



Money and Banking

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1. Money and Financial Services

To expand business activities, develop trading activities that have been evolved from the barter system, various support services are required. Financial services, transportation, communication, insurance and warehousing are the main supportive services required to smooth business activities. However, organization that provide these services are also business organization. Financial services are mainly provided by financial institutes based on money and other financial instruments.

1.1 Money

People use money for various transactions. Money is in the form of coin and notes. People wish to acquire money, keep the money with them and spend. Money does not have physical or materialistic value. Money has only a nominal value that can purchase goods and services. This is called purchasing power of money. Money is a limited resource. Money is the most essential factor for trade today. Money is shortly referred to anything that is accepted to exchange with good/ services.

Money take two forms,

- Coins:

Decades back gold, silver and copper coins were used to exchange goods and services. Later people started making metal pieces of different sizes of which the weight, value, were carved on the metal piece. This practice led to today's issued coins in use.

- Paper money/notes

The note was first issued in 1952 and the coin in 1963 in Sri Lanka. The rights an responsibility to print and issue notes was given to the respective Governments. The money printing, issuing and controlling power is with the Central Bank of Sri Lanka.

Legal Tender of Money

Any note / coin that is issued by the Central Bank of the country has acceptance for any transaction within the country. This is called legal tender of money.

Any Organization or person could reject cheques, credit card, debit card but money that issued by the central government cannot be rejected.

Limited Legal Tender – coins of values less than one rupee are money with limited legal tender. The Sri Lankan law allows cents 1, 2 and 5 to be used to pay only until 1 rupee at once. Cents 10, 25 and 50 can be pay until 5 rupee at once only. A person has a right to not accept such coins when this limit exceeded.

Unlimited legal tender – coins and notes that have a value higher than 1 rupee are money with unlimited legal tender. These could be used to pay unlimited amount.

1.2. Characteristics of money

- General acceptance
- Easy identification
- Divisibility (can be divided into smaller units)
- Transportability (Easy to transport)
- Non-counterfeit ability (difficult to duplicate)
- Durability

1.3. Functions of Money

There are four basic function of money

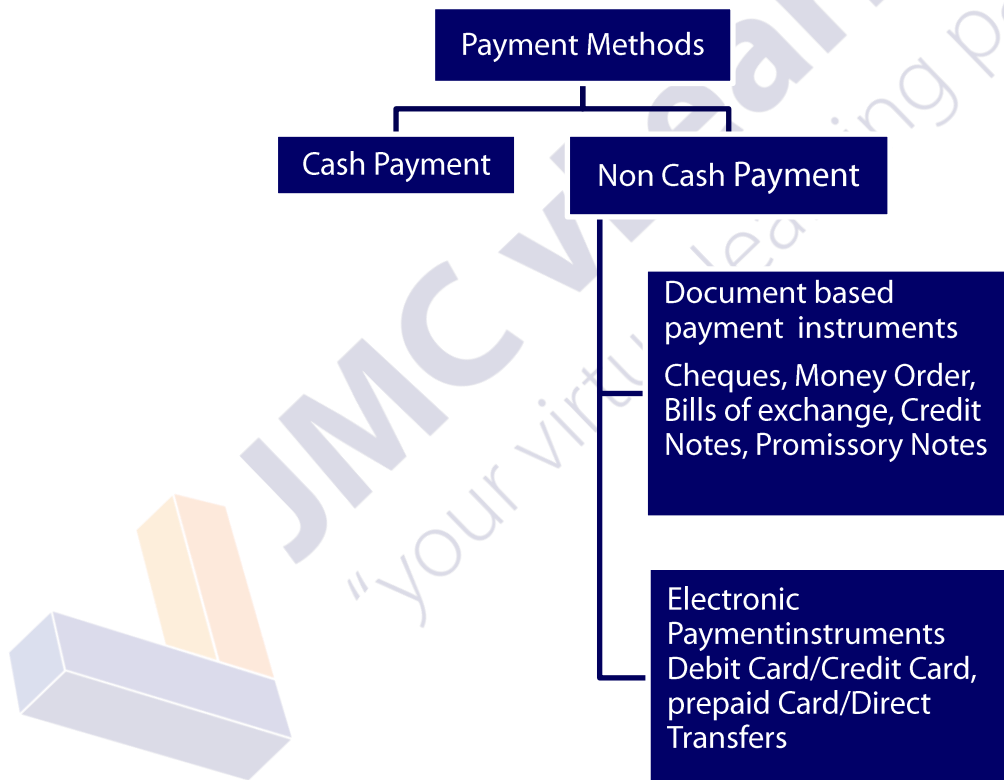
- Medium of exchange: money allows goods and services to be traded without the need for a barter system. Barter systems rely on there being a double coincidence of wants between the two people involved in an exchange
- Store of value: this can refer to any asset whose "value" can be used now or used in the future i.e. its value can be retrieved at a later date. This means that people can save now to fund spending at a later date.
- Standard of Value: this refers to anything that allows the value of something to be expressed in an understandable way, and in a way that allows the value of items to be compared.
- Standard of future payment: this refers to the expressing of the value of a debt i.e. if people borrow today, then they can pay back their loan in the future in a way that is acceptable to the person who made the loan.

