

## What Does Finance Mean? Its History, Types, and Why It Matters

### What Is Finance?

Finance is all about dealing with money—managing it, creating it, and understanding how it works in the real world.

It's the system behind credit, debt, investments, and the whole idea of using what you have now to pay for things later.

One of its big ideas is the “**time value of money**”: money today is more valuable than money tomorrow because you can invest it, earn interest, and watch it grow.

Can be split into three main groups:

- **Public Finance:** This is the government's side of things—taxes, budgets, government spending, and even how they borrow money.
- **Corporate Finance:** This covers how businesses handle their money, including assets, debts, and making profits.
- **Personal Finance:** This is about your own money—budgeting, saving, insurance, mortgages, and planning for retirement.

There are also special areas like **behavioral finance**, which digs into the psychology behind why we make certain financial decisions.

### Public Finance?

Public finance deals with everything government-related: from tax systems and budgets to government spending and debt. It's all about managing the money of a whole country, including borrowing (like taking loans or issuing bonds) to keep things running.

### What About Corporate Finance?

For businesses, finance is about managing money for growth. Companies handle assets, liabilities, revenue, and debt. Whether it's taking out loans, issuing stocks, or using lines of credit, good financial management helps companies expand.

### And Personal Finance?

This is the everyday side of finance. It covers how you manage your income, pay your bills, save for the future, buy insurance. Make smart choices

## Financial Jargon Terms

- **Asset:** Something valuable that you own (like cash, property, or stocks).
- **Balance Sheet:** A snapshot showing a company's assets, debts, and overall net worth.
- **Cash Flow:** The money moving in and out of your pocket or a business.
- **Compound Interest:** Interest calculated not just on the original amount, but also on the interest already earned.
- **Equity:** What you own in a company—stocks are sometimes called “equities” because they represent ownership.
- **Liability:** What you owe—debts or other financial obligations.
- **Liquidity:** How fast you can turn an asset into cash (real estate, for example, isn't very liquid).
- **Profit:** The leftover money after expenses have been paid.

## Early Presence of Finance

- **Ancient Beginnings:**
  - **Sumerians & Babylon:** Around 1800 BCE, the Babylonian Code of Hammurabi set rules for things like land ownership, labor, and credit (yes, they even had loans with interest!).
  - **Cowrie Shells & Coins:** In China, cowrie shells were used as money by 1200 BCE, and later, metal coins came into play. King Croesus of Lydia (modern-day Turkey) was one of the first to mint gold coins around 564 BCE.
  - **Roman Temples as Banks:** In ancient Rome, temples stored money because priests were trusted, and they even lent money out!

- **Stocks, Bonds, and Options:**

- The first exchange is said to have started in Antwerp in 1531.
- The East India Company in the 1600s was the first public company to sell stock and pay dividends.
- The London Stock Exchange got formal in 1773 (though its roots go back to the Royal Exchange of the 1570s), and the New York Stock Exchange followed soon after in 1793.
- The earliest known bond dates to 2400 BCE—a stone tablet that recorded a promise to repay grain.
- Governments have been borrowing money for ages: think of the Bank of England in the 1600s or the U.S. issuing Treasury bonds during the Revolutionary War.

- **Early Options:**

An interesting tidbit from history is about the philosopher Thales. As told by Aristotle, Thales once secured the rights to all the olive presses in Chios and Miletus, betting on a bumper olive harvest. This is an early form of options trading!

## **Advances in Accounting**

Calculating interest the “smart” way wasn’t a modern invention either. Ancient Babylonians even had a term for “interest on interest.” Fast forward to medieval times, and you see the roots of modern accounting:

- **Leonardo Fibonacci** wrote “Liber Abaci” in 1201, comparing compound and simple interest.
- **Luca Pacioli’s** 1494 book was the first full-on guide to bookkeeping.
- Later on, authors like William Colson (1612) and Richard Witt (1613) further popularized compound interest calculations.

- The concept of life annuities, which mixed interest rates with survival rates, started popping up in England and the Netherlands in the late 1600s.

