Cash flows in banking system

Business, Management

Bank Profitability

Regarding finance and United States interests in the economy, the banking system has always played an imperative and irreplaceable role for the country. Banks were first introduced as a financial institution to upkeep customer deposits while at the same time paying them an annual interest payment. Using a large chunk of these investments, the bank then lends these credits to other customers as loans, completing a productive and efficient cycle within the economy. There are, however, many factors explaining bank profitability, some of which unknown to the average man. It’s apparent that these factors are what determine the successfulness of a banking economy, where the ultimate goal is “ to increase shareholder value,” a business’s ability to produce a more efficient rate of free cash flow. When few or more of these factors fail to meet the recommended expectations, bank profitability declines; thus, leaving the bank economy with nothing more than a group of customers skeptical of investing in the banking system. Inevitably, this failure would result in major catastrophic economic events, or a stock market crash; therefore, it is in the country’s best interests to uphold the factors of bank profitability, such as liquidity, pay loan, operational risk management, bank deposits, and capital investment.

Liquidity plays a substantial role when weighing the pros and cons of a bank’s ability to meet its long term financial obligations, or solvency. Solvency may depend on liquidity as liquidity, on the other hand, is defined by a business’s ability to meet its short term obligations. In order to thrive as a business, solvency must be at a supportive level for the entire organization, which branches off of the business's liquidity. When referring to the liquidity of a bank, it becomes " the measure of the ability and ease with which assets can be converted to cash," in other words, a bank's capability to easily maintain cash flow between customer and economy. If liquidity is at a reasonable level, then the population expects that the bank maintains substantial bank profitability. In order for the bank to remain viable, liquid assets are also required in the form that it meets near-term obligations. The idea roots off of the fact that a big portion of the United States population would not conceive to invest in a bank with discreditable liquidity, as the consumer would not be obtaining any surefire benefits. With that in mind, the trust between the population and the banking system begins to dwindle; therefore, a less amount of cash flow as well as less bank profitability results from the situation. With that said, it is crucial that any banking system organization devices a technique in which liquidity stays up to par in order to support the continuous cycle that banks depend on.

In any bank, the most imperative source of revenue and profitability come from pay loans. The payment of this credit loan is what banks heavily depend on in order to grow economically and financially. Statistically speaking, the average person living in the United States will eventually come across a case and stage in their lifetime where their needs are not met by using their own financial assets. Fortunately, this is where the banking system steps in and grants loans to these people in turn for payment later down the road. Many people are forced to utilize money resources and loans at times of economic distress; however, the banking system is able to efficiently turn this into an advantage to suit both the consumer and business sides. In exchange for a slightly higher payment at a later time, the bank grants an immediate loan to aid a person who is in need of the money. In turn, this greatly increases bank profitability and helps the consumer at a time of distress. The problem with pay loans, however, is that banks heavily depend on the payment within the allotted amount of time. Failure to uphold the agreement by the consumer will merely result in an exponential increase of debt toward the bank (which may only reduce the chances of actual payment), and will incur problems within the system as well, which is otherwise known as operational risk management. Because pay loans are such an important aspect to the profitability of the organization, constant failure to obtain these payments will eventually lead to, worst case scenario, a sudden crash of the business. Generally, consumer payment is what drives bank profitability and should definitely be kept on the watch list to avoid internal situations.

Operational risk management, as stated before, is the credit risk of not obtaining the resources granted to debtors. Inevitably, in order to obtain bank profitability through pay loans, all banks have the critical risk of being put in danger by debtors. All banks must therefore calculate this risk and determine the liability of a any given debtor and how big of a loan will be granted. It is this kind of caution from the banks that reduces the likelihood of the system failing at any given time, as the risk will always be there in order to obtain greater profit. As Alan Greenspan, Chairman of the Federal Reserve American Bankers Association once said, " it would be a mistake to conclude that the only way to succeed in banking is through ever-greater size and diversity. Indeed, better risk management may be the only truly necessary element of success in banking." In other words, the banking system will never be able to completely avoid operational risk management. It's in the banks best interests to manage these risks accordingly to produce the best outcome in banking.

Bank deposits would be another way to increase bank profitability. Deposits are generally divided into three groups: current loan deposits, saving interest-free loan deposit, and time investment deposits. In the case of current loan deposits, any person or corporate body deposit their additional funds into their savings account, receive a checkbook to use on checking accounts, and investors generally invest with specific purposes. Likewise, this is the second most common of the three bank deposits as all consumers typically have a purpose in working with banks. The saving interest-free loan deposit is the most common deposit in banking systems at this time. Many people or entities generally deposit their funds for an indefinite amount of time and receive a booklet whenever they required the mentioned funds. In traditional banks, interest will apply to the saving interest-free loan, where the consumer will acquire a reward as an incentive to using the banks even further. Finally, time investment deposits occur when someone maintains an abnormally large amount of cash assets in the bank and for some reason, is not incorporating the money in any way at all. Through the large amount of money as well as the time invested into the bank, costumers typically look for as much of a benefit as possible when investing. As banks are able to insure the replacement of your money for up to a specific amount, there is no downside to this type of bank deposit. In addition to the security of one's money, interest will be paid to the owner of the assets. Paying interest to the owners gives consumers another reason to trust banks and keep the cycle between consumer and bank profitability at a peak, fortunately enough.

Lastly, another main factor of bank profitability comes from the bank's capital. In terms of financial businesses, a capital acts as a cushion in a case of high operational risk management, where the probability of having large unexpected losses is significant enough to worry about. In order to maintain high solvency and liquidity, the value of a firm's assets must surpass those of its liabilities, which is where capital comes into play. Over a period of time, banks have failed to obtain any form of government assistance during dire times of need merely because of the lack of stable liquidity or inadequate capital. For this reason, it is critical for the banking system to maintain a good capital as it not only lessens the impact of an unexpected loss, but to also stay eligible for government assistance. Banks are defined as being in a stable and healthy position when this factor is adequate and sufficient.

Generally speaking, there are many more factors that influence the amount of cash flow and bank profitability in the economy; however, each have their own purpose and play a role in the continuous cycle created specifically by the banking system to ensure bank profitability. While there are more than just a few factors to uphold the system, it is apparent that it actually becomes quite fragile once two or three of these factors begin to malfunction; therefore, many marketers are required to keep watch over banks to ensure that they never enter the danger zone or even get close to bankruptcy. Some of these factors even branch out to others, explaining its fragile nature. For example, an inadequate liquidity will eventually result in very little solvency for the bank in the long run. Additionally, liquidity at that stage may be due to low pay loans or bank deposits. Overall, the banking factors follow the domino effect, making it crucial to keep all of these factors in check. Bank profitability greatly depends on this course of action, and it is predictably what keeps the financial economy running.