FINANCE 1

Keywords

- Financial system: comprised of financial institutions, markets and instruments/securities which enable the provision of financial services, financial contracting and exchanging assets & risk
  - Organises and coordinates the interactions (flow of funds) between surplus and deficit units,
- Finance: studying financial decision-making under uncertain conditions and regarding RA
- Financial innovation: process of improving the provision of financial services by increasing their efficiency (lowering cost, improving range and convenience)
- Transaction: arrangement b/w buyer and seller to exchange asset/service for payment
- Settlement: when value/purchasing power and title transfer (not necessarily at same time as transaction)
- Primary market: arranges issues of new security (issuers hire investment banks to sell securities)
- Secondary market: trading in existing securities (institutions provide trading services, e.g. stock market) → assist primary markets by providing liquidity (cash out), investors likely to buy new securities if they believe they can be sold in liquid/active secondary market, price discovery to work out value, develop supply of investment funds

Financial Function

Arranging settlement of commercial transactions

- Main aim is to promote efficiency of commercial transactions by using low-cost & reliable payment instruments
- Performed by banks and not markets
- Domestic and internationally
- E.g. means of exchange include money and other methods of payment/settling transactions

Promote flow of funds/arranging financing

- Movement of funds from surplus to deficit units within the financial system to attempt to improve the efficient use of funds depending on risk involved → seeks parties who can give fund suppliers higher returns than they would have achieved by retaining their funds and financial system must assess the level of risk that can be accepted when matching suppliers to deficit units
- Surplus units: possess savings (income>outlay during a certain period) → supply funds via bank deposits, superannuation contributions, retained earnings, budget surplus
- Deficit units: demand funds (income<outlay) to meet expenditure
- Participants may alter between being a deficit and surplus unit
- Function performed by:
  - Arranged via transactions in financial markets/direct financing: deficit units raise funds directly from surplus units typically from issuing securities (contracts tradeable in financial markets which are issued by deficit to surplus units to raise funds equal to price which indicate the promised returns & obligations → asset. Quantity & unit, price, date, payment/settlement terms)
  - Arranged through financial institutions/indirect financing: deposit-taking institutions act as intermediary which borrows from surplus units and lends to deficit units → two contracts between intermediary and each of surplus/deficit unit which is a promise/commitment for which the law remedies should there be a breach

Mismatch in Preferences (surplus/deficit)

- Return on/Cost of funds: high/low