## **Different Types of Finance**

### **Public Finance**

This covers the money management on a country's scale. Governments use taxes, borrowing, fees, and even fines to keep things running smoothly and address market failures.

### **Corporate Finance**

For companies, finance is all about raising money, whether by taking loans, issuing stocks, or selling bonds. A firm might use these funds to expand, acquire other companies, or improve operations. Examples include everything from small startups getting angel investments to giant corporations issuing IPOs.

### **Personal Finance**

On the personal side, finance is about budgeting, planning for big purchases, buying insurance, and saving for retirement. It's the everyday management of your money—making sure you're not overspending and that you're setting aside enough for future needs.

### **Social Finance**

This is the part where money meets social good. It's all about investing in social enterprises or initiatives that bring both financial returns and positive social outcomes. Think microfinance for small business owners or social impact bonds that pay off only when certain social goals are met.

### **Behavioral Finance**

Ever wonder why people sometimes make odd financial decisions? Behavioral finance digs into that. It explores the psychology behind money moves, explaining things like why we might stick to a "money jar" for fun but still rack up credit card debt, or why everyone seems to rush into the same investments during a market frenzy.

Some key ideas include:

- **Mental Accounting:** How we compartmentalize our money (and sometimes not in the smartest ways).
- **Herd Behavior:** Following the crowd, even when it might not be the best idea.
- **Anchoring:** Sticking to a reference point that might not make sense anymore.
- **Overconfidence:** Thinking we're better at picking stocks than we really are.

Scholars like Daniel Kahneman, Amos Tversky, Dan Ariely and Richard Thaler have been major influencers in showing how our minds can skew financial decisions.

## **Finance vs. Economics**

While finance and economics are closely linked, they focus on different things. Economics tends to look at the big picture—how whole countries or markets perform and how policies affect them. Finance zooms in on the nuts and bolts of money management for individuals, companies, or specific industries. In practice, they overlap a lot, but each has its own way of explaining why and how money moves.

## **Roles in Finance**

- **Accountant/Auditor:** Keeping track of money and making sure everything adds up.
- **Banker:** From commercial bankers working with businesses to investment bankers helping companies raise money.
- **Capital Manager:** Helping companies decide where to invest their cash.
- **Lender:** Managing loans and mortgages.
- **Market Analyst:** Predicting trends and advising on financial moves.

Salaries vary widely.

## **Finance vs. Accounting**

- **Accounting** is all about keeping the books—tracking daily cash flows, expenses, and income.
- **Finance** is broader, dealing with everything from budgeting to investments and even risk management. Accounting is a domain of finance.

## What is Money?

### Definition:

Money is a system of value that facilitates the exchange of goods in an economy. It serves as a medium of exchange, a store of value, and a unit of account, helping to eliminate the inefficiencies of barter trade.

### Key Points:

- Money reduces transaction costs compared to barter systems.
- It historically originated from commodities like grain and livestock.
- Modern money includes fiat currency, money substitutes, and digital currencies.
- Standardized currencies are controlled by central banks.
- Cryptocurrencies possess some monetary properties but are not widely adopted for daily transactions.

### How Money Works:

- Money acts as an intermediary good, solving the *double coincidence of wants* problem in barter trade.
- Early forms included agricultural commodities, cowrie shells, and metals.
- Over time, money evolved from physical goods to abstract representations like coins, paper notes, and digital records.

- Cigarettes were used as currency in World War II prisoner-of-war camps due to their widespread demand and easy divisibility.

## Properties of Money

For money to be effective, it must have these five key properties:

1. **Fungibility:** Each unit must be interchangeable with another of the same value.
2. **Durability:** Money should withstand multiple transactions without degrading.
3. **Portability:** It must be easy to carry and transfer.
4. **Recognizability:** The authenticity and value should be easily identifiable.
5. **Stability:** Its supply should remain relatively constant to prevent value fluctuations.

