Funds in various ways. for essay

Why do entities choose the type of investment or source of funds that they do? Are there any other choices? Do these other choices exist? Why do they exist? Funds may travel from surplus entities to deficit entities, but why does this happen, and how. Surplus entities choose the type of investment to financially benefit themselves, as do deficit entities, choose the best finance of funds available to them with the lowest penalty. Not always is this choice available. Most of the types of investment and finance available has strict conditions, this is why these entities choose what is available to them. These funds may flow through primary and secondary markets.

The finance may be debt or equity. Who really knows the best decision for the flow of funds? These days there are so many options, but most have one common denominator. The bank. The financial system consists of funds flowing from surplus entities to deficit entities.

These funds are a vital tool for surplus entities, as they can create greater wealth. These funds are also equally, if not more vital, for deficit entities. Deficit entities use these funds to finance their plans. The financial system is ever more becoming a fact of human existence, and the biggest part of this financial system, is the flow of funds from surplus entities to deficit entities.

To match with the growing need for the use of the financial system, there is a growing diversity in the way these funds can flow. In 2008, where financial systems are used on a daily, if not hourly basis, we find that these systems are continually improving into a more ‘ modern’ financial system. This can be seen with the enormous boost in the number of automatic teller machines (ATMs) from 4600 in 1990 to over 21 000 by 2005 and the even more astonishing boost in the number of EFTPOS terminals in the same time period from 15 500 to over 465 000. The introduction of money and the development of local markets to trade goods were the genesis of the financial system today. (Lewis) People are not only becoming increasingly aware of new technology in the financial system, i. e.

credit cards, smart cards etc. They are finding out about other ways to save excess funds, and to source excess funds. Wealth being accumulated in the form of money has created specialised markets developed to enable the efficient transfer of funds from savers/investors (surplus entities) to users of funds (deficit entities). One of the main reasons of the increase in diversity in the flow of funds is the eligibility to participate in these flows. An example of this would be a small business wishing to take out long-term debt to finance a new building.

This small business only being established for fewer than 2 does not have enough audited accounting records or similar evidence to service this debt. Thus the introduction of a ‘ new style’ controversial bank loan, the ‘ low-doc loan’, this product has been especially aimed as deficit entities with no evidence to acquire funds. Funds from surplus entities can flow through equity markets, debt markets or through financial intermediaries to deficit entities Equity markets consist of Shares, Commodities, Property, International Equity and Collectibles. For entities with surplus funds, Equity markets are quite attractive.

The attractive part being the higher return they can make. Although there is a big attractiveness to this type on investment, there is a down side. Equity markets are more risky, being, there is a chance that the business you are investing in may collapse or turn insolvent, if this were to happen, the shares or equity purchased in that company would virtually disappear. Equity markets open an opportunity to trade with not only primary, but are also traded in secondary markets. On the other hand for a Business looking to obtain funds (deficit entity), this may be done by issuing shares in the business.

This way, the business does not have to source funds in the debt market but can source funds internally. Surplus entities (lenders) include households, companies, the government and the rest of the world. Deficit entities (borrowers) includes households, companies the government and the rest of the world. Funds usually go through the matching principle, which means a short-term asset should be met with a short-term liability. Another of the ways to source fund is through the Debt market. Examples of Debt Markets include: Treasury bonds, notes, corporate debentures, Commercial bills, Promissory notes, Bank products, Securitised assets, and International debt.

The advantage for a surplus entity in investing in the debt market is security. Banks are the most secure investment. The down side of this is the lower return to receive from this investment compared to equity markets. Deficit entities find the debt market the best to obtain fund from, as seen in the RBA Bulletin, commercial banks hold more than 49. 1% of the total assets of financial institutions. Down sides? Of course.

Some of the downsides of obtaining funds through the debt market are the servicing of the debt i. e. the interest payable for the life of the loan. Also there are bank fees, and other financial costs in setting up the debt finance.

Depository financial institutions, such a commercial banks, gather savings from depositors and provide loans to customers. Pg 11 FIM As mentioned before, the new ‘ low-doc’ debt finance is very risky, as the entity taking out the debt finance must provide their property/s to secure the loan. In the markets for general goods and services it is common for buyers and sellers to go through a ‘ middleman’. The same is with banks and other financial intermediaries, they are like the middlemen. Lastly there are other financial intermediaries with whom a surplus entity can invest and a deficit entity can borrow.

These other non-bank financial intermediaries include building societies, credit unions, unit trusts, finance companies, mortgage companies, super funds, securitisers, money market corporations, life offices, and approved deposit funds and funds managers. These other financial intermediaries are increasingly becoming more popular, although, the recent collapse of some major players had shaken the confidence in them. There are still constantly, new ways of fund to be transferred, however the existence of this diversity has been put in place for ease of use, and for the transfer of funds to be completed smoothly. In the time of currency first being introduced in the Roman Empire, these markets have arisen, and since that time, these markets have had to modify themselves to suit many contributing factors.

Another factor is Government policy. Many things affect the financial system, and so it is ever so creating more ways to keep this existence of this diversity. The diverse existence in which funds flow through the financial system from surplus entities to deficit entities can be accounted for, through the above explanation and exemplification of the various types and uses of these funds for both surplus and deficit entities and also through Surplus entities making a decision to benefit themselves more return from high risk, or lower return from lower risk, and from Deficit entities, seeking out the best deal for their acquisition of funds. These diversities have been created over ime, to coincide with the changing needs of these types of entities and the many types of diversity's have been accounted for with the expansion of the global economy and financial markets. More importantly, a financial system encourages accumulated savings which then are available for investment in an economy through these diversities. Reference List Lewis, P, Garnett, A, Hawtrey, K, Treadgold, M, Issues, Indicators and Ideas: A Guide to the Australian Economy, 4th edition, Pearson, Australia.

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