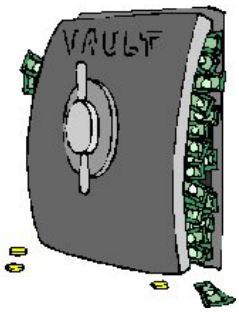
# Topic 1(n) Banks and building societies

## What are banks?




**Banks** are large companies that provide a wide range of financial services. They are a type of **financial intermediary**. Financial intermediaries take in deposits from those people who have more money than they need to spend and lend it to those who do not have enough.

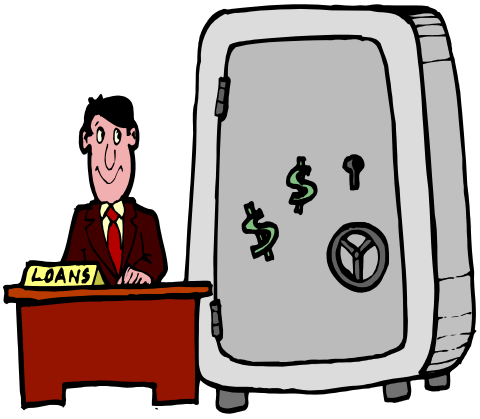
Banks provide services to personal customers and to companies.

## What do banks do?

Here are the main services provided by banks to personal customers:

- **making payments** (banks call this **money transmission**): they provide us with ways to pay and receive money, for example:
  - providing **cash;**
  - operating **current accounts** on which people can draw cheques to pay others;
  - giving **debit cards** to their accountholders;
  - operating **standing orders** and **direct debits** on current accounts;
  - providing **credit cards** which are a method of payment and also a type of loan;
  - selling foreign currencies and travellers' cheques.

- **keeping money safe and offering savings accounts**: they offer us accounts that we can keep our money in until we spend it, or save what we don't want to spend straight away, for example:
  - current accounts: the accountholders have a chequebook that they can use to make payments out of the money they hold in the account;
  - **deposit accounts**: these are for savings and there are different accounts for different types of savers and different lengths of time.




- **making loans**: they lend us money when we don't have enough to buy what we need or want, for example:
  - **overdrafts** allow current accountholders to take out more than they have paid in;
  - **personal loans** of between 1 and 7 years can be used to pay for items like a computer or a car;
  - **credit cards** allow you to use your card to pay for your shopping electronically now and pay it back to the credit card company later and over a period of time;
  - **mortgage loans** enable people to buy a house by borrowing over a long period, usually 25 years.

**Savers' money is safe even if the bank suffers a robbery!**

It is safer for savers to keep their money in a bank because they will not lose it and it will not get stolen; even if a bank suffers a robbery, the depositors do not lose their money. And it is easier for borrowers to get a loan from a bank than from an individual person because the bank spreads its risk over large numbers of customers, so even if one customer doesn't pay the loan back, the others do and the bank still profits. Banks are specialist lenders and they have ways of reducing risk and also of spotting someone who is unlikely to repay.

## Who owns banks?

Modern banks are very large companies that are owned by their **shareholders.** They have to make a profit for these shareholders and they do this in two main ways:

(a) They charge more interest to their borrowers than they pay to their depositors (savers) and the difference is their **profit margin**.

(b) They have fees and charges for a number of the services they provide.

Banks need to make enough profit to keep their shareholders happy but, if they make too much, their customers think they are being charged too much. They need to strike a balance between the two extremes. Banks have to reduce their profits each year to allow for those people who will fail to repay their loans; these are called **loan defaults** and they are a type of **bad debt**.

## The main UK banks

Here, in alphabetical order, are the names of the main banks that operate in the UK. They are very large multinational companies with links all over the world.

- Abbey
- Barclays
- HBOS (Halifax Bank of Scotland)
- HSBC (Hong-Kong Shanghai Banking Corporation)
- Lloyds TSB (Lloyds Trustee Savings Bank)
- Royal Bank of Scotland (which includes NatWest)

***Each of the above banks has a logo and a slogan. Go to the Internet or to a branch and find out what these are.***

***Walk down your local high street and see how many of these banks you can find. Go in and pick up some leaflets, take them home and read about some of the services they offer.***

## The history of banks

The first bankers were goldsmiths. People who had gold and who didn't want to spend it were afraid they would lose it or have it stolen so they took it to a goldsmith, who was one of the few people to have a safe. The goldsmith would give them a receipt that they could use later to take out their deposit. Eventually people began to use these receipts to make payments instead of actually taking out the gold and using that, and the paper receipts became the first banknotes. When the goldsmiths realised that only a small amount of the gold deposited with them was wanted each day, they began to lend out the rest to creditworthy people and these were the first bank loans. Goldsmith-bankers provided monarchs and merchants with the money to fund their travels around the world.

All of the banks mentioned above have a long history. Following is the history of one the larger banks, Lloyds TSB.

**Lloyds TSB**

In 1765, John Taylor and Sampson Lloyd set up a private banking business in Birmingham. Two of their sons went on to establish a bank in London, which eventually became absorbed into the Lloyds Banking Company. The bank expanded by **merging** with other banks and it also began to move into other countries.