## Uses of Money

1. **Medium of Exchange:** Used to buy and sell goods and services.
2. **Unit of Account:** Helps track prices, profits, and economic changes over time.
3. **Store of Value:** Retains purchasing power for future transactions.
4. **Standard of Deferred Payment:** Facilitates credit and debt transactions.

## Types of Money

### 1. Market-Determined Money:

- Emerges naturally in markets due to convenience.
- Historically included precious metals like gold and silver.
- In cashless environments, goods like cigarettes or instant noodles act as money.

## **2. Government-Issued Currency:**

- Standardized money regulated by governments (e.g., printed notes and coins).
- Recognized as *legal tender*—must be accepted for debts and payments.
- Governments benefit from *seigniorage* (profit from money issuance).

## **3. Fiat Currency:**

- No intrinsic value but backed by the government's stability.
- Central banks control its supply for economic stability.
- The IMF and World Bank monitor global currency exchanges.

## **4. Money Substitutes & Fiduciary Media:**

- Representations of money, such as banknotes or digital transactions.
- Banks historically issued *bills of exchange* as claims to stored money.
- Risks: *Fractional reserve banking* can lead to bank runs if withdrawals exceed reserves.

## **5. Cryptocurrencies:**

- Digital, decentralized, and not issued by any government.
- Have some properties of money but lack widespread acceptance.
- Examples: Bitcoin, Ethereum (El Salvador has recognized Bitcoin as legal tender).



# Understanding Accounting Principles and Market Valuation

## Introduction

Accounting principles play a crucial role in how businesses report their financial health. This report explores key accounting concepts such as **historical cost accounting**, **fair value accounting**, and **cash basis accounting**, using real-world examples to illustrate their implications.

## Historical Cost vs. Fair Value Accounting

A wool-producing business serves as an example to compare two major accounting methods:

- **Historical Cost Accounting:** Assets (such as sheep and land) are recorded at their original purchase price, regardless of market fluctuations. For eg, if a business buys sheep for \$1m and land for \$1.2m, these values remain on the books unless an alternative valuation method is applied.
- **Fair Value Accounting:** Assets are periodically re-evaluated based on market conditions. If the market price of sheep rises to \$2 million due to a shortage, and the land value increases to \$2 million due to development opportunities, these updated values can be reflected in financial statements.

Both methods are legitimate, but fair value accounting provides a more dynamic representation of a company's financial status. Regulatory bodies, such as the **Financial Accounting Standards Board (FASB)**, prefer fair value reporting where possible.

## Cash Basis Accounting and Business Profitability

Another important concept discussed is **cash basis accounting**, where transactions are recorded when cash is received or paid. While this method is simple and used by many businesses, it can lead to fluctuations in reported profitability.

This highlights the importance of **accrual accounting**, which records transactions when they occur, rather than when cash is exchanged, providing a clearer picture of a company's financial health.

## **Mark-to-Market Accounting**

# **Report on Banking, Financial Trends, and Daily Insights**

Banking has evolved from a simple exchange system in medieval Italy to a global financial network holding trillions in assets. While banks facilitate economic growth, their shift from long-term financial security to short-term profit maximization has led to instability, notably seen in the 2008 financial crisis. Alternative financing models, including credit unions, crowdfunding, and microcredits, are now gaining traction as ethical alternatives.

## **The Role and Evolution of Banking**

Originally designed to simplify trade and finance, banks emerged as risk managers, lending money at higher interest rates than they offer to depositors. Over time, financial institutions took on more complex, sometimes risky practices, leading to economic crises. The 2008 collapse highlighted the dangers of unchecked speculation, resulting in tighter regulations but also resistance from the banking sector.

Alternative financing models now challenge traditional banking. Credit unions prioritize member benefits over profits, crowdfunding empowers individuals to fund projects directly, and microcredit programs provide small loans to help entrepreneurs in developing nations.

## **Personal Observations and Experiences**

### **Academic and Professional Growth**

- Interest in foreign currency assets and India's role in digital public infrastructure suggests an evolving awareness of global finance.

