CHAPTER THIRTEEN

Banking Functions, Retail Banking and Laws in Everyday Banking

CHAPTER STRUCTURE

KEY TAKEAWAYS FROM THE CHAPTER

- Understand the basic banking terms.
- Examine the banking functions and obligations of banks to customers.
- Understand the scope and SWOT analysis of retail banking.
- Information on CBM in banking.
- Examine the laws in everyday banking.

SECTION I

BASIC CONCEPTS

Commercial banking activities can be broadly categorized as retail banking and corporate banking. Retail banking refers to the banking functions undertaken by individuals whereas corporate banking refers to the banking services offered to the firms irrespective of their size (small, medium and large-scale organizations). The distinction has already been elucidated in our earlier chapter on banks' lending function.

A third type of banking—investment banking—has been in the news during the last two decades. How is investment banking different from retail and corporate banking?

Pure investment banks typically do not accept deposits from or make loans to individuals, as commercial banks do. They provide fee-based financial services such as acting as advisors, managers or underwriters to public share issues, facilitating mergers and acquisitions, corporate restructuring, private equity deals, or corporate bond placements, or acting as brokers/dealers/custodians in the capital markets, and so on.

Negotiable Instruments

Negotiable instruments have a great significance in the modern business world. These instruments have gained prominence as the principal instruments for making payment and discharging business obligations. Negotiation implies transfer by endorsement if payable to the order or by delivery if payable to bearer. 'Instrument' implies a documentary means of transferring ownership.

Section 13 of the Negotiable Instruments Act, 1881 defines a negotiable instrument to be 'a promissory note, bill of exchange or cheque, payable either to order or to bearer'.

The major negotiable instruments are bill of exchange and cheque payable either to order or bearer. For example, when a cheque is transferred to any person, the cheque (instrument) is said to be negotiated.

Bill of Exchange It is an instrument in writing, containing an unconditional order, signed by the maker, directing a person to pay a certain sum of money to a certain person or to the order of that certain person or to the bearer of the instrument (Refer to the Negotiable Instrument Act (N. I. Act), Section 5, India, for more information and also the earlier chapters on bank lending. In the United States, the Uniform Commercial Code Article 3 covers the use of such negotiable instruments.).

Cheque The characteristic features of a cheque can be specified as follows:

- As per the Negotiable Instrument Act, a cheque is a bill of exchange.
- It is always drawn on a bank and is payable on demand.
- It has three parties:
  1. **Drawer:** A person who draws the cheque on a bank.
  2. **Drawee:** A bank on whom the cheque is drawn.
  3. **Payee:** A person to whom the payment is to be made by the bank.
- A cheque can be payable either to order or to bearer.
- When a cheque is crossed, the banker shall not pay the amount over the counter.
- When a payee accepts a cheque and if it is dishonoured, he can claim the money from the drawer.
- A customer has the right to 'stop payment' before the due date, after he issues the cheque.

It is a common practice to return cheques where the amount differs in words and figures. The customer is not expected to draw cheques by leaving any blank space that would facilitate insertion of words/figures.

The banker has to cross-check the signature, with the specimen available in the branch, when a cheque is presented for payment.

Difference Between Cheque and Bill of Exchange Every cheque is a bill of exchange. However, every bill of exchange is not necessarily a cheque. The essential differences are as follows:

- A bill of exchange need not necessarily be drawn on a banker.
- A bill of exchange may be payable on demand or payable on a future date.
- A bill of exchange payable on a future date is called usance bill.

Types of Deposits

Deposits[1] can be classified into demand deposits and time deposits.

Demand Deposits These are of two types:

1. Saving deposits
2. Current deposits

1. **Saving deposits:** As saving accounts are meant to encourage savings habit, organizations whose purpose is profit are not allowed to open such accounts. Interest is paid on a half-yearly basis in these accounts. A minimum balance is stipulated by each bank. A balance amount above the minimum stipulated amount is eligible for a 3.5 per cent interest rate in India at present.
2. **Current deposits:** Since this account is to meet the transaction needs of the customer, there is no restriction on the number of transaction in the account or in the type of customers eligible to open these accounts. Account holders are not entitled to any interest from the bank.

Time Deposits These are also called as fixed deposits or term deposits. These are repayable after the expiry of a specified period varying from 7 days to 120 months.

