



EduTap



Concept Notes

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Retail Banking: Introduction

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1 Introduction

The Indian economy over the past decades has been witnessing an upswing due to the **liberalization policy** adopted by the planners.

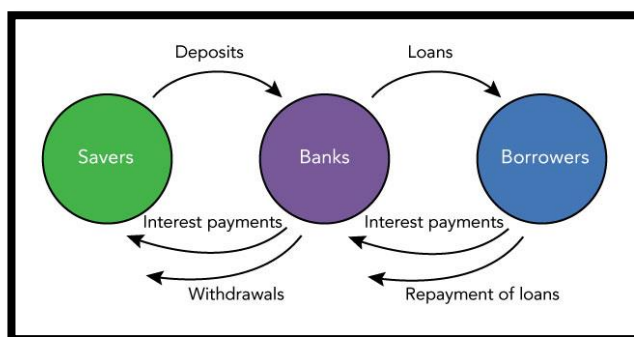
- The **economic changes** have given rise to **increased income and saving levels** leading to **increased demand** on the financial markets and **more particularly on banks**, which continue to be a **safe and secure source for individual savings and investments**.
- From a **mere service provider to park surpluses**, banks have blossomed into **one stop financial hub for all kinds of financial needs** of the customers.

Considering the increased competition, It becomes **imperative on the part of the banks** to develop **products customized** to suit the needs of variety of customers and move away from a **Product Centric Approach to Customer Centric Approach**.

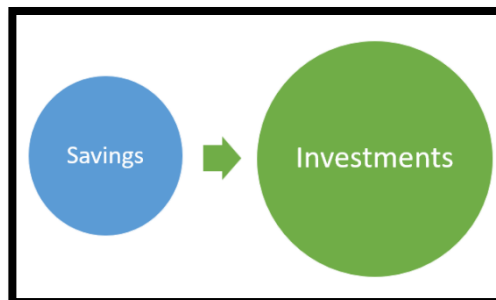
1.1 Functions of Banks

Intermediation is the primary function of banks and **mobilisation of deposits** is the first step to intermediation. They **accept deposit from public** and **lend it to the enterprise class engaged in productive activities**.

- The robustness of any economy depends to a **great extent on the savings** that are generated in it. These **savings** constitute **the source for creation of further wealth** by deploying them in tune with economic directions adopted by a country.
- **Investments** stimulate economic activities to greater heights leading to economic prosperity.



Intermediation function of Banks



Savings Convert into Investment in Economy

1.2 Retail Banking

Retail Banking refers to provision of **banking products and services** offered to **individual customers**, typically for non-entrepreneurial purposes.

- Retail banking involves offering of products of **both sides of the balance sheet**, e.g., fixed deposit, current/savings

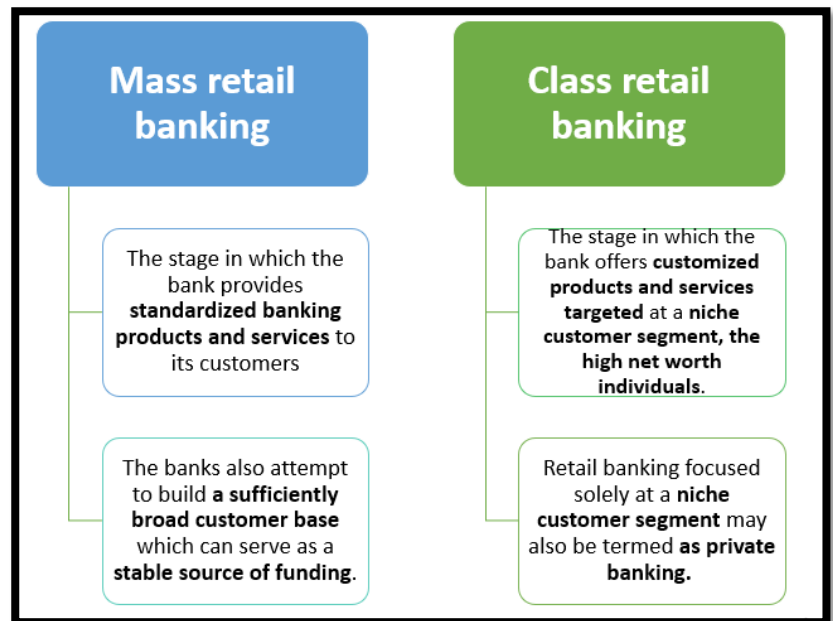
BALANCE SHEET	
ASSETS	LIABILITIES
What the bank owns (Branch buildings, computers, cash in their tills, government bonds, other financial assets etc) + What people owe to the bank (Loans, mortgages, overdrafts etc)	Everything the bank owes to other people (or other banks) + Whatever's left for the shareholders (Shareholder equity)

