NATURE OF A BANK.

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In its simplest function a bank has a co-operative quality. It does for many persons cheaply what, without it, each would be obliged to do at considerable expense for himself. A trustworthy bank, with vaults giving protection against fire and robbery, serves for each one of many persons; while to gain like security a single individual could ill afford so expensive a vault. In short, by the division of labor, a separate profession has been evolved in society which performs certain services whereby all who need them are convenienced and saved expense. If this were all, however, a bank would be no more than a safe place of deposit; but it is much more than this.

A natural consequence of the deposit of money with a bank for convenience and safe keeping was the creation of methods by which the ownership of these deposits could be transferred without actually moving the money itself. In early banks, devices for this purpose were already used. In modern times the transfer is promptly and easily made by a check, or draft, which is merely an order upon the bank by the depositor to credit a certain sum to the person named. In this way a deposit becomes as available for payments as if actual money were passed from hand to hand.

A savings bank, or a loan company, is not a commercial bank in the proper sense. Depositors furnish the total funds (or capital) loaned by a savings bank on time-securities; and it is understood that they need not expect to have deposits paid back on demand. Most savings banks, because their resources are invested in time-loans, properly reserve the right to exact a notice of perhaps sixty days in case of intended withdrawal of deposits. A loan company, whose funds are paid in by shareholders, is not very different in kind from a savings bank. The funds are subscribed to be loaned out on mortgages or time-securities. Since savings banks are provided for those who are less able to invest on their own account, legal precautions hedge in the kind of investments they can make; while a loan company takes its own risks without much limitation, its shareholders taking their chances. In neither case do these institutions receive deposits which take the form of demand liabilities.

A commercial bank, however, not only receives deposits, but it is particularly distinguished by the fact that it engages to repay a deposit on demand. The banker finds that it is not necessary for him to retain all of the money in his vaults to enable him to do this; because not all of the depositors will want to draw out their funds at the same time. Some will ask for payment today, but others will be making deposits. As a result, he ascertains by experience that if he keeps on hand in cash a proportion only—say one-fourth or one-third—of the resources which have been entrusted to him, he will still be able to meet on presentation all demands of depositors or noteholders. He is, therefore, enabled to loan the balance of these funds just as he can loan his own capital. Thus another function of a bank is developed—that of loaning, or discounting.

THE BANK'S CAPITAL.

Many persons and firms have balances which they are not ready to invest permanently, and these are freely deposited in banks. Small sums, each of little effect by itself, are accumulated in great numbers, and make very large amounts in the aggregate. So that, bits of capital that would be ineffective for serious productive operations on a great scale, are thus placed where they may be put to important uses. In this way, the savings of the small, or uninformed capitalists are made efficient for the productive use of active members of the community to whom they may be loaned. Although banks do not actually increase the wealth of society, they lead to the productive use of amounts which, without banks, would remain inactive. They place funds where society gets the most from them, by allowing them to pass into the hands of the most efficient members of the community.

This process of uniting scattered sums into large capitals which can be effectively employed, is, of course, not only the function of commercial banks, but equally that of savings banks or building and loan associations. The distinguishing function of commercial banks, however, is the creation by them of a demand liability through which the sums left with them may serve as a currency, since by the use of notes or of deposits and checks, they are available purchasing power in the hands of their owners. The investor in a building and loan association or savings bank, on the other hand, loses the opportunity to use his money in other ways because no demand obligation is credited to him. That is to say, the deposit in a commercial bank performs a currency function, while the deposit in a building and loan association or savings bank is no longer currency, but an investment, since in the former case the depositor receives a claim payable on demand and in the latter case he does not. This is the primary distinction between a bank and other financial institutions.

LEGITIMATE BANKING.

Banks cannot make something out of nothing. They cannot coin wealth or money out of any intangible thing. The operations of legitimate banking are always based on property; whenever these operations are not so based, they cease to be legitimate, and become speculative. The profit of banking arises from the discount operation or lending. Of course, supposing the rate of interest to be fixed, the more a bank can lend, the more its profits will be. What, then, can it lend? It has its capital; it can lend that. It has also the resources entrusted to it by the public through the discount operation; it can loan such part of these resources as it does not need to hold in cash to meet the demands of depositors and noteholders. This, then, is the limit placed upon its power to loan—its own capital and the resources of others entrusted to it (except so much thereof as must be held as a reserve). It does not "coin its credit." If a bank has won the confidence of the public by the safe and conservative management of its loans and investments, it will receive large deposits. The larger its deposits, the larger the sums it can loan; and hence the larger its profits.

The bank becomes responsible, whenever it loans its depositors' funds, that the titles to these funds may be realizable upon in cash; and quickly in case of suddenly increased demands in time of emergency. It assumes this responsibility to the full extent of its capital, which must meet any losses due to bad judgment. Upon the banker, then, rests the responsibility of deciding that the security for a loan is realizable in a kind of property that is always salable. Hence every business transaction involving a loan from a bank must pass the judgment of the banker who is acting with full knowledge that an error will be followed by financial loss. This is the reason why it is possible to say that the resources of a bank, received as the security for loans reflect quite accurately the character and soundness of the business transactions of the country.

BANK PROFITS.

The profit of banking arises from the discount operation. The bank buys and sells something, and makes a gain thereby in the same way as other commercial institutions. In making a loan, the bank buys the right (well secured) to receive a given sum of money at some future date; for this it gives an equal sum less the interest. The borrower gets this amount in cash or more often in the form of a liability of the bank to pay on demand. The profit consists in the fact that the demand-liability given the borrower is always less (by the profit) than the amounts to be received in the future. The borrower needs immediate means of payment; and the bank can give this to him in either of several forms, whichever the customer prefers. It can give him actual money from its uninvested resources (either a portion of its own capital or money left with it by others); or it can give him its circulating notes; or it can give him a credit on its books —a deposit account. The two forms of payment last mentioned are those