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# HISTORY AND THE CHARACTERISTICS OF THE FINANCE. TYPICAL ANALYSIS ON THE FINANCE

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**Annotation.** Finance is a term for matters regarding the management, creation, and study of money and investments. It involves the use of credit and debt, securities, and investment to finance current projects using future income flows. Because of this temporal aspect, finance is closely linked to the time value of money, interest rates, and other related topics.

**Keywords.** Finance, money and investments, economics, transactions, public finance, corporate finance, social finance, behavioral finance.

Finance, as a study of theory and practice distinct from the field of economics, arose in the 1940s and 1950s with the works of Harry Markowitz, William F. Sharpe, Fischer Black, and Myron Scholes, to name just a few. Particular realms of finance—such as banking, lending, and investing, of course, money itself—have been around since the dawn of civilization in some form or another. The financial transactions of the early Sumerians were formalized in the Babylonian Code of Hammurabi (circa 1800 BCE). This set of rules regulated ownership or rental of land, employment of agricultural labor, and credit. There were loans back then, and yes, interest was charged on them—rates varied depending on whether you were borrowing grain or silver. By 1200 BCE, cowrie shells were used as a form of money in China. Coined money was introduced in the first millennium BCE. King Croesus of Lydia (now Turkey) was one of the first to strike and circulate gold coins around 564 BCE—hence the expression, "rich as Croesus." In ancient Rome, coins were stored in the basement of temples as priests or temple workers were considered the most honest, devout, and safest to safeguard assets. Temples also loaned money, acting as financial centers of major cities.

Types of Finance

Public Finance

The federal government helps prevent market failure by overseeing the allocation of resources, distribution of income, and stabilization of the economy. Regular funding for these programs is secured mostly through taxation. Borrowing from banks, insurance companies, and other governments and earning dividends from its companies also help finance the federal government.

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State and local governments also receive grants and aid from the federal government. Other sources of public finance include user charges from ports, airport services, and other facilities; fines resulting from breaking laws; revenues from licenses and fees, such as for driving; and sales of government securities and bond issues.

Corporate Finance

Businesses obtain financing through a variety of means, ranging from equity investments to credit arrangements. A firm might take out a loan from a bank or arrange for a line of credit. Acquiring and managing debt properly can help a company expand and become more profitable.

Startups may receive capital from angel investors or venture capitalists in exchange for a percentage of ownership. If a company thrives and goes public, it will issue shares on a stock exchange; such initial public offerings (IPO) bring a great influx of cash into a firm. Established companies may sell additional shares or issue corporate bonds to raise money. Businesses may purchase dividend-paying stocks, blue-chip bonds, or interest-bearing bank certificates of deposit (CDs); they may also buy other companies in an effort to boost revenue.

Personal Finance

Personal financial planning generally involves analyzing an individual's or a family's current financial position, predicting short-term, and long-term needs, and executing a plan to fulfill those needs within individual financial constraints. Personal finance depends largely on one's earnings, living requirements, and individual goals and desires.

Matters of personal finance include but are not limited to: the securing of financial products like credit cards; life and home insurance; mortgages; and retirement products. Personal banking (such as checking and savings accounts, individual retirement accounts (IRAs), and 401(k) plans) is also considered a part of personal finance.

The most important aspects of personal finance include:

Assessing the current financial status (expected cash flow, current savings, and so on)

Buying insurance to protect against risk and to ensure one's material standing is secure

Calculating and filing taxes

Earmarking savings and investments

Planning for retirement

As a specialized field, personal finance is a recent development, though forms of it have been taught in universities and schools as "home economics" or "consumer

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economics" since the early 20th century. The field was initially disregarded by male economists, as "home economics" appeared to be the purview of housewives. Recently, economists have repeatedly stressed widespread education in matters of personal finance as integral to the macro performance of the overall national economy.

Social Finance

Social finance typically refers to investments made in social enterprises including charitable organizations and some cooperatives. Rather than an outright donation, these investments take the form of equity or debt financing, in which the investor seeks both a financial reward as well as a social gain. Modern forms of social finance also include some segments of microfinance, specifically loans to small business owners and entrepreneurs in less developed countries to enable their enterprises to grow. Lenders earn a return on their loans while simultaneously helping to improve individuals' standard of living and to benefit the local society and economy. Social impact bonds (also known as Pay for Success Bonds or social benefit bonds) are a specific type of instrument that acts as a contract with the public sector or local government. Repayment and return on investment are contingent upon the achievement of certain social outcomes and achievements.