accounts on the liability side; and mortgages, loans (e.g., personal, housing, auto and educational) on the asset side.

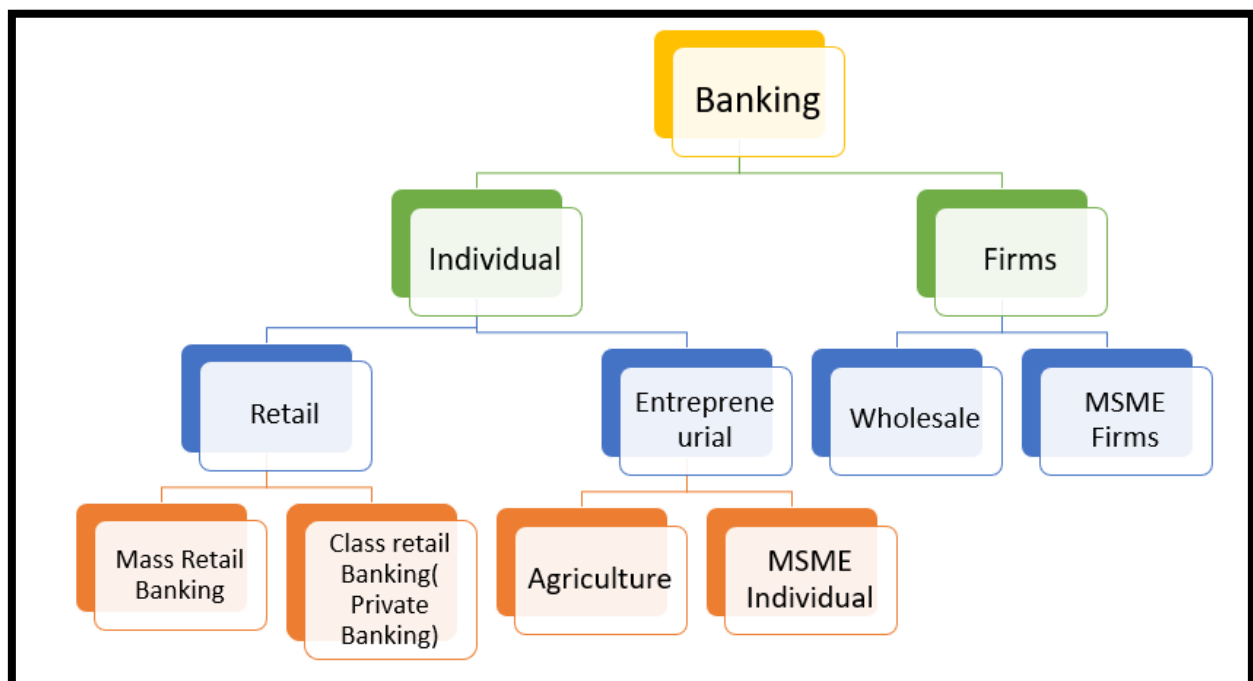
- Additionally, **retail banking** also involves offering of **credit cards, depository services, para-banking products and services** viz, insurance products, capital market products, etc., to individuals.

