Essence of banking

Kaltrina Shkodra

Abstract

Financial systems perform the essential economic function of channeling funds from units who have saved surplus funds to units who have a shortage of funds[1]. The units who have saved can lend funds: they are known as lender-savers. The units with a shortage of funds must borrow funds to finance their spending: they are the borrower-spenders.
In direct finance, borrower-spenders borrow funds directly from lenders in the financial markets by selling them securities. In indirect finance, a financial intermediary stands between the lender-savers and the borrower-spenders: the intermediary helps to transfer funds from one to the other.
Another important function of a financial system is the monetary function. The introduction of money into the economy enables savers and spenders to separate the act of sale from the act of purchase and allows them to overcome the main problem of barter, which is the 'double coincidence of wants' (each of the two parties involved in a transaction has to want simultaneously the good the other party is offering to exchange).
From a structural point of view, a financial system can be seen in terms of the entities that compose the system. A financial system comprises financial markets, securities and financial intermediaries.
Financial markets[2] are markets in which funds are moved from people who have an excess of available funds (and lack of investment opportunities) to people who have investment opportunities (and lack of funds).

Keywords: financial system, banking, financial market.

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