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Introduction: From Banking to Retail Banking

1.1 What you will find in this chapter

The term ‘bank’ can be applied to a wide range of financial institutions. The objective of this chapter is to provide a brief overview of banking and the role played by banks in an increasingly complex financial world. It begins with a review of the meanings of banking and bank so as to come to a definition of the term ‘retail bank.’

1.2 Where we are now depends on how we got here

In recent years, the conceptualization of the banking business has radically changed. The largest banks in many countries have transformed themselves, typically via mergers and acquisitions (M&A), into multi-product financial service conglomerates with offerings including retail banking, asset management, brokerage, insurance, investment banking, and wealth management. These major developments on the product side have been matched by the emergence of a diverse array of new funding sources. Driven by securitization, particularly of residential mortgages, banks have become less constrained by their deposit bases for lending. On-balance-sheet assets have increasingly been bundled and sold into the market to release capital to finance expansion. Off-balance-sheet vehicles (such as structured investment vehicles, SIVs) have been created to enable banks to collateralize assets funded by the issue of short-term paper, not only generating profits, but also enabling them to raise resources to finance growing funding gaps (loans minus deposits). Small and medium-sized institutions have also actively participated in diversifying their product and funding features. While banks have been undergoing these changes, a big question has arisen: Do we still think
banks occupy a dominant position in financial services? This is because, after many years of focusing activities to increase shareholder value, banks seem to have lost their way. This has led to a commoditization of some banking products and activities to the point where there is little perceived difference between financial service providers within local, regional, and national markets and other non-financial providers eager to enter the banking market.

For some customers and products, a clear demarcation line between these suppliers does not presently exist, whereas for other banking products there is a very clear distinction, as demonstrated by the availability of transnational banking products such as foreign exchange, international cash management, and other services that facilitate cross-border banking and commerce services. Given this, a large number of customers have now become shoppers, and they view banking services as single commoditized products, rather than as a mechanism to facilitate a total relationship of services. If this is the situation, looking backward can be useful to learn from and leverage past experience, starting with the origins of banks.

1.3 A preliminary issue: what is a bank?

This may seem like an elementary question, but it is important to start from the beginning.

The word ‘bank’ evokes different mental pictures for different individuals. Some will think of the quintessential bank building with neoclassical columns and a large vault. Others will envision a balance sheet showing the bank’s assets, liabilities, and capital. Still others will fall back on the regulatory definition of a bank, which is, generally, an organization that accepts deposits, makes loans, and invests in securities. For our purposes, however, a bank is both a financial intermediary and a corporate entity. It is a financial intermediary, because it:

- Serves as a financial go-between, taking in deposits from those who save and making loans with those deposits to qualified borrowers;
- Fosters economic development; and
- Acts as a community’s economic engine.

A bank is a corporate entity because it is:

- Formed by shareholders;
- Governed by a banking charter, articles of association, by-laws or similar documents; and