Typically, retail banking begins with a **target clientele**, which is the common masses, and it slowly graduates through a stage, which can be called as '**class retail banking**.'

Retail Banking has two stages namely **Mass retail banking** and **Class retail banking** as shown in the image.



A graphical representation of the **positioning of mass retail banking** vis-à-vis other segments of banking is as under:



1.3 Understanding Retail Banking

Before we move further, Let us understand the components of retail banking .

1. What is Retail Banking?

"Retail Banking is a **banking service** that is geared primarily towards **individual consumers** rather than large institutions.

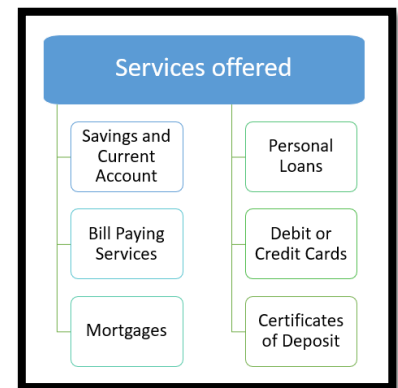
2. Who provides Retail banking ?

Retail banking is usually made available by **commercial banks**. Retail banks can be **local community banks** or the **divisions of large commercial banks**.

3. What services are provided by Retail Banks?

Unlike wholesale banking, retail banking focuses strictly on consumer markets.

- **Services** - Retail banking entities provide a **wide range of personal banking services** as shown in the image.
- **Mode of Service delivery** - Today, much of retail banking is streamlined electronically via **Automated Teller Machines (ATMs)**, or through virtual retail banking known as online banking."



2 Characteristics of Retail Banking

Retail Banking provides **banking services to multiple customer groups** with multiple products through **multiple channels of distribution**. The characteristics are as follows

1. Banking facilities are targeted at **individual customers or small organisations**.
2. Meets the **need of a large number of customers** with well diversified portfolios.
3. It is focussed towards **the mass market segment** covering a large population of individuals and non-individual entities.
4. It offers different **liability, asset** and a plethora of service products to the various customer categories.
5. The **delivery model of retail banking is both physical and virtual**, i.e., services are extended through branches and also through technology driven electronic off-site delivery channels like ATMs, Internet Banking, Mobile Banking, Phone Banking, etc.
6. The services are **extended to small- and medium-size businesses** as well.

3 Advantages of Retail Banking

- **Client base** will be **large** and therefore **risk is spread** across the customer base.

- **Customer loyalty will be strong** with a good scope for **cross selling** and customers tend not to change from one bank to another very often.
- **Attractive and wide interest spreads** since customers are too fragmented to bargain effectively. There is **less volatility** in demand and credit cycle **than from large corporates**.
- **Large numbers of clients** can facilitate marketing, mass selling and the ability to categorize /select clients using scoring systems/data mining.

4 Constraints in Retail Banking

Though retail banking as a segment has a number of embedded advantages, the segment suffers from constraints too. A few of the constraints are as listed below:

1. **Problems in managing large numbers of clients**, especially if the available IT systems are not sufficiently robust.
2. Rapid evolution of products can lead to IT complications.
3. The costs of maintaining branch networks and **handling large numbers of low-value transactions tend to be relatively high**. (For this reason, banks are encouraging clients to use cheaper distribution channels, such as ATMs, the mobile or the internet for these transactions and reserve the branches for higher value added transactions).
4. **Any loss in faith in a particular bank** can lead to sudden outflow of retail deposits resulting in **collapse of the bank**. This is called a **bank run**.
5. The competition is **very fierce** which may sometimes lead to **unhealthy competition**.