In 1810, the Reverend Henry Duncan of Ruthwell, Dumfriesshire in Scotland set up a bank to help his poorest parishioners save for times of hardship. It was a popular scheme and by 1818 there were 465 savings banks in Britain. These individual banks came together as the Trustee Savings Bank Association in 1887. The bank grew throughout Britain and it became a company in 1986. In 1995 it merged with Lloyds Bank to become Lloyds TSB Group plc.

You can find out more on the Lloyds TSB website: www.lloydstsb.com

All the major banks started off small and have ended up very large! They have grown from within as they have reinvested their profits but they have also merged with and taken over other banks. This process is still continuing, and the latest trend is for mergers and **takeovers** to involve companies based in other European countries, or more distant regions of the world. A recent example was the takeover of Abbey by the Spanish bank Banco Santander in 2004.

## What do building societies do?

Building societies are financial intermediaries that, like banks, offer a wide range of financial services under the headings of money transmission, accepting deposits and making loans. Most of their customers are individuals – they do not deal with businesses in the way that banks do.

We can divide the main services of building societies into three areas. The first two are their traditional and main work.

- Accepting deposits: about 15 million adults in Britain have savings accounts with building societies.


- Making mortgage loans, i.e. lending people money to buy a house: over 2½ million adults are buying their own homes with the help of loans from building societies.
- Other services: like banks, building societies offer current accounts, credit cards, cash machines, travel money, personal loans and insurance.

## Who owns building societies?

Building societies are **mutuals** – this means that they are owned by their investing members, who have share accounts. They are not companies and so they do not have external shareholders – all their members have deposited money with the society. These members earn interest on the money they have invested but they do not receive dividends and the societies do not have to make large payouts of profits like banks do. So the societies run on lower costs and offer cheaper mortgages and better rates of interest on savings than banks do.

A

***Look up the word 'mutual' in the dictionary. What is the definition? How does this apply to building societies?***

## Who are the building societies?

The biggest and best-known building society is the Nationwide. Here are the names of some of the other 62 British building societies:

- Britannia Building Society
- Cambridge Building Society
- Manchester Building Society
- Swansea Building Society
- Yorkshire Building Society

Q

***What do you notice about the names of the building societies?***

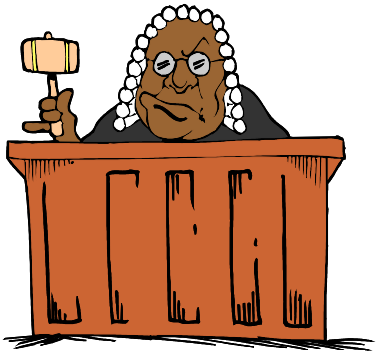
All the building societies are called after place names because building societies sprang up in local areas. This does not mean that you have to live in that area in order to deposit money with them or borrow from them. Some of the biggest building societies of the past have become companies or have been bought by banks.

A

***Find out which building societies come from your part of the country. Look up their history and the services they offer.***

# Why do building societies want to become banks?

In 1989, the Abbey National Building Society changed its status and became a bank. Other building societies followed suit, e.g. the Cheltenham & Gloucester became part of Lloyds Bank, and the Halifax, the largest building society, merged with the Bank of Scotland to become HBOS.



**The law does not allow building societies to carry out too much risky lending.**

Unlike banks, building societies do not have any outside shareholders, who are expected to risk their money; instead they get their funds from their internal shareholders and their depositors. The money provided by these people is supposed to be protected and so the law does not allow the societies to do risky lending. The safest form of lending is mortgage loans because the money lent is secured on the property purchased. This means that if the borrower defaults, the building society can take the property and sell it to recover its money.

But there is a lot of profit to be made from personal loans and credit cards, which are not secured on any property and so a higher rate of interest can be charged. Banks make a lot of money out of these but building societies can only do a small amount of **unsecured lending**. If they want to take advantage of customers' huge demand for credit, they need to become banks. So they issue shares and become companies instead.

### Nationwide – proud to be different

The Nationwide Building Society has its origins in Northampton in 1848 and also within the co-operative movement in London in 1883. Over 100 mergers later, the biggest being the merger with the Anglia Building Society in 1987, the Nationwide is the fifth-largest mortgage lender in the UK and the ninth-largest retail banking, saving and lending organisation.

The Nationwide is the largest building society in the world and is committed to staying mutual. This means that it has no intention of becoming a bank – it emphasises its mutual status and markets the fact that it puts its members first. You may have seen its 'New Customers Only' advert in which it shows how it behaves well to existing customers. Its slogan is 'Proud to be Different'. Because the other large building societies have now become banks, it has been left as by far the biggest player in the building society market. At the same time, it can distinguish itself from banks by promoting its caring attitude to its customers.

## Review questions

1. What name do we give to an organisation that takes deposits from people who have too much money and lends it out to those who haven't got enough?

