

6.3 Some exercises on aspects of banking

1.

Why are bank promises considered to be almost as good as money, when your promises, or mine, are not?

Response

This question was posed to draw attention to the remarkable nature of banking, which is essentially the conversion of promises into money. Possible responses might include the following points:

- banks are generally better known than individuals, and promises from known entities are more acceptable than promises from unknown entities
- it is commonly assumed that banks are monitored and highly regulated, and are therefore less likely to issue promises which they cannot pay. A firm which buys largely on a cash basis would suffer little from the loss of its creditor records, and a firm which sells largely on a cash basis would suffer little from the loss of its debtor records.

2.

Most of the large modern banks were founded in the 19th century and established themselves in grand, impressive local buildings. Some recent banks have been established with only an internet presence. Comment on the change in customer mentality that has allowed this development.

Response

This question draws attention to the extraordinary degree of trust involved in banking operations. Before such trust was widespread in the community, it was necessary for banks to prove that they could be trusted with deposits from the general public, and one way of doing this was to have a visible and imposing local presence.

It is a testament to public trust or gullibility – or to the effectiveness of banking regulation and confidence in legal process – that many members of the public seem quite happy to give their money into the hands of people whom they have never seen, and whose whereabouts may be anywhere in cyberspace.

3.

Explain the importance of reliable banking arrangements for the efficient conduct of business.

Response

Possible responses might include the following points:

- the relative security of holding bank promises as against holding cash – if you hold cash, anyone may rob you; if you hold bank promises, only the bank may rob you
- ease and speed of transfer – it is easier and faster to transfer bank promises than it is to transfer cash
- with relation to the point above, the faster a firm can obtain payment, the less investment it requires to set up and stay in business.