Behavioral Finance

There was a time when theoretical and empirical evidence seemed to suggest that conventional financial theories were reasonably successful at predicting and explaining certain types of economic events. Nonetheless, as time went on, academics in the financial and economic realms detected anomalies and behaviors which occurred in the real world but could not be explained by any available theories.

It became increasingly clear that conventional theories could explain certain “idealized” events—but that the real world was, in fact, a great deal more messy and disorganized, and that market participants frequently behave in ways that are irrational and thus difficult to predict according to those models. As a result, academics began to turn to cognitive psychology in order to account for irrational and illogical behaviors which are unexplained by modern financial theory. Behavioral science is the field that was born out of these efforts; it seeks to explain our actions, whereas modern finance seeks to explain the actions of the idealized “economic man” (Homo economicus). Behavioral finance, a sub-field of behavioral economics, proposes psychology-based theories to explain financial anomalies, such as severe rises or falls in stock price. The purpose is to identify and understand why people make certain financial choices. Within behavioral finance, it is assumed the information structure and the characteristics of market participants systematically

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influence individuals' investment decisions as well as market outcomes. Daniel Kahneman and Amos Tversky, who began to collaborate in the late 1960s, are considered by many to be the fathers of behavioral finance. Joining them later was Richard Thaler, who combined economics and finance with elements of psychology in order to develop concepts like mental accounting, the endowment effect, and other biases that have an impact on people's behavior.

Economics and finance are interrelated, informing and influencing each other. Investors care about economic data because they also influence the markets to a great degree. It's important for investors to avoid "either/or" arguments regarding economics and finance; both are important and have valid applications.

In general, the focus of economics—especially macroeconomics—tends to be a bigger picture in nature, such as how a country, region, or market is performing. Economics also can focus on public policy, while the focus of finance is more individual, company or industry-specific. Microeconomics explains what to expect if certain conditions change on the industry, firm, or individual level. If a manufacturer raises the prices of cars, microeconomics says consumers will tend to buy fewer than before. If a major copper mine collapses in South America, the price of copper will tend to increase, because supply is restricted. Finance also focuses on how companies and investors evaluate risk and return. Historically, economics has been more theoretical and finance more practical, but in the last 20 years, the distinction has become much less pronounced.

Finance, as a field of study and an area of business, definitely has strong roots in related-scientific areas, such as statistics and mathematics. Furthermore, many modern financial theories resemble scientific or mathematical formulas. However, there is no denying the fact that the financial industry also includes non-scientific elements that liken it to an art. For example, it has been discovered that human emotions (and decisions made because of them) play a large role in many aspects of the financial world.

Modern financial theories, such as the Black Scholes model, draw heavily on the laws of statistics and mathematics found in science; their very creation would have been impossible if science hadn't laid the initial groundwork. Also, theoretical constructs, such as the capital asset pricing model (CAPM) and the efficient market hypothesis (EMH), attempt to logically explain the behavior of the stock market in an emotionless, completely rational manner, wholly ignoring elements such as market sentiment and investor sentiment.

Finance As an Art

Still, while these and other academic advancements have greatly improved the day-to-day operations of the financial markets, history is rife with examples that

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seem to contradict the notion that finance behaves according to rational scientific laws. For example, stock market disasters, such as the October 1987 crash (Black Monday), which saw the Dow Jones Industrial Average (DJIA) fall 22%, and the great 1929 stock market crash beginning on Black Thursday (Oct. 24, 1929), are not suitably explained by scientific theories such as the EMH. The human element of fear also played a part (the reason a dramatic fall in the stock market is often called a "panic").

In addition, the track records of investors have shown that markets are not entirely efficient and, therefore, not entirely scientific. Studies have shown that investor sentiment appears to be mildly influenced by weather, with the overall market generally becoming more bullish when the weather is predominantly sunny. Other phenomena include the January effect, the pattern of stock prices falling near the end of one calendar year and rising at the beginning of the next.

Careers in Finance

Accountant: An accountant manages a company's financial records, tracks expenses, and runs reports.

Auditor: An auditor is someone tasked with ensuring accuracy in financial records. They may be employed by a company to analyze finances, or they may work for the government.

Banker: A commercial banker works with businesses to provide banking services such as accounts and loans. An investment banker is someone who focuses on companies looking to raise capital or conduct a sale or merger.

Capital manager: A capital management professional helps a company allocate its capital resources and balance them against its debts.

Lender: Someone who works in lending, such as a loan officer, manages the issuance of loans. For example, a mortgage lender works up contracts that secure a real estate loan.

Market analyst: Market analysts evaluate trends and make forecasts that account for changing market conditions, preparing recommendations that can guide a company's financial decisions.

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