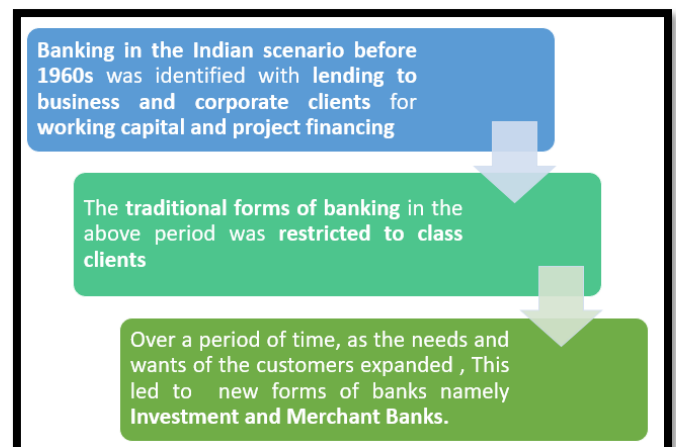
5 Evolution Of Retail Banking

Having understood what retail banking is all about; let us see the evolution and history of retail banking.

5.1 Retail Banking as a Business Model

Retail Banking, as a business model of banks, had evolved over the years from the **traditional banking space** as shown in the image.

- From being **plain vanilla commercial functions**, banks took new avatars like **Investment Banks and Merchant Banks**, to carry out the investment side of banking and also corporate capital raising, fund raising and debt structuring activities.
 - **Investment function** was hived off as a separate activity and also standalone



investment banks had emerged to take care of the multi-dimensional functions of ***Investment Banking, Mergers and Acquisitions***, etc.

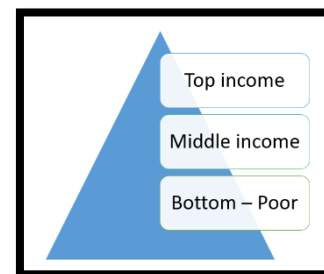
- **Merchant Banks** were the answer for **Capital and Debt raising** and other related activities.
- As the evolution of banking was a **continuous process**, the character of the customers base changed from **homogenous to heterogeneous** over a period of time, banks were under the compulsion to redesign their products and services models to cater to these customers and fulfill their varied needs. Thus, came **corporate banking and retail banking**.

5.2 Retail Banking Scenario in India

The **evolution of retail banking in India** can be traced back to the **entry of foreign banks**. The conventional banking business by **Public Sector Banks (PSBs)** was done on a more **generalized approach** and there was **no specific demarcation as retail and non-retail** activities.

- **Foreign banks operating in India** set the trend and in the late 1970 and early 1980s and came out with their consumer banking models specifically targeted at the **personal segment**.
 - **Standard Chartered Bank, Grindlays Bank and Citibank** created waves with their **credit card products** and spurred the **retail banking space**.
- **Indian Banks** - **State Bank of India** and some public sector banks like **Indian Overseas Bank, Bank of India, Bank of Baroda and Andhra Bank** developed and marketed **asset products and card products** to cater to retail segment.
- **Private Sector Banks** - The entry of **new generation** private sector banks in **early 1990s** has created a new approach to retail banking by banks. **With the advantage of technology right from start**, these banks had a **clear positioning for retail banking** and aggressively strategized for creating new markets for the retail segment.
- **Retail war** - The **new generation private banks** had posed a **threat to the retail business of foreign banks** that had by then well-defined business models for retail banking.
 - **To add to the fuel, PSBs also with technology initiatives** and redefined business model for retail had aggressively entered the market space, creating a **retail war** and capture their share of the pie in the **liberalized economic environment** and the **resultant opportunities in retail banking**.
- **India's preparedness for IT revolution** has impacted the **banking sector significantly**. It led all the banks to adopt **core banking solution**. It led to **organized and comprehensive computerization of operations** of banks across all levels. **IT has allowed the integration of ATMs, mobile banking and internet banking**.