Senior citizens get higher interest rates. Hence, joint deposits with them make sense.

Non-Resident Indian (NRI) Accounts

The present menu of bank accounts for Non-Resident Indians (NRIs) has three categories:

- Non-resident (external) rupee accounts (NRE)
- Non-resident (ordinary) rupee accounts (NRO)
- Foreign currency non-resident (banks) accounts [FCNR] (B)

These accounts can be distinguished as follows:

- While NRO and NRE accounts can be kept in the form of current, savings or term deposit accounts, FCNR (B) deposit can be kept only in the form of term deposits, for periods ranging from 6 months to 3 years.
- Remittances from abroad can be credited to any of these accounts. But earnings of NRIs on the property held by them in India, which are non-repatriable, can be credited only to NRO accounts.
- Money from an NRO account is non-repatriable, but NRE and FCNR deposits are repatriable.
- The entire interest earned on NRO accounts is eligible for repatriation. Persons of Indian nationality who have been NRIs for a period of not less than 1 year and have returned to India are eligible to open a RFC (Resident Foreign Currency) account.
- An NRO account may be jointly held with residents.
- NRE and FCNR (B) accounts cannot be jointly held with residents. But resident power of attorney is permitted for local payments and investments in India.
- Balances held in NRE/FCNR accounts are exempted from wealth tax and interest earned is exempted from income tax. There are no tax exemptions on interest earned on NRO accounts.

Mandates and Power of Attorney

An account holder can appoint a third person to act on his behalf to do certain acts like drawing cheques or instructing bank to debit the account for various purposes like issuance of drafts.

Mandates The following are the salient features of mandates:

- It is an unstamped letter signed by the customer, authorizing a person to operate the account on his behalf.
- Signature of the mandatory should be obtained in the letter of mandate.
- A letter of mandate is generally issued for a short and temporary period.

Power of Attorney The following are the salient features of power of attorney:

- It is a stamped document and generally executed in the presence of a notary/magistrate of a court.
- Two types of powers are granted—special and general powers of attorney. Special power of attorney is often for a single transaction and general power of attorney confers an agent very extensive powers.

Lien Lien is the right of the creditor to retain possession of the goods and securities owned by the debtor until the debt due from the latter is paid. General lien gives a right to possess the goods, banker's lien adds to it, the right of sale in case of default by the latter. Therefore, it is called an implied pledge.

SECTION II

RETAIL BANKING—NATURE AND SCOPE

Retail banking encompasses retail deposit schemes, retail loans, credit cards, deposit cards, insurance products, mutual funds, depository services including demat facilities. It includes various products and services forming a part of the assets as well as the liabilities segment of the banks. A simplistic definition could be 'banking catering to the multiple requirements of individuals relating to deposits, advances and associated services'. See Figures 13.1 and 13.2.