- Studies in computer science at MIT Manipal, coupled with an ambition to excel in the field, indicate a drive toward integrating technology with finance.
- Exposure to research projects and complex concepts like quasiparticles and self-healing polymers points to curiosity beyond immediate coursework.

## **Social and Daily Life**

- University life includes academic struggles, social dynamics, and personal reflections on friendships and interactions.
- The balance between productivity and leisure is a recurring theme, with moments of high motivation juxtaposed against procrastination.
- Significant events, like birthdays, group study sessions, and spontaneous outings, shape emotional experiences, ranging from excitement to disappointment.

## **Reflections on Personal Finance and Future Trends**

- Observations on price hikes, digital payment systems, and corporate financial dealings suggest an awareness of how financial systems impact daily life.
- The increasing role of AI and automation in finance could align with academic pursuits, offering potential career pathways in fintech.

Stow cash, source of loans and banks use this money to lend out money and collect interest

## FBP – II

### Definition & Role:

Think of **commercial banks** as your everyday money hub. They **accept deposits** and offer different types of **loans**—whether you're eyeing a new car, a house, or just need a personal loan. Essentially, they use your deposited cash as **capital** to make it available for lending, keeping the money flowing in the economy.

### Core Services:

These banks provide the basics you need for day-to-day finances. You can open **checking and savings accounts**, use **debit cards** for your purchases, or stash away cash in **safe deposit boxes**. They also offer various **lending services** like **lines of credit** and **mortgages**, plus some **investment products** like **certificates of deposit (CDs)** and retirement accounts, making them a one-stop-shop for your financial needs.

### Revenue Generation:

The way these banks make their dough is pretty clever—they earn money by charging you different **service fees** (like monthly account fees, **overdraft**, and **NSF fees**) and by collecting **interest income** on the loans they give out. The sweet spot is in the difference between the low interest they pay on deposits and the higher rates they charge on loans.

### Physical & Digital Presence:

Traditionally, you'd visit a branch in your neighborhood (the good old **brick-and-mortar** experience). But nowadays, many banks are going all-digital with fully **online** operations. This not only cuts down on overhead costs but often lets them pass on better rates and fewer fees to you.

### Economic Impact:

Commercial banks are super important for keeping the economy chugging along. They're at the heart of the **fractional reserve banking** system, which means they lend out most of the money deposited in them, creating more **credit**, **capital**, and **liquidity**. This process helps boost everything from your local coffee shop to big business investments.

### **Regulation & Safety:**

No need to stress about your money—these banks are under strict **regulatory oversight** and your deposits are generally insured by the **Federal Deposit Insurance Corporation (FDIC)** up to \$250,000. This insurance is like a safety net, giving you peace of mind even if the economy takes a hit.

### **Comparison with Investment Banks:**

While **investment banks** are busy handling high-stakes deals like **underwriting** and **mergers and acquisitions** for big corporations, commercial banks are all about everyday banking for people like you and me, including **retail customers** and small to mid-size businesses.

### **Real-World Examples:**

When you hear names like **Chase Bank**, **Bank of America**, or **Ally Bank** (which is one of the major **online banks**), you're looking at real-world examples of commercial banks doing what they do best—keeping our financial systems running smoothly.

### **What is CBDC?**

**CBDC (Central Bank Digital Currency)** is essentially digital money issued by a central bank. It's similar to the cash you've always known, but in a **digital format**—think of it as paper money versus an electronic version.

### **Digital vs. Traditional Payments:**

While many countries (and especially India) are already familiar with digital payments via systems like **UPI**, a significant number of low-value transactions are still conducted in **cash**. This means people still value the **anonymity** and familiarity of cash over digital methods.

### **Anonymity & Privacy:**

Unlike current digital payment systems, **CBDCs** can be designed to offer **anonymous transactions**, addressing privacy concerns. This could appeal to users who want their spending habits kept private.

