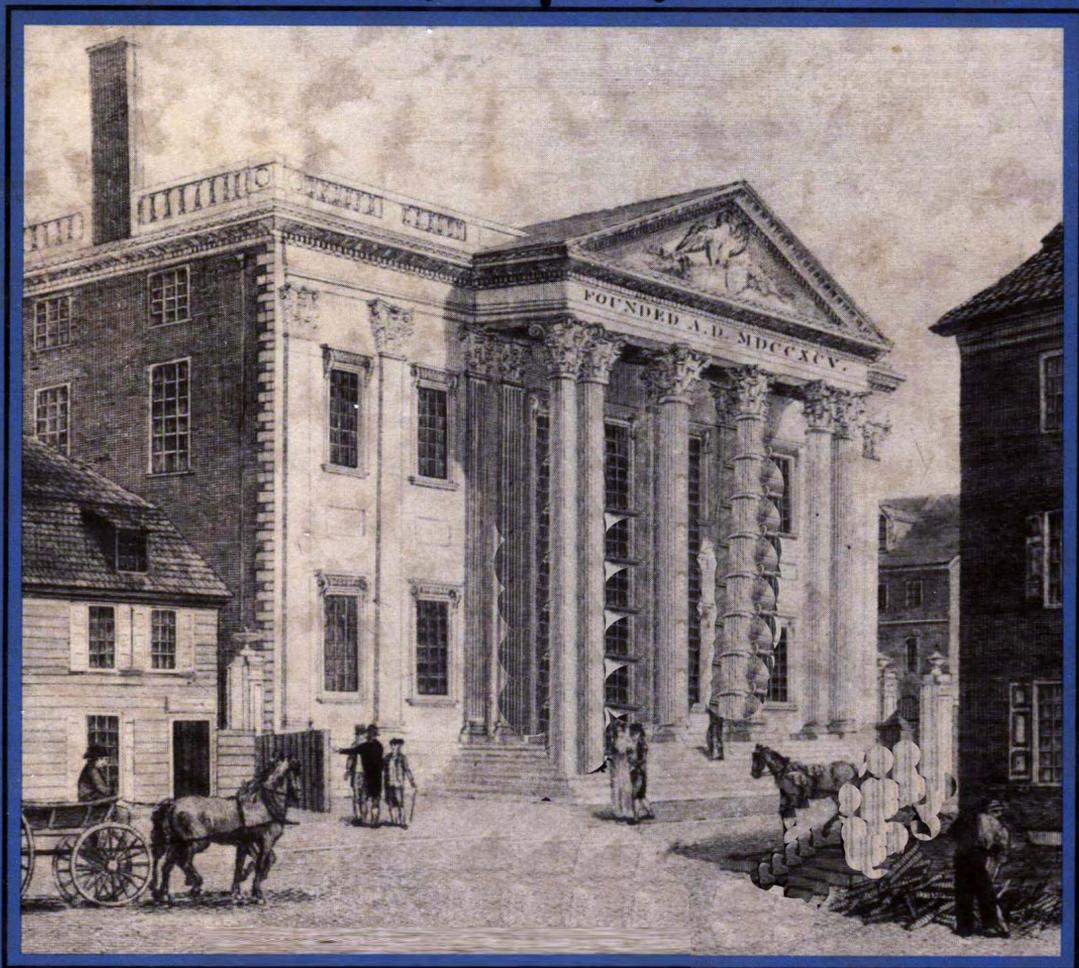


Fourth Edition

# COMMERCIAL BANKING



Edward W. Reed / Edward K. Gill

**fourth edition**

# **COMMERCIAL BANKING**

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# PREFACE

This book is about the business of commercial banking—and that business has undergone rapid change in recent years as banks have confronted volatile economic conditions and revised regulations. Banks are seeking profits and accessing funding sources in ways new to them. At the same time, nonbank competition in traditional banking activities has increased dramatically. This revision of *Commercial Banking* attempts to depict the new environment in which bank management must operate.

There is a danger, however, that writers of textbooks on banks will focus too extensively on the new elements in banking, forgetting that most of what banks do is what they have done for many years: accept deposits and make loans and investments. New methods may have some influence on how these activities are carried out, but the basic business is unchanged.

Nor has the importance of commercial banks diminished because of changes in the environment. Commercial banks make funds available to meet the needs of individuals, businesses, and governments. In so doing, they facilitate the flow of goods and services and the activities of governments. The commercial banking system provides a large portion of our medium of exchange and is the primary instrument through which monetary policy is conducted.

The ability of our commercial banking system to perform its tasks efficiently and in harmony with our needs and economic goals depends in

large measure on effective management. Banks must be managed prudently, safely, and profitably if we are to have a strong, adaptable banking system capable of meeting the needs of society.

This book reviews the management aspects of commercial banks. It has been written with the objective of providing students and professionals with a description and analysis of the operations of commercial banks. It is an investigation into the techniques and principles employed by commercial banks in the performance of their many functions. Although the focus is on management and the individual bank, the book does not lose sight of the social and monetary importance of the banking system.

Lending is the major business of commercial banks, and more bank personnel are involved in the lending activity than in any other. In recognition of its importance, we devote seven of the nineteen chapters to lending. In addition, the text covers structure, organization and management, deposits, cash and liquidity management, investments, trust services, and international banking. Two chapters are devoted to two areas of vital importance, profitability and bank capital. Because of the quasi-public nature of banking, we consider each of these topics in light of the laws and regulations under which banks operate.

