

What is...

retail and SME banking?

BANKTrack

Retail and SME banking refers to banking services designed for households and small and medium enterprises (SMEs). In contrast, corporate banking focuses on big, corporate and institutional clients.

Retail commercial banking

There are different kinds of retail banks. The biggest group of retail banks are the commercial banks, which typically accept and repay deposits, and offer small business, consumer and mortgage loans. In addition, they provide various payment services like bank cards, credit cards and e-banking. They traditionally don't engage in speculation on financial markets.

Other types of retail banks

In addition to commercial banks there are also other depository institutions (sometimes also referred to as 'thrift institutions') designed for the retail market. In the US especially, Savings and Loan's (S&L) banks are an important banking institution. They obtain funds through deposits, and use these mainly to provide long-term mortgage loans. Mutual savings banks operate similarly, but their organizational structure is quite different, since the depositors own the bank. Finally, credit unions are small cooperative deposit institutions that are often organized around a union or a firm. They obtain funds by accepting deposits and use these to make consumer loans. There are 10 000 of credit unions in the US.

Bank re-lending

Most depository institutions only have to keep a small percentage of the deposits from clients in reserve, since normally not all depositors will want their money back at the same time. The rest of the money can be lent out. Bank supervisors set minimum limits on what percentage has to be kept as reserve, and an international agreement the Basel Capital Accord -- even exists on this matter. Reserve requirements imposed by the regulators are often around 10%, so that banks

will only have to keep \$10 as a reserve for a \$100 deposit. The other \$90 can be lent out; if this \$90 in turn is deposited at another bank, again only 10% of this amount has to be held as a reserve. Thus, bank re-lending plays the important function of growing the money supply in an economy. This is very important in a country's macroeconomic landscape, because it can impact inflation and price levels.

But a dangerous aspect of bank re-lending is that problems can arise whenever an unusually high number of depositors want their money back at the same time and the bank cannot provide these funds immediately because they are lent out. This can lead to a financial crisis if people lose their trust in a bank or the entire financial system. Further, this process can be self-enforcing: as soon as people learn others are collecting their deposits they will do so too, creating a run on the bank. This eventually could result in a bank collapse or provoke a wider banking crisis. In most industrialised countries, supervision on this issue is quite tight and runs on bank are not very common. Government-provided deposit insurance may exist to protect depositors' money, and the central bank can operate as a 'lender of last resort', that is, it can provide temporary funds for banks when suddenly many depositors demand their money back. In many less developed countries, however, this capacity is much less developed. The risk of runs on banks is therefore still a problem and can cause thousands of households to lose their savings, as happened in Mexico, Argentina and Zimbabwe in the 1990s. In some countries, foreign banks are trusted more than domestic counterparts, but not everyone has access to their more expensive services.

Trends and critical issues

- **Deteriorating services.** When the stock markets were booming, people started to put more of their cash into mutual funds and securities rather than deposit accounts. As a

consequence, banks of all sizes became more dependent on fee-based services and retail banking became less and less of a lucrative activity. The profits on household deposits were perceived as too low, and the costs of small branches too high. As a result, in many countries customers have been forced to use cheaper automated channels such as the internet or automatic money distributors for transactions on one's personal account. Increasingly, retail products have also been offered through non-financial institutions like supermarkets.

- **Exclusion from services.** Some social groups are increasingly excluded from financial services. Sometimes banks exclude the very poor from services by "red-lining", identifying poor areas and limiting access to credit for low-income households. Research also shows that often ethnic minorities have less access to credit. Given the important function credit has in enabling economic development, these groups thus become further marginalized.
- **Too few services for SMEs.** Most financial firms see lending to Small and Medium Enterprises as a high risk and costly to administer, which means SME's have less access to credit or are faced with higher interest rates compared to larger corporations. Yet, SMEs are often the most dynamic and innovative segment of a country's economy and provide the bulk of employment. This problem is sometimes recognized at the national or international levels but it has not been successfully resolved.
- **Predatory lending.** In some countries, banks and other financial firms aggressively sell easy loans with high interest rates designed specifically to exploit vulnerable and unsophisticated borrowers. Existing laws do not protect these vulnerable members of society. Credit cards have also been promoted more aggressively around the world. This easy method of payment combined with relaxed pay back terms have attracted many customers.

However, the interest rates charged on credit card expenditures are much higher than regular credits, and have thus led to severe indebtedness. These personal debt levels have reached crisis proportions in various countries including the US, the UK and South Korea.

CSR initiatives

Many corporate social responsibility initiatives in the financial sector are directed towards mitigating the adverse impacts of banks' corporate financing, particularly of big infrastructure projects. However, until now, not much attention has been directed to the societal role banks perform, and their responsibilities to provide services to a broader public. Some good initiatives have been identified, however. For example, some banks have committed to keeping branches open in non-urban areas to support to the elderly and the rural population. Ethnic banking has also been an initiative in some countries, which offers retail financial services to particular ethnic groups that have less access to the regular institutions.

Some development agencies have also identified the importance of SME lending. For example, the International Finance Corporation (IFC, the private arm of the World Bank) has set up a special department to promote SME credit. Also, the World Bank has started trainings, with Citigroup, to promote the financing of SMEs in Latin America.

Increasingly, banks also engage in micro-credit activities in developing countries. Small entrepreneurs are provided with very small loans, which are generally believed to be a very good mechanism to combat poverty. Too often, however, these initiatives are used by banks as mere public relations exercises or charity, and are not considered part of banks' core activities.

Web references

Global Fair Banking Initiative:
<http://www.ncrc.org/global/index.htm>