FIGURE 13.1 BANK'S FUNCTIONS

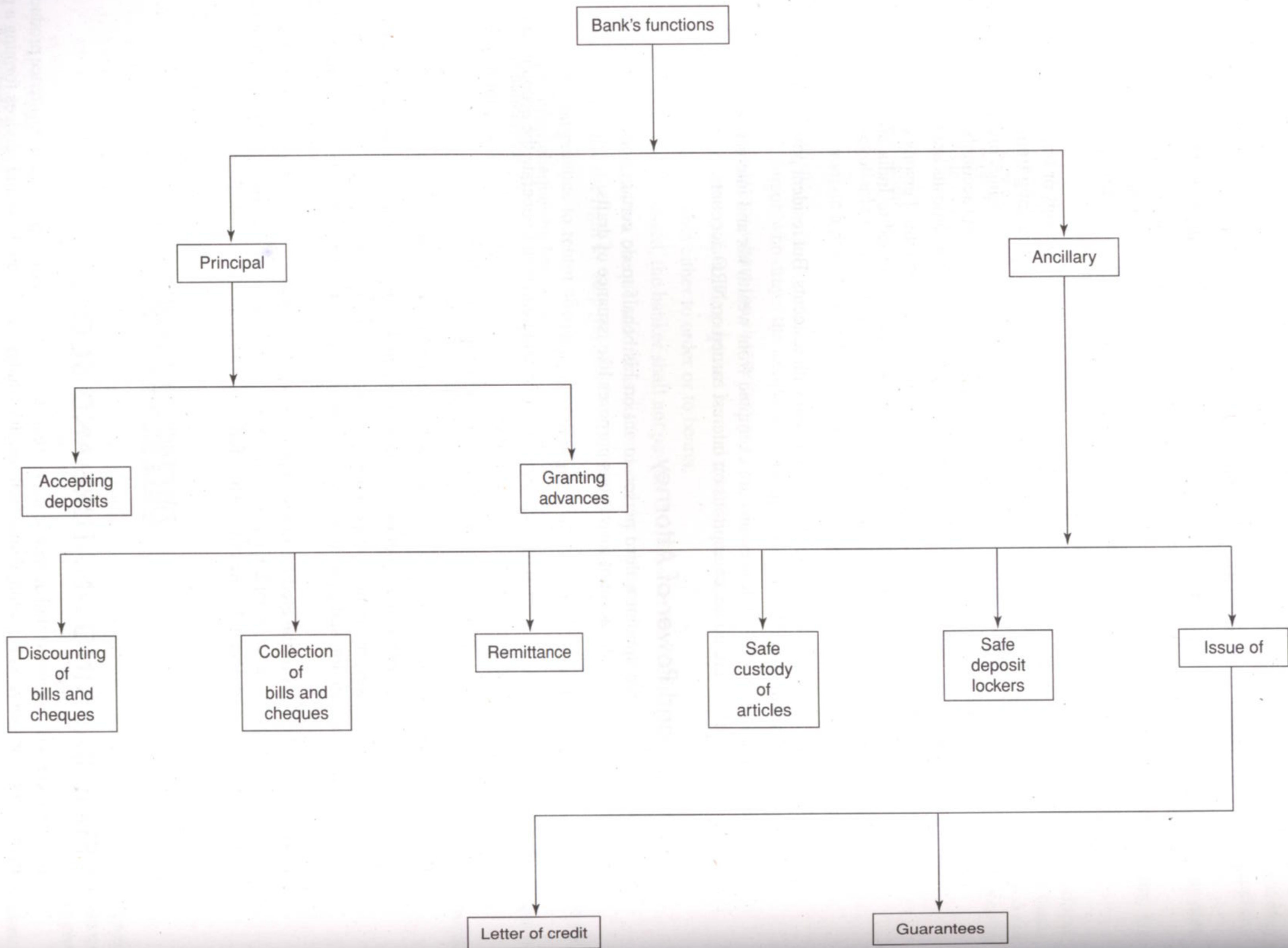
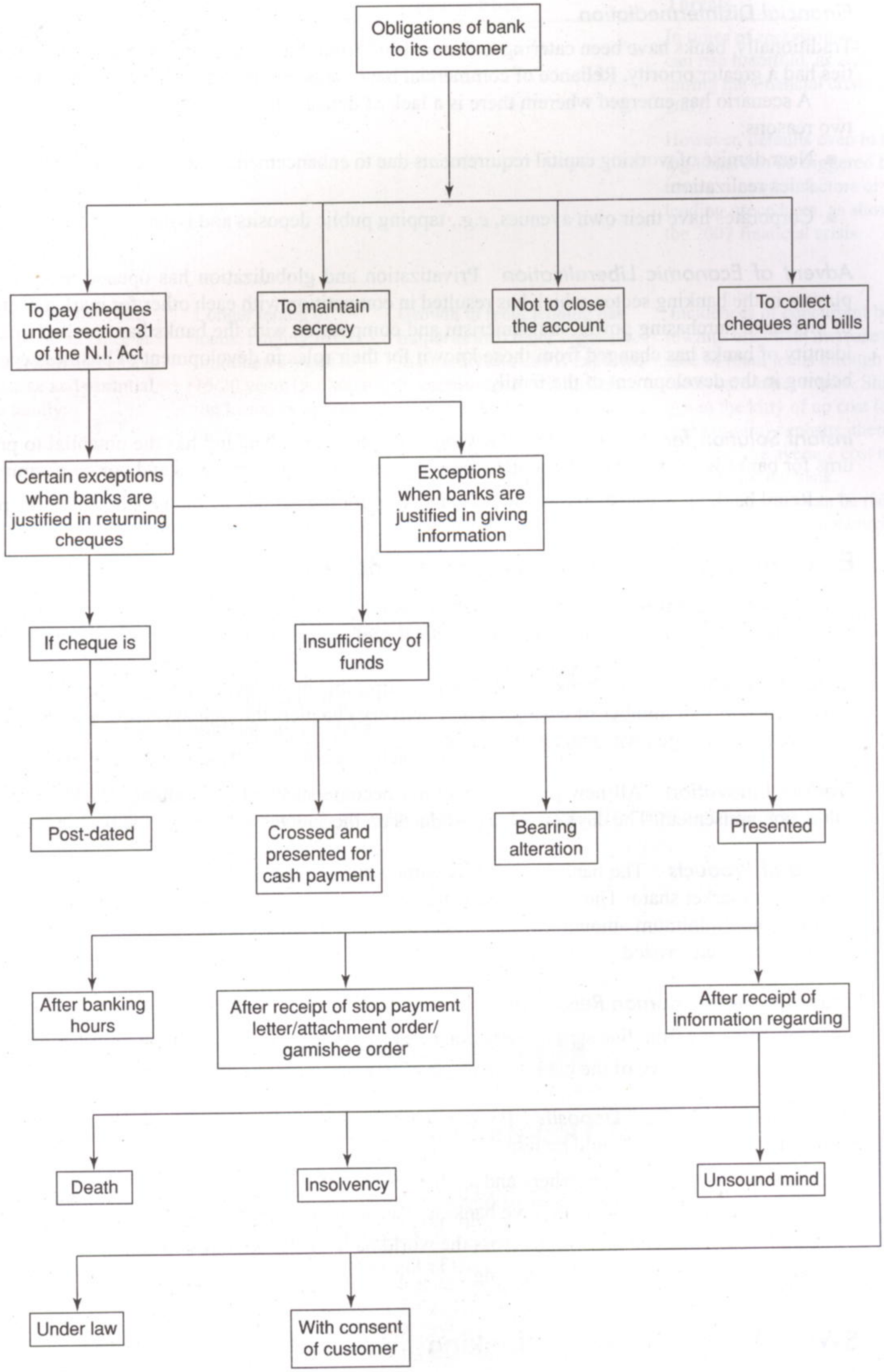