- **Modern Payment Systems** - Due to technological advancement, India witnessed the adoption of modern payment systems, **securities settlement, electronic fund transfer, cheque truncation system, ATMs** and many other modern system of banking transactions.
- **New trend in retail banking** - Of late banks, **especially foreign banks, new generation private players, Non-Banking Finance Companies (NBFCs) and MNCs** are seriously looking at the **bottom of the customer pyramid** and reengineering their retail strategies to develop independent and exclusive strategies for this segment.



5.3 RBI Data on Retail Banking in India

The Indian retail banking is in **growth trajectory**. The growth in various elements of retail banking space over the past few years are published by RBI in their Bulletin, "**Report on Trend and Progress of Banking in India &, Financial Stability Report**", which reflects the business performance achieved in the retail assets and other services by banks as under:

A. Growth Rate of Retail Assets of the Banking System

Based on the image in the next page , few important learnings from the image are discussed below.

1. The **housing loan component** which constitutes more than **52% of the total retail portfolio** of banks increased by 29.68% from 2019 to 2021. All though there is slight decline in growth as compared to the corresponding previous year.

(Amount in ₹ Billion)				
S No.	Type of Retail Asset	2019	2020	2021
1.	Housing Loans	12044	13965	15619
	Percentage growth over the previous year	19.5	15.9	11.8
2.	Consumer durable loans	92	111	216
	Percentage growth over the previous year	-51.7	21.3	93.4
3.	Credit Card Receivables	1113	1321	1386
	Percentage growth over the previous year	34.5	18.6	4.9
4.	Vehicle/ Auto Loans	2697	2894	3295
	Percentage growth over the previous year	12.9	7.3	13.9
5.	Other Retail / Personal Loans	6335	7510	8560
	Percentage growth over the previous year	22.77	18.54	13.99
6.	Educational Loans	762	791	788
	Percentage growth over the previous year	1.8	3.7	-0.3
	Total Retail Loans	23043	26592	29864
	Percentage growth over the previous year	18.6	15.4	12.3

(Source: Trend and progress of banking in India 2020-21-RBI)

B. Percentage of Retail Assets to Total Assets of the Banking System

S. No.	Details of Advances	2019	2020	2021
1.	Total Advances of Banking System	95269	100984	106408
2.	Percentage growth over the previous year	13.4	6.00	5.4
3.	Percentage share of Retail to Total Advances	24.18	26.33	28.06

Retail loan portfolio of banks continued to grow at around an average 26.60% during 2019-2021 even though there was deceleration in the total credit growth of banks.

C. Number of ATMs of Schedule Commercial Banks

ATMs	Number as on 31.03.2019	Number as on 31.03.2020	Number as on 31.03.2021
Number of Onsite ATMs	106259	113271	115605
Number of Offsite ATMs	95813	97489	97970
Total Number of ATMs	202072	210760	213575
Number of Bank Branches	120535	122994	122976
ATMs as percentage of Bank Branches	167%	171%	173%
Number of Branches covered under CBS	120535	122994	122976
Coverage of Branches	100%	100%	100%

Source: RBI Bulletin)

As seen above ATM as percentage of bank branches are 173%.

6 Prerequisite for Success of Retail Banking

There are various factors that can subscribe to the success of retail banking in India, a few of which are listed here in below

1. **Presence of an efficient delivery mechanism** - It is the most important pre-requisite for retail banking to succeed. **What essentially binds customers to their bank** is the **quality of services offered, the fairness and affordability of pricing** and the **promptness of service**.
2. **Direct Banking** - The Fastest growing channel of the Future Direct banking is **online banking from a specific institution**. Online Banking compasses a wide range of channel approaches to sell and service customers' needs, including **ATMs, call and email centres, mobile banking devices, direct mail, and a variety of web-based models**.
3. **Product appropriateness** - Another essential pre-condition for the success of retail banking is **appropriateness of product and services for the customers**. Banks must **invest heavily into data analytics** and assess what are the **appropriate products and services** for the specific groups of their customers to increase the customer base.