### **Reducing Settlement Risks:**

Traditional digital payments involve multiple parties (like different banks and intermediaries), which can lead to **settlement risks** (known as **Herstatt risk**). With **CBDCs**, transactions could be processed directly, reducing these risks and even enabling seamless **global payments**.

### **Impact on Banks:**

Even with the introduction of **CBDCs**, traditional banks won't disappear. They'll continue to

play a critical role in handling **deposits** and **loans**. The shift might change how deposits work, but banks will remain key intermediaries in the financial system.

### **Implementation Challenges:**

There are many decisions to be made before **CBDCs** become mainstream. Central banks need to consider whether to launch just a **retail CBDC** or also a **wholesale version**, choose between a **distributed ledger** (like blockchain) or a **centralized ledger**, decide on **token-based (anonymous)** versus **account-based (identifiable)** systems, and determine whether to issue the currency directly or through commercial banks.

### **Global Perspective:**

Countries around the world are at different stages of exploring **CBDCs**. For example, the **Bahamas' Sand Dollar** and **Cambodia's Project Bakong** are already in advanced stages, highlighting a global shift toward rethinking the very nature of money.

### **How Banks Work:**

Imagine a simple bank as a place where people store their **savings** (whether it's **gold coins** or paper money) instead of keeping it hidden in their backyard. The bank acts as a trusted intermediary, offering a safe **vault** (think of it like a secure, Greek-temple style building) for your money.

### **Pooling Savings for Investments:**

The bank collects **deposits** from many individuals, creating a large pool of money. This pool is then used to fund **loans** for projects—like building irrigation ditches or factories—that aim to generate more wealth for the community.

### **Balance Sheets & Reserves:**

When you deposit money, it shows up as a liability on the bank's **balance sheet** because they owe you that money back. The bank keeps a fraction (say, **10%** as a cash reserve) safe for withdrawals, while lending out the remaining **90%** to earn interest.

### **Earning Money:**

The bank makes its profit by charging a higher **interest rate** on the loans than what it pays to depositors. For example, if it lends out money at **10%** interest and pays out **5%** to depositors, the difference (after covering expenses like salaries and security) becomes the

bank's profit.

### **Mutual Benefit:**

This system not only allows the bank to earn a profit but also helps depositors see their money **grow** through interest, and it fuels community projects that create real value and wealth for everyone involved.

### **What is UBI?**

**Universal Basic Income (UBI)** is the idea that every individual receives a fixed, unconditional amount of money (around **\$1,000 a month** in the US) to cover basic living expenses, regardless of whether they work. This system aims to provide a **financial floor** that helps eliminate poverty.

### **Freedom to Choose:**

With UBI, people might have more freedom to decide whether to work, go back to school, or pursue other interests. Studies suggest that while some reduce their work hours slightly (often to invest in education or better opportunities), they don't simply waste the money on **alcohol** or **tobacco**—debunking the myth that free money leads to **laziness**.

### **Critique of Current Welfare:**

Existing welfare systems come with strict conditions—like mandatory job applications or course participation—that can trap people in poverty and waste their time. UBI is seen as a way to remove these strings, offering a **universal safety net** without penalizing extra effort.

### **Economic Feasibility & Inflation:**

UBI isn't about creating new money out of thin air but about redistributing funds already in the system. This means that, when implemented correctly, it shouldn't trigger runaway **inflation**. Funding models could include cutting redundant welfare programs or imposing **higher taxes** on the wealthy to balance the books.

### **Incentives and Social Impact:**

By guaranteeing a basic income, UBI might empower people to negotiate better working conditions, as it provides them with a fallback option. However, it also challenges our traditional view of work, which not only provides income but also **social status** and personal fulfillment.

### **Challenges Ahead:**

Despite its promise, UBI faces hurdles such as ensuring it doesn't lead to unintended **government overreach** or exacerbate regional cost-of-living differences. There's also the broader societal debate about whether work should remain central to our identity and

purpose.

**The Big Picture:**

While UBI might be the most promising approach to sustainably reducing poverty and easing financial stress, more research and larger pilot programs are needed to fully understand its impact and refine its implementation.