

Financial Institution

1/ Definition Of Financial Institution

A financial institution (FI) is an organization that facilitates the flow of capital between savers and borrowers. It offers a wide range of financial products and services that enable individuals, businesses and governments to manage their money, invest for the future and access the capital they need to grow.

Beyond traditional banking, there is a diverse array of non-bank financial institutions (NBFIs), including brokerage firms and asset managers. These organizations collectively ensure capital flows efficiently through the economy, fueling innovation, funding business expansion and supporting economic growth.

Financial institutions are organizations that provide financial services to their clients. These include banks, credit unions, insurance companies, brokerage firms, and asset management companies. They play a crucial economic role by facilitating monetary transactions, lending, investment, and risk management. Financial institutions act as intermediaries between savers and borrowers, mobilize savings, and channel them into productive investments, thereby fostering economic growth and financial stability.

2/ Types of Financial Institutions

2-1/ Banks

Banks accept funds from individuals and businesses, and lend a portion of these deposits to other entities. This core function not only defines banks as depository institutions but also subjects them to specific regulations and legislation, which often determine their service offerings and operational scope.

**** Types of Banks**

- Commercial banks

The most common type of FI is the commercial bank. Commercial banks are large, multifaceted financial institutions that operate across local, regional and international borders. Their primary functions are to accept deposits from individuals and businesses, and then lend out a portion of those deposits to other entities. This is the characteristic that sets commercial banks apart.

But that's far from all that commercial banks offer. One of the additional services they offer is facilitating foreign currency transactions, which allows companies to buy or sell internationally traded currencies **for immediate (spot) or future (forward) use.**

- *Investment banks*

Investment banks specialize in providing a wide range of financial services related to the issuance and trading of securities. One of their core functions is securities underwriting, which helps companies issue and sell stocks, bonds and other securities to the public. They also offer custodial services. In addition, they facilitate mergers, acquisitions, divestitures and other complex corporate reorganizations. Finally, investment banks act as brokers and financial advisors, executing trades and providing strategic guidance for institutional investors.

- *Universal banks*

Universal banks are financial institutions that combine both commercial and investment banking under one roof. They offer retail banking services, such as savings and checking accounts, loans and mortgages, alongside corporate banking solutions like business loans and cash management. In addition, they engage in investment banking activities, including underwriting, mergers and acquisitions, and securities trading, as well as wealth management services tailored for high-net-worth individuals.

Industrial banks

Industrial banks, also known as industrial loan companies, are a specialized type of FI with a more limited scope of services compared to traditional commercial banks. Industrial banks primarily sell investment shares and accept customer deposits, which they then lend via installment loans to consumers and small businesses. Unlike commercial banks, industrial banks do not offer checking account services and are, therefore, not subject to the same general banking regulations. Instead, they are locally chartered and may even be owned by non-bank holding companies. - -

Central banks

The role of central banks in the financial system is to serve as the bank for the government and the banking sector. In this capacity, their primary role is to implement monetary policy. Central banks use methods such as setting reserve requirements, conducting open market operations, and adjusting interest rates to manage the money supply and influence inflation and economic growth. They are

also often responsible for issuing the national currency and overseeing the country's payment systems and financial institutions.

2-2/ Nonbank Financial Institutions

Nonbank financial institutions (NBFIs) are a diverse group of entities that operate outside the traditional banking system. While NBFIs provide many of the same financial services as banks, such as extending credit and accepting deposits, they are not subject to the same regulations and oversight.

** Types of Nonbank Financial Institutions

- Broker-dealers

Broker-dealers, or brokerage firms, are entities that trade securities for their own account or on behalf of their customers. They facilitate transactions by finding counterparties and executing the trades. When executing trades for their own account, they take positions in various securities. This allows them to act as market makers, providing liquidity by standing ready to buy and sell securities.

- Private equity firms

Private equity firms are specialized investment management companies that focus on acquiring and actively managing privately held companies. They raise capital from institutional investors (such as pension funds) and high-net-worth individuals to fund private company investments.

- Captive finance companies

Captive finance companies are subsidiaries of large industrial corporations. Their primary purpose is to provide financing solely for the purchase of products manufactured by their parent corporation.

- Asset-based lenders

Asset-based lenders offer loans that are secured by the borrower's assets, such as accounts receivable or inventory. The amount of credit extended is determined by a "borrowing base" calculation that multiplies the value of the eligible collateral by an advance rate.

- Insurance companies

Insurance companies are considered NBFIs due to the range of financial services they provide beyond insurance products. Insurance firms make substantial investments in commercial real estate and bond markets, competing with banks for

short- and medium-term loans. They also offer mortgage funding, leasing services and long-term savings products.

- *Asset managers*

Asset managers invest client funds across money market and capital market instruments. They offer specialized funds and diversified portfolios to meet different investment requirements. By delegating assets to professional managers, companies can achieve greater diversification across asset classes, issuers and geographies.

- *Credit unions*

Credit unions provide many of the same services as traditional banks; however, they operate under a different structure. As member-owned, not-for-profit cooperatives, credit unions focus on serving their members rather than maximizing profits. They offer a variety of financial services such as savings, loans and access to payment networks, often at more favorable rates than banks.

- *Fintech companies*

Fintech companies are technology-driven firms that offer financial services, either in competition with or in partnership with traditional Fis. These companies leverage innovative technologies to provide a wide range of services, such as payment processing, digital banking and financial management tools.

3/ Role of Financial Institutions

- **Economic Growth of the Nation**

At the national level, financial institutions are subject to government regulation. They serve as government agents and develop the country's economy. For instance, following government regulations, financial institutions may extend a selective credit line with lower interest rates to assist a struggling industry in resolving its problems.

- **Regulate Monetary Supply**

The financial institution assists in controlling the amount of money in the economy. These organizations keep the money supply stable and manage inflation.

- **Banking Services**

Commercial banks and other financial institutions assist their clients by offering savings and deposit services. Additionally, they provide their clients with credit options, including overdraft facilities, to meet their short-term funding needs.

- **Pension Fund Services**

Financial institutions assist people in retirement through their different investment plans. A pension fund is one of these investing possibilities.

4/ Functions of Financial Institution

✓ **Intermediation**

They collect funds from individuals and businesses as deposits and then lend them to borrowers who need capital for various purposes, such as starting a business or purchasing a home.

✓ **Depository Services**

Financial institutions provide depository services by accepting deposits from individuals and businesses.

✓ **Credit Provision**

Financial institutions extend credit to individuals and businesses through loans and credit lines.

✓ **Investment Services**

Financial institutions offer investment services to help individuals and businesses manage and grow wealth. They provide access to investment products such as stocks, bonds, mutual funds, and other securities.

✓ **Risk Management**

Financial institutions assist individuals and businesses in managing financial risks. They provide insurance products, such as life insurance, health insurance, property insurance, and liability insurance, to protect against potential losses and unforeseen events.

✓ **Payment and Settlement Services**

Financial institutions facilitate payment transactions between individuals and businesses. They provide payment and settlement services such as processing electronic fund transfers, issuing credit and debit cards, and managing payment systems to enable smooth and secure transactions.

✓ **Asset Management**

Financial institutions offer asset management services, where they manage investment portfolios on behalf of clients. They provide expertise in selecting investment options, diversifying portfolios, and monitoring market conditions to optimize returns and meet clients' financial goals.

✓ **Financial Advisory**