1.4. Types of Money

Fiat money	Money that is printed and issued by the central finance authority is fiat money. Simply coins and notes issued by the Central Bank of SL.
Bank money	Current Money maintained by commercial bank . Used via cheques.
Near money	Assets that do not have 100% liquidity like fiat money but can be easily and quickly transferred to the money. Savings A/C,FD, Commercial bills etc.
Commodity money	A form of currency in which the value of the currency comes from the material of which it is

	made. gold, silver, grains, livestock, salt, and other materials have served as commodity money at different points in history.
Perfect money/ standard money	This money has a materialistic value though not accepted for transactions . This also refer to as commodity backed money. Ex -Gold Pound of Great Britain
E-cash/E-money	E-money , is a digital money product that provides a way to pay for products and services without resorting to the use of paper or coin currency. Transactions can be made over the internet, email, or personal computer .

1.5. Payments Methods



1.6. Payment Infrastructure Facilities

- Automated teller machines (ATM)
- Electronic fund transfer at point of sales – This allows the use of credit and debit cards for transactions.
- Telephone banking (Tele-Banking)
- Internal banking

2. Financial Institutions

With the expansion of financial transaction and activities, banks and other financial institutions were established to smooth the process. Businessman realized that travelling with cash is unsafe; hence, wanted to keep the cash with someone else as a safety measure. This concept initiated banks. The services of banks and the entire banking system have become a necessity to the country. National and international financial institutions and services have developed rapidly today.

The banking and financial system of Sri Lanka consists of the following.

- Central bank of Sri Lanka
- Licensed commercial banks (local and foreign banks)
- Licensed specialized banks
- Registered finance banks
- Merchants banks and investments bank
- Savings and loan associations
- Leasing establishments
- Other specialized financial institutions
- Primary leaders
- Deposit taking institutions

Services of banks and financial services

- Accept deposits (savings, fixed deposits, current accounts)
- Provide loans
- Issue letter of credit
- Issue travelers' cheques
- Overdraft facility
- Safe security facility
- Automated banking services
- Shares underwriting
- Bank guarantee
- Maintain deposits of foreign currencies (NRFC / RFC)
- Purchase and sale of foreign exchange
- Various services for international trade

2.1 The Central Bank of Sri Lanka

The Central Bank was established in 1950 under the Monetary Law Act 1949 with the amendments in 2002.

Main objectives are:

1. Economic and price stabilization
2. Financial system stabilization

In order to achieve above mentioned objectives, functions of the Central Bank are as follows

- Act as the banker of the government
- Issue coins and notes
- Set financial policies
- Act, the banker of all the banks
- Supervisee and control activities of all banks and non-bank financial institutions
- Lend loans to the government
- Act as the financial and economic advisor of the government
- Control exchange rates
- Conduct economic researches

Central bank and the commercial can be distinguished based on the main objectives and functions

Central Bank	Commercial Bank
<ul style="list-style-type: none"> • One central bank for the country 	<ul style="list-style-type: none"> • Aim at earning profit
<ul style="list-style-type: none"> • Central bank governs commercial banks 	<ul style="list-style-type: none"> • There are money commercial banks competing in the bank to attract funds.
<ul style="list-style-type: none"> • Has rights to print & issue notes 	<ul style="list-style-type: none"> • Commercial bank should adhere the policies set the central bank
<ul style="list-style-type: none"> • Stabilized economy is the main aim 	
<ul style="list-style-type: none"> • Central bank adjust and controls the financial system 	

2.1.1 SLIPS and SWIFT

In the past, all banking transaction within a bank and between banks were done manually. This consumed lots of time as well as energy, consumed lots of resources and money, Hence, the banking transactions and information gathering were delayed.

In order to resolve such conflicts and delays, automated systems were introduced. This increases the efficiency and effectiveness of the banking system.

Sri Lankan Interbank Payments System (SLIPS) is an online interbank electronic fund transfer system catering mainly for low-value payments (up to Rs. 5 million). Electronic fund transfer (EFT) is a movement of funds from one account to another without the corresponding piece of paper to authorize or prove that the transfer had occurred. Thus, crediting and debiting of accounts are handled more promptly and accurately without the need to write cheques, pay orders or vouchers. Moving electronic records rather than paper results in payments being processed much efficiently with advanced security features and audit trails.

SLIPS owned by Lankan Clear, an organization owned by the Central Bank(47.19) and all commercial banks (52.81%) operating in Sri Lanka.

