Modern Banking - 1. Introduction

What is a Bank?

Two Core Activities

- **Money** → deposits, payments
- **Credit** → loans, lending

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But… Modern Banks Do More

- Offer **additional services** (investment, insurance, advisory, etc.)
- Not the **only** providers of money & credit (shadow banks, fintech, bigtech)

What Makes Banks Unique?

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Core Definition

> ***A financial institution whose <u>current</u> operations consist of <u>granting loans</u> and receiving <u>deposits</u> from the <u>public</u>.***
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Breaking Down the Definition

- **Current** → main operations
- **Granting loans** → credit creation
- **Deposits** → savings + money

What makes bank unique!

- **Public** → uninformed depositors

This mean that access to payments → **public good**

Why Regulate Banks?

- **Protect depositors** from loss and fraud
- **Ensure trust** in money & payments
- **Stability**: banks sit at the core of financial system

Origins of Modern Banking

Money Changing

First activity of banks: **money changing**

Etymology

- Greek: *trapeza* = scale
- Italian: *banco* = bench (for coins)
  - When a money changer failed → the bench was broken
  - Italian: **bancarotta** = broken bench (→ **bankruptcy**)

From Money Changing to Safekeeping

- Money changers had safes for their own coins
- Realized they could **store merchants' deposits**
- Safekeeping reduced risk of loss/robbery

First bankers

- **Scriveners**: literate advisors, brokers, lenders, deposit-takers
- **Goldsmiths (17th c. England)**: safes for goldware → accepted deposits
- Early **trust-based intermediaries**

Deposits: No Return

- Early deposits = **zero or negative return**
- Purpose: **safety**, not investment
- Bankers had to maintain **confidence** not to misuse deposits

Timeline

1. Early Banking Practices

- **Mesopotamia (2000 BCE)**
  - Hammurabi's Code (Babylon) → regulated loans & debt

> *Law 100: "If a merchant gives silver as a loan at interest, he shall take only 1 shekel of silver as interest on 1 shekel; if he takes more, he shall forfeit all."*

> *Law 117: "If a man be in debt and he sell his wife, son, or daughter, they shall serve for three years in the house of the purchaser or creditor; in the fourth year they shall regain their freedom."*

- **Ancient Greece**: trapeza (money changers)

2. Medieval & Renaissance (10th-15th c.)

- **Templars (12th–14th c.)**:
  - Cheque-like instruments for crusaders & pilgrims
  - First **international financial system**
- **Italian city-states (12th–15th c.)**: Florence, Venice, Genoa = trade hubs
  - **Medici Bank (1397–1494)**: first multinational bank
  - **Pacioli's innovation (1494)**: double-entry bookkeeping

3. Colonial Expansion (15th–17th c.)

Finance to support growth of trade

- **Banco di San Giorgio (1407)** – Genoa - **First public bank**
    - Managed public debt, accepted deposits
- **Bank of Amsterdam (1609)**
    - Standardized coinage, clearing bank, proto-central bank
- **Venetian banks**: financed global trade & wars

4. Industrial Revolution (19th c.)

- **Savings & cooperative banks**
- **Cheque system spread**

5. Rise of Modern Banking (20th - today c.)

- Post-WWII → **retail banking** boom
  - Checking accounts, mortgages, consumer credit
- **Regulation** after crises (e.g., 1929)
- **Globalisation** → multinational banking groups
- **Technological Innovation**
  - 1950s: Payment cards (Diners Club, later Visa/MasterCard)
  - 1967: ATMs (Barclays, UK)
  - 1973: SWIFT messaging system

Modern Banking

The Need for Finance

> *"A well-developed, smoothly functioning financial system facilitates*
> *the efficient life cycle allocation of household consumption and the efficient allocation of physical capital to its most productive use in the business sector."*
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For centuries… the job of banks

- Intermediated between **savers and borrowers**
- Provision **money & credit** at the core of the economy
- Ensured **trust, stability, and payments**

Modern Developments

Since 1970s

- Financial markets developed rapidly
- Wave of **financial innovations**
- Entry of new players:
    - **Investment banks & securities firms** (bond issuance, securitization, derivatives)
    - **Institutional investors** (pension funds, mutual funds, insurance companies)
    - **Fintechs** (digital lending, payments, crowdfunding)
    - **BigTechs** (digital wallets, cloud, platform finance)

Banks vs. Alternatives

- Many services once exclusive to banks are now offered by:
    - **Capital markets**
    - **Other financial institutions**
    - **Technology platforms**

Core Question: Why Banks Still Exist?

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Paths to understand:

- **Financial markets are imperfect**
  - **Information frictions** (asymmetric, incomplete, confidential)
- **Regulation** (entry barriers, public service, safety nets)
- **Capacity to adapt**
  - Banks evolve with a **dynamic financial landscape**
  - The definition of “bank” and its core activities keeps **morphing over time**