2. What are the three main groups of services provided by banks?

3. A bank's profit margin is the difference between _____ and _____.

4. What are the two main types of financial service traditionally offered by building societies and which still form their main business?

5. What word describes the legal status of a building society?

## Case study

**Read the case study and then answer the questions that follow.**

Around 3 million adults in the UK do not have a bank account and so they cannot take advantage of any financial services offered by banks, e.g. they cannot use cheques or credit cards, or apply for a loan. They use cash for everything.

Some people do not have a tradition of keeping their money in a bank account. These people are likely to be drawn into the network eventually, as an increasing number of employers prefer to pay wages and salaries directly into bank accounts, rather than using cash pay packets, which are a security problem. And the government now wants to pay benefits and pensions direct into a bank account rather than in cash.

There is another group of people who have been turned down for an account by banks because of their bad **credit record**, in particular people who have had a **County Court Judgment** (CCJ) made against them. But it is better for these people to borrow from a bank than from a moneylender, who will charge very high interest and might use threats to get the money back.

Banks now provide 'basic accounts' for people who do not have much money or who are not very creditworthy. But they do not advertise these accounts very strongly because they do not make much money out of them. Someone who is receiving state benefits is not likely to be a good lending prospect and so the bank cannot sell them other financial services.

It is government policy to bring more people into the banking system and this is called **financial inclusion**. The government feels that people who have a bank account are more likely to find a job. Inclusion of the 3 million who are outside the system at the moment would also encourage banks to open branches in poorer areas and this might encourage people to open businesses there.

1. What problems might there be for someone who does all their financial transactions in cash?

2. What type of people do not have bank accounts?

3. What factors might bring these people into the banking system?

4. Why is financial inclusion a social as well as an economic policy?

# Learning activities

## Internet

1. Go to the websites of the following banks and find out something about their history and the services that they offer. How does this information tally with the information you got from the leaflets you picked up?

   Abbey: www.abbey.com

   HBOS: www.hbosplc.com

   HSBC: www.hsbc.co.uk

   Royal Bank of Scotland: www.rbs.co.uk

   Go to the website of the British Bankers' Association (www.bba.org.uk), which contains a lot of information about banks in Britain. Find out the names of the main British banks and discover which other companies they own. Surf the site – there are booklets and fact sheets that tell you a lot about banks and the services they offer.

   What other banks can you find apart from the ones mentioned in this topic?

2. Go to the website of the Building Societies Association (BSA) on www.bsa.org.uk and find out the names of the 63 building societies. Browse through the fact sheets on the website and see what interesting information you can find.

   Now go to the website of several of the building societies – why not concentrate on the ones that come from your area. The website of the Nationwide is www.nationwide.co.uk. You can find this address and those of the other societies on the BSA website. Find out something about the building society – its background and services. Does it take part in any local or charitable activities?

   On these websites, look up the rates of interest paid by building societies on their savings accounts; compare these with the rates paid by banks on similar accounts. Which pays the better interest?

## Group

Get into pairs. One person will be the banker and the other will be the customer. Prepare and act out an interview scene in which the customer asks the banker for a loan and the banker finds out about the customer.

## Individual

1. Tick the boxes in the table below to show what each of the financial services is for. Some services may have more than one purpose.

| **Service** | **Money transmission** (making payments) | **Accepting deposits** (paying money in) | **Loans** (borrowing services) |
|---|---|---|---|
| Overdraft | | | |
| Deposit account | | | |
| Cheques | | | |
| Cash | | | |
| Personal loan | | | |
| Debit card | | | |
| Credit card | | | |
| Foreign currencies | | | |

2. Many bank customers use financial services under all the main headings. How is it possible for the same person to have a savings account and also to be borrowing money from a bank?

3. Tick one of the boxes on the right to show which of the following statements refer to a bank and which to a building society.

| | **Bank** | **Building society** |
|---|---|---|
| Owned by its members. | | |
| Offers a very wide range of personal financial services and does a lot of unsecured lending. | | |
| Issues shares that you can buy and sell on the **Stock Exchange**. | | |
| It is a multinational company. | | |
| Its main aim is to pay the best interest rate to its savers and to charge the cheapest interest rate to its borrowers. | | |

## Key points for Banks and building societies

- ☐ Banks are financial intermediaries that provide money transmission services, accept deposits and make loans.
- ☐ Banks are companies that are owned by their shareholders and make their profits on the difference between the interest rate they charge their borrowers and the interest rate they pay their savers.
- ☐ There are six large banking groups in Britain and these also operate internationally.
- ☐ Financial inclusion means trying to encourage everyone to have a bank account so they will be ready for work and are able to escape poverty. They will then have access to a wide range of banking services.
- ☐ Building societies are financial intermediaries that offer similar services to banks but concentrate on savings accounts and mortgage loans.
- ☐ Building societies are mutuals – this means that they are owned by their members and not by shareholders, like banks are.
- ☐ There are 63 building societies in Britain and the largest is the Nationwide.
- ☐ Many building societies have changed into banks so they can do unsecured lending – as building societies they are restricted in this profitable but risky market.