4. **Pricing** - The pricing demonstrates that the products and services, both on the **liability as well as on the asset side**, are heavily weighed against the retail customers as a group.
5. **Scoring models for assessing the credit worthiness** - The scoring models are being used for assessing the credit worthiness of borrowers to bring in greater transparency and efficiency. Most of the banks are using credit information reports to assess the **financial discipline of the applicants**.
6. **Consumer protection environment** - Across the globe, the regulators and supervisors are turning **increasingly intolerant of unfair market practices** adopted by the market participants. It has been observed that **large amounts of penalties are levied on banks** by the regulators mainly **for failing to protect consumers' interests and for unfair practices**. More focus needs to be given to **develop conviction on the customers** that their **rights are adequately protected**.

7 Challenges For Retail Banking

1. **Consumer Protection & Pricing** - There are several examples reported on pricing being arbitrary such as there are **charges for non-maintenance of minimum balance, charges for cheque return** and there are charges **even for customers not conducting any transactions**, etc. Another **disquieting feature in the pricing of products and services by banks**, is the **poor subsidising the rich**.
2. **Understanding of KYC/AML issues** - The banks in the developed countries have faced **significant amount of penalties from the regulators** for their failure to conduct adequate **due diligence on their customers**. Even, in India, **RBI** had imposed penalties on some of the banks for their failure to have proper **due diligence on their customers**.
3. **Managing Risk** – The risks could be in **the form of inadequacy of internal guidelines or non-adherence by staff**, fraudulent practices employed by customers, hackers, etc. The **banks also need to recognize** and manage risks arising from mis-selling, etc., besides the other business risks like **market risk, liquidity risk, interest rate risk, etc.**
4. **Effects of disruptive new technologies** - With the increased proliferation of **alternate delivery channels (ATMs, internet mobile banking and QR codes)**, so has the **scope for fraudulent transactions** grown through impersonations, identity thefts, sim swap, and device control apps etc.
5. **Continuing growth** - Despite banks concerted efforts on **increasing the banking penetration** and bringing more adult population under the formal financial system over the last 7-8 years, **more than half of the target population remains uncovered**. Similarly, **the credit penetration from the banking system** in the country is abysmally low at about 10%. **In absence of access to formal sources of finance**, the alternate cost of funds for the people is exorbitantly high.

8 Reasons for the Growth of the Retail Banking Segment

There are various reasons that contribute to the growth trajectory of Retail Banking segment, a few of which are as under:

1. **Rise of the Young Indian Professionals** - The **Improving purchasing power of younger population** coupled with **more liberal attitudes toward personal debt**, is contributing to India's retail banking segment.
2. **Growth as an Economic superpower** - As the growth story gets unfolded in India, **retail banking** is going to emerge as a **major driver**. **T. Kearney**, a global management consulting firm, identified India as the '**second most attractive retail destination**' of the **30 emergent markets**.
3. **Financial market reforms** - The growth in the field of retail lending is primarily because of the **speedy advancement in the IT sector, evolving macroeconomic environment**, numerous micro level demand and supply side factors and financial market reforms.
4. **Engine of economic growth** - **Retail banks** play a critical role in their home economies. They **offer critical credit functions**, which largely fuel the engine of economic growth in their economies. When **retail banks are failing**, little or no credit is available for credit seekers, and economic activity becomes depressed.
5. **Mass-market banking** - The **retail banking sector** is often described as a **typical mass-market banking**, offering services such as **savings and operative accounts and all kinds of personal loans, including auto loans and student loans**.
6. **Automation of banking process** - The growth in retail banking has been facilitated by **growth in banking technology and automation of banking processes** to enable extension of reach and rationalization of costs. **ATMs** have the advantage of **reducing the branch traffic** and enables banks with small networks to offset the traditional disadvantages by increasing their reach and spread.
7. **Easy and affordable access** - Banks provide retail loans through a wide range of options/ flexibility. **Banks** even finance cost of registration, stamp duty, society charges and other associated expenditures such as furniture and fixtures **in case of housing loans** and cost of registration and insurance, etc., in case of auto loans.
8. **Financial Liquidity** - Banks making financing attractive by offering free/concessional/ value added services like **issue of credit card, insurance, etc.**
9. **Technological innovations** - Convenience banking in the form of **debit cards, internet and phone-banking, anywhere and anytime banking** has attracted many new customers into the banking field. **QR code based payment options** are available even at a smallest outlet in remote areas.
10. **Decline in interest rates** - The interest rates decline in **Indian money market** has also contributed to **the growth of retail credit** by generating the demand for such credit. The interest rates on retail loans have declined from a high of **16-18% in 1995-96** to presently in the band of **7.5-9%**.

