

- 1 Organizations use the money markets as an alternative to borrowing from banks.
- 2 Money markets are a source of long-term finance.
- 3 All money market instruments pay interest.
- 4 Certificates of deposit are issued by major manufacturing companies.
- 5 Commercial paper is guaranteed by the government.
- 6 Some money market instruments can have more than one owner before they mature.

25.2 Match the words in the box with the definitions below. Look at A and B opposite to help you.

cash flow	competitive	discount
liquidity	maturity	par value
redeemed	short-term	unsecured

- 1 a price below the usual or advertised price
- 2 adjective describing a good price, compared to others on the market
- 3 the ability to sell an asset quickly for cash
- 4 (in finance) adjective meaning up to one year
- 5 adjective meaning with no guarantee or collateral
- 6 repaid
- 7 the length of time before a bond has to be repaid
- 8 the movement of money in and out of an organization
- 9 the price written on a security

25.3 Match the two parts of the sentences. Look at B and C opposite to help you.

- 1 Most money market securities
  - 2 A treasury bill is safe because it
  - 3 Commercial paper
  - 4 Certificates of deposit (CDs)
  - 5 Repurchase agreements (repos)
- a is issued by corporations, so it is riskier than T-bills.  
b are short-term, liquid, safe, and sold at a discount.  
c is guaranteed by the government.  
d are short-term exchanges of cash for securities.  
e are issued to holders of time deposits in a bank.

### Over to you



What kind of money market instruments are you familiar with? Which ones would be most useful for your company, or for a company you would like to work for?

## A

**Market opportunities**

If you have a brilliant idea for a new product or service, or a better or cheaper way of supplying an existing product or service, you will probably require finance: money to start up a company to take this **market opportunity**, or to expand an existing company. If you want to interest venture capitalists (see Unit 28) in your project, you will have to write a **business plan**.

Business plans begin with a summary, often called an **Executive Summary**, which explains in one or two pages:

- what sort of company it is
- what the product or service is, and what is special about it
- who the managers are
- how much money you need, and what you will use it for.

## B

**The company, the product and the market**

If the company already exists, the first chapter of the business plan explains how it was started and how it has grown, and gives a history of sales and profits. It describes the company today, and the plans for the future.

The second chapter describes what you already sell or want to sell. It explains what differentiates the product or service from other existing ones – what makes it different or **unique**. It focuses on the **benefits** or advantages for customers – how it will improve people's lives!

The chapter on the market describes the industry you operate in, the market segments, the other firms in the market (your competitors), changes in the industry, and **projected trends** – forecasts for the future – and technological opportunities. It outlines what the customers need, where they are, and how you plan to reach them. It explains how you will make sure that customers know about your product or service and why they will prefer it to the competition. It gives details of your **marketing strategy**, including sales tactics – the ways you plan to achieve sales, advertising, publicity and **sales promotions** – incentives to encourage customers to buy.

The chapter on the management team gives details about the most important staff. The chapter on strategy outlines your strategies for marketing, pricing, distribution, sales, etc., and how you are going to **implement** them or carry them out.

## C

**The financial analysis**

The financial analysis gives details of the historical performance, if it is an existing company, and describes existing finance and assets. It explains why the business needs funds, and gives **sales forecasts** (the sales the business expects to achieve in a particular period of time), projected or expected financial statements (profit and loss account, cash flow statement, and balance sheet), and projections for future income. It will probably include a breakeven analysis, and an analysis of financial ratios.

Various appendices can come at the end of the business plan, including the **curriculum vitae (CV)** of each top manager and promotional materials for your products.

BrE: curriculum vitae; AmE: résumé

50.1 Make word combinations using a word from each box. Then use the word combinations to complete the sentences below. Look at A and B opposite to help you.

implement  
reach  
require  
supply

customers  
finance  
services  
strategies

- 1 Are you sure you can ..... these ..... more efficiently than your competitors?
- 2 This business plan gives details of the ..... we ....., and what we're going to do with it.
- 3 We'll hire two experienced managers to help us ..... our .....
- 4 We're convinced our innovative advertising will allow us to ..... our potential .....

50.2 Complete the sentences. Look at A, B and C opposite to help you.

- 1 We're convinced this is a great ..... : people will really want what we plan to offer.
- 2 Our ..... is over 100,000 units a year.
- 3 The product is ..... : there's absolutely nothing else like it on the market.
- 4 Our ..... is essentially to advertise a lot and sell at a very low price.
- 5 The advertising will stress the ..... the consumers will get from the product – how it will save them time and money.
- 6 We'll also use a few ....., such as giving away free samples or offering discounts.

50.3 Use the words below to make word combinations with 'market' that have appeared in this book. Then sort the word combinations: which are concerned with finance and which with marketing?

bear                      value

capitalization                      stock

currency                      skimming

equity                      share

maker                      segment

over-the-counter                      price

secondary                      primary

penetration

market

### Over to you

If you were starting up a new company, what product or service would it offer? What would you include in your business plan to try to convince venture capitalists to invest?

Level: master one

## Investing

What is investing?

Investing is a way to have your money work for you. Rather than hide your money in a safe or under your mattress, you can put that money to work at a bank or a business.

### Growing Your Money

The main goal of investing is to grow your money. For example, when buying stock in a company you hope that the company will be successful and the stock will be worth more in the future than it is today.

### Risk vs. Reward

Most all investments have some risk. You could end up with less money in the future than you do today. Some investments are riskier than others, but usually the more risk you are willing to take, the more money you could make.

For example, a federally insured CD with a bank is not very risky. The bank promises to pay you a certain percentage over a given amount of time. Even if the bank goes out of business, your money may be insured by the federal government. This sounds great, except CDs today only pay a few percent each year. This isn't a lot of return on your investment.

A higher risk example would be stock in a new technology company. If this company takes off, your money might go up 10 times in the next few years. However, the company could also go out of business, making the stock worthless and you would lose all your money.

### Types of Investments

There are a lot of types of investments. Here are a few of the more common investments people make:

**Stocks** - Stocks represent ownership in a company. You can buy stock in all sorts of companies like Coca Cola, Apple, and Wal-Mart. The hope is that the company will be profitable and grow. Then the value of the stock will go up and your money will grow, too.

**Mutual Funds** - Mutual funds are like stocks. A mutual fund represents a group of stocks. When you buy a mutual fund you are investing in a group of stocks. This is a way to invest in a number of different stocks, but not have to buy a bunch of individual stocks.

**Bonds** - A bond is sort of like a loan. When you buy a bond you are lending your money to a company or government. Bonds can pay higher interest than a bank account, but also come with more risk.

**Real Estate** - A lot of people invest in real estate. This can be buildings or land. The biggest investment many people make is when they buy their home.

**Bank** - One of the most conservative investments is with the bank. This might be with a savings account, a money market account, or a CD. With the bank you get some security, but the return is low.

Gold - Precious metals such as gold are often used as investments.

What does diversify mean?

One thing that many financial advisors will tell people is that they should diversify. This means to invest in a variety of areas. Rather than put all of your money into one stock, invest in a variety of investments such as stocks, bonds, and mutual funds.