We are indebted to many people, both practitioners and academicians. We are particularly grateful to Richard V. Cotter and Richard K. Smith. Information and suggestions have been provided by so many people that we are reluctant to attempt to list all of them, but to each one we owe a debt of gratitude.

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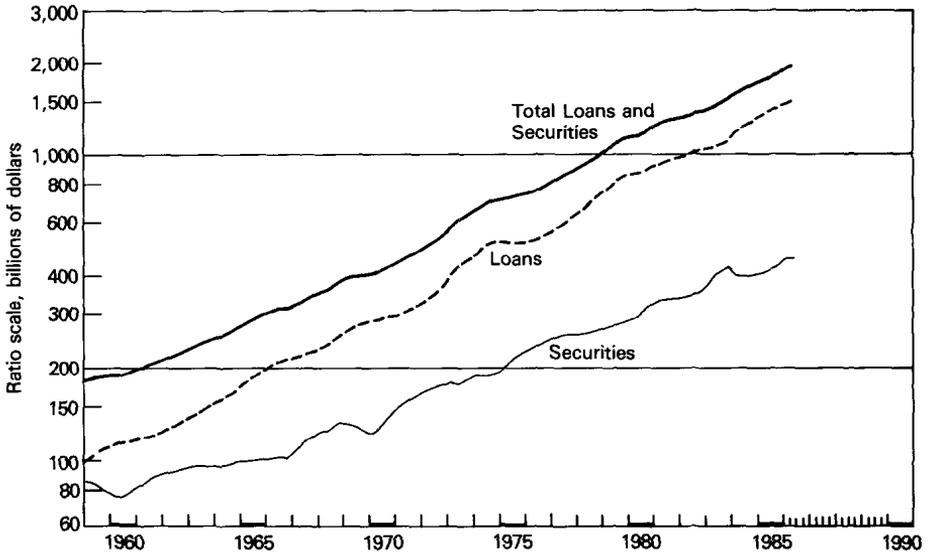
## **COMMERCIAL BANKING: AN OVERVIEW**

Commercial banking is one of our oldest industries. The first bank was organized in 1782 before the adoption of our federal Constitution, and many of the banks that were organized in the 1800s are still in operation. Commercial banks are the most important type of financial institution in the nation in terms of aggregate assets. The growth of their assets and liabilities is presented in Figures 1-1 and 1-2. Total assets approximate \$3 trillion. In terms of employment, banking is one of our largest industries, with over 1.5 million employees.

### **FUNCTIONS OF COMMERCIAL BANKS**

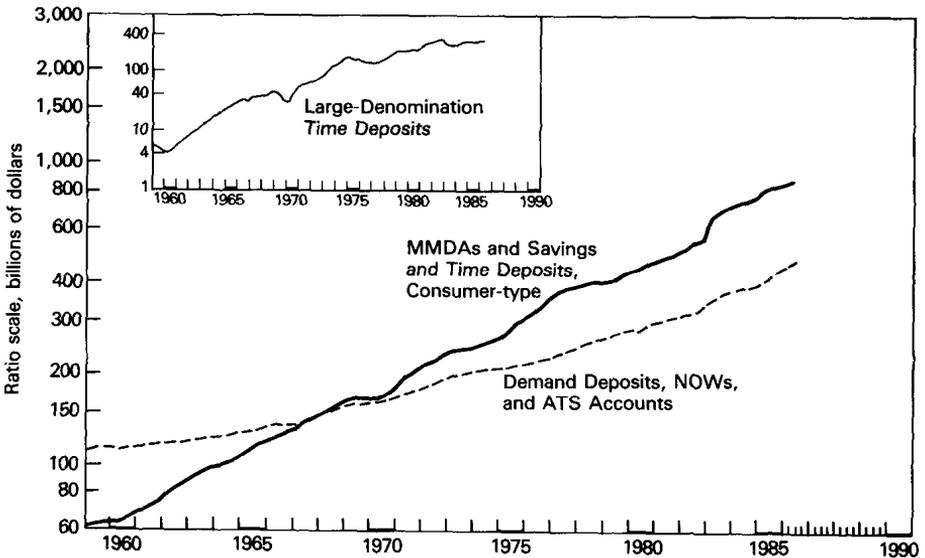
The business of banking is very broad and far-reaching; with the introduction of the one-bank holding company and the possibility of relaxation of some of the restrictions imposed on banking, the number and variety of services provided by commercial banks and their affiliates have expanded. Recent innovations in banking include the introduction of credit cards, accounting services for business firms, factoring, leasing, automated teller machines, discount brokerage, participation in the Eurodollar market, and lock box banking. The importance of commercial banks can best be illustrated by a brief explanation of their major functions.

**FIGURE 1-1 Principal Assets of Commercial Banks (seasonally adjusted, quarterly averages)**



SOURCE: Board of Governors of the Federal Reserve System, *Historical Chartbook*, 1986 (1987).

**FIGURE 1-2 Principal Liabilities of Commercial Banks (seasonally adjusted, quarterly averages)**



SOURCE: Board of Governors of the Federal Reserve System, *Historical Chartbook*, 1986 (1987).