Society for Worldwide Interbank Financial Telecommunication (SWIFT)

SWIFT provides a network that enables financial institutions worldwide to send and receive information about financial transactions in a secure, standardized and reliable environment. More than 10500 banking organizations, securities institutions and corporate customers in 215 countries exchange millions of standardized financial messages.

SWIFT does not facilitate funds transfer; rather it sends payments orders, which must be settled by correspondent accounts that the institutions have with each other. Each financial institution, to exchange banking transactions, must have a banking relationship by either being a bank or affiliating itself with one (or more) so as to enjoy those particular business features.

2.1.2. Payment and settlement Systems

RTGS

With the modernization of the banking activities, higher technology was embraced to the banking systems. All manual payment and settlement methods were automated under the real time gross settlement system (RTGS). The RTGS system is an electronic and computer based fund transfer system, Payments will be debited from the paying participant's account within seconds, provided that the sending bank has sufficient balance in its account to make the payment.

SSSS

Further, the government securities that were issued as scrips were transformed to scrip less securities under the scrip less securities settlement system (SSSS). The settlement of all securities will be recorded in the computer system instantaneously. With the introduction of the SSSS, the need for physical delivery and verification of certificates will not arise. The scrip less securities will eliminate the risks associated with paper based securities. SSSS are based on RTGS where funds are transferred instantaneously. With this electronic infrastructure will assist popularized government securities among investors and ownership of securities will be broad and depth of the securities market will increase.

2.1.3 Policy Interest Rates of the central bank

The central bank uses mainly three policy rates via the monetary policy.

1. Repo rate

The discount rate at which the central Bank repurchases government securities from the commercial banks. To temporarily expand the money supply the Central bank decreases Repo rate (So bank can swap their holdings of government securities for cash). To contract the money supply, it increase the repo rates. Repo is short for repossession.

2. Reverse-repo rate

Reverse repo rate is the rate at which the Central Bank borrows money from Commercial Banks. Banks are always happy to lend money to the central bank since their money is in safe hands with good interest.

An increase in the reverse repo rate will motivate banks to park more funds with Central bank to earn higher returns on idle cash. And also it helps to Central bank to drain excess money out of the banking system.

3. Bank interest rate

This is the rate at which the Central bank lends money to the Commercial banks to satisfy temporary liquidity needs.

2.2 Licensed Commercial Banks

Banks that can maintain savings accounts, current accounts and timely accounts for the general public and trade foreign exchange along with many other financial services under the license of the Central Bank of Sri Lanka are called as licensed commercial bank. There are local and foreign commercial banks in Sri Lanka.

Local Commercial Bank – HNB, BOC

Foreign Commercial Banks – HSBC, Standard Chartered

2.3 Licensed Specialized Bank

Under the Bank Act 1988, licensed specialized banks can be operated by receiving a license from the Central bank of Sri Lanka. Special features of these banks are

cannot maintain current accounts and involve in the foreign exchange related activities.

Ex:DFCC bank, NSB, Sanasa Development Bank.

2.4 Finance Companies

Companies that are specialized to maintain deposit and offer financial services are called finance companies. These companies should get license from the Central Bank. General activities:

- Leasing services
- Real estate business
- Loan facilities
- Invest in government and commercial bank securities

Ex: Lanka ORIX finance PLC, Singer Finance (Lanka) PLC, Commercial Leasing & Finance PLC

2.5 Leasing Companies

Companies that offer financial facilities to lease assets are called leasing companies. Leasing is a contractual agreement calling for the user (lessee) to pay the owner (less or) for use of an asset.

Three types of leasing agreements,

- I. Finance Leasing – the lessee agrees to pay an installment during the agreed period of the lease. Although the asset is not owned by the lessee, he/she is responsible for the maintenance and any other services required for the asset. Such assets should be shown in the balance sheet of the lessee as an asset bought by the company.
- II. Operating leasing – the leasing company will be responsible for the maintenance and any other services required for the asset. Thus, the leasing company will take the asset back at the end of the lease. The lessee need not show such assets in the balance sheet.
- III. Contract hire – in this type of leasing, a company would sell its asset to the leasing company. The will acquire it again via leasing it back. In this way, the lessee can gain cash by selling the asset to the leasing company and use it as well. The lessee should pay an installment to the leasing company. The leasing company will have limited responsibility for the maintenance and any other services required for the asset. The lessee need not show such assets in the balance sheet. This is mostly used for company cars.

2.6 Merchant Bank / Investment Bank

These companies provide managerial and professional advisory services to business. Functions of a merchant bank:

- Investment and managerial advisory services
- Prepare project proposal and related reports
- Financial and marketing advisory services

- Loans, financing facilities, factoring, leasing, insurance brokering, merchant banking, underwriting and treasury.
- Foreign exchange related activities.