8.1 Scope of Retail Banking in India

- The **rural India has more purchasing power** at their disposal and this is an opportunity to market Retail Banking.
- India has 300 million households and 400 million middle class population. More than **90% of the savings** come from the household sector. Falling interest rates have resulted in a shift. **"Now People Want to Save Less and Spend More."**
- Nuclear family concept** is gaining much importance which may lead to **large savings**. The number of banking services to be provided is increasing day-by-day.

9 Future of Retail Banking

Many changes have happened in the banking space during **the two years of the pandemic**. Digital ways have become the new norm.

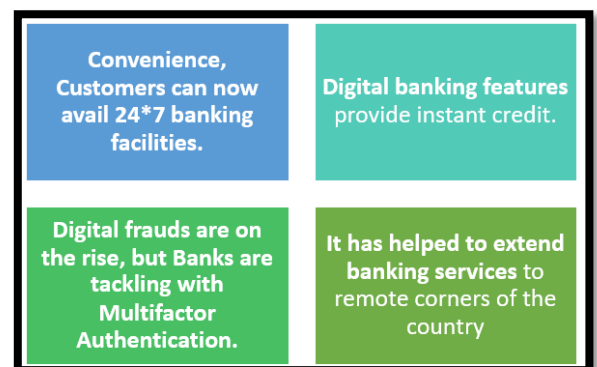
- CEOs and managers** who never planned meetings remotely have **mastered the art of presiding** over on-line meetings. Customers have **started using on-line sites** for all their shopping needs in a major way.
- Banks and financial institutions** have felt tremendous pressure to **innovate and provide seamless digital services** that replicate the **same digital experience** that a technology company provides to stay relevant to current times.

Based on research and findings, here are a few pandemic-sparked retail banking trends worth keeping an eye on for 2022 and beyond.

9.1 Growth in Digital Banking

The temporary reduced hours of brick-and-mortar bank branches forced many customers to **download their financial institution's app** finally. This has led to increase in digital banking.

When **we talk of digital banking**, it is generally referred to as **banking on a mobile app** via **smartphone or banking online via computer**. The benefits and the importance of digital banking can be summarized as seen in the image.



9.2 Rapid Adaptation of Blockchain by Retail Bankers

Traditional money transfer solutions have been problematic in both **the B2B (business-to-business)** and **P2P (peer-to-peer)** areas, plagued by slow transfer times and high costs.

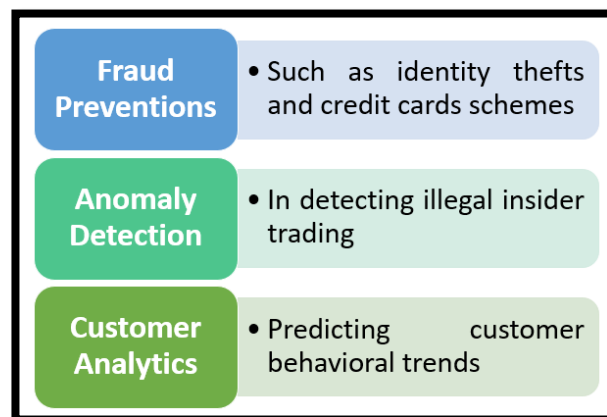
- The clearing firms** involved in the transactions have **independent processing systems**, **making the process stringent**. **The lack of standardization** between these bodies and correspondent banks means that costs are high, and settlement periods are longer.

- But, **thanks to Blockchain**, which has the **potential to solve these challenges** by **offering faster transaction times**, more transparency, and lower costs, changing the money transfer equation.

9.3 Artificial Intelligence (AI) and Data Science in Banking

With **financial institutions revenues exceeding the incomes of nations**, it comes as no surprise that they are the first to embrace AI and Data Science technologies. **Bankers and leaders in the banking industry** firmly believe that Artificial Intelligence will be game-changing.

- With its **efficiency to work with unstructured data**, AI is well poised to deal with the rising incidence of cybercrimes, financial fraud threats, and lots more.
- Some of the ways AI & Data Science can be used in banks are discussed in the image.



9.4 Cyber Security to be a Top Priority

Banks and financial institutions have always been at the forefront of enterprise cyber security. **The enormous stores of cash and consumer data** make them a **top target for hackers**. The threat of financial losses, regulatory consequences, and reputational damage has spurred them to **innovate and accelerate the field of cyber security**.

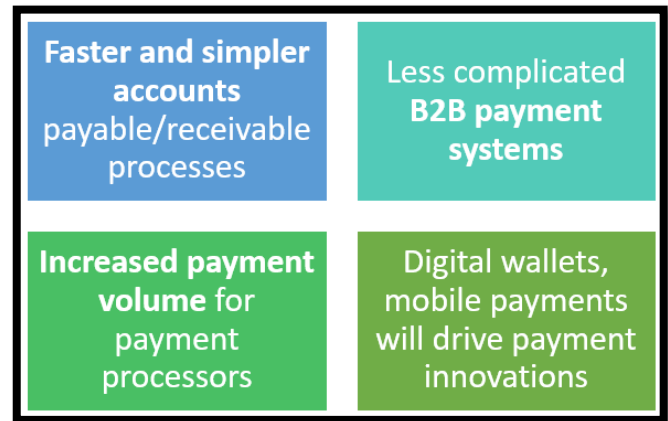
A few measures requires to be implemented immediately may be:

- I. A **well-defined security policy** serves as a crucial road map for **any bank IT team** to maintain a truly adaptive security architecture going forward.
- II. Banks must **continuously monitor** their network for changes to configurations and ensure that these changes are approved and compliant with policy
- III. **A chain is as strong as the weakest link** this proverb applies most appropriately for the cyber security of the banks because **"humans are the weakest link"**. That is why 95% of security breaches are blamed to on human error. Training for awareness and fraud prevention for staff and customers education is the need of the hour.

9.5 Payment Innovations

The term **"Instant Payment"** refers to **the ability to make payments within a matter of seconds**, which in turn will be highly beneficial for both parties throughout the payment landscape. As we advance, **mobile wallets will replace physical wallets** - a wallet with customer's credit cards, rewards cards, and much more.

- With the innovation of advanced technology in payment systems by **NPCI (National Payment Corporation of India)**, the payment timings have significantly reduced and it is expected to improve further.
- This will allow **banks and financial services** to upgrade to facilities as shown in the image.



9.6 Rise of Big Tech in Banking Industry

Tech firms like **Apple, Google & Samsung** have been providing payment services for several years now, and few have started to coalesce to accelerate their financial services movement.

- Banks have a limited ability to retain their users compared to traditional ones. Simultaneously, **technology companies** have always had much more success in developing in a **closed ecosystem**. And they are now looking to bring finance under their banner.
 - With **Apple Card** showing its prominence. And **Google, Stripe, and PayPal** are preparing to start or expand banking and payment-related offerings. The industry is already shaken.
- It is believed that **the partnership between banks and tech companies** are more likely than **tech companies outright becoming banks**. Instead of viewing big tech companies as a threat, banking and financial institutions should embrace partnerships and collaboration with them.