FIGURE 13.2 OBLIGATIONS OF A BANK TO ITS CUSTOMER



Why Banks Focus on Retail Business?

Financial Disintermediation

Traditionally, banks have been catering to demands of economic developments; finance for manufacturing activities had a greater priority. Reliance of commercial banks was on blue-chip companies for deployment of funds.

A scenario has emerged wherein there is a lack of demand for credit from large corporates, primarily due to two reasons:

- Near demise of working capital requirements due to enhancement in activities like productivity and increased sales realization.
- Corporates have their own avenues, *e.g.*, tapping public deposits and issuance of shares and debentures.

Advent of Economic Liberalization Privatization and globalization has opened the gate for a lot of new players in the banking sector, which has resulted in competition with each other for market share. The confluence of increased purchasing power, consumerism and competition with the banks has resulted in a retail chase. The identity of banks has changed from those known for their roles in development of business/economy to the ones helping in the development of the family.

Instant Solution for the Ills in the Banking Business Retail banking has the potential to provide decent returns for banks with an extended clientele base in an era of thinning margins and non-performing advances.

Retail banking is based on the principle 'banking for the people, by the people and of the people'.

Emerging Issues in Handling Retail Banking

Knowing the Customer A concept which is easier said than practised. Each branch should set up data warehouse wherein meaningful data on customers, their preferences, spending patterns, etc. can be mined.

Technology Issues Retail banking calls for huge investments in technology, *e.g.*, providing anytime, anywhere convenience to vast number of customers and delivery channels through asynchronous transfer modes (ATMs), which requires a huge investment by the banks.

Product Innovation All new products may not become successful. Products should be introduced to create value, not amusement. The days of selling products on the shelves are gone in the banking sector.

Pricing of Products The banking sector is witnessing a pricing war with each bank wanting to have a larger slice of the market share. The much needed transparency in pricing is also missing with many hidden charges. For example, 'minimum amount due' and 'total amount due' in the credit card application form and processing charges are not advertised.

Issues Related to Human Resources

- Motivating the front line staff by projecting them as sales managers of products rather than as clerks at work.
- Changing the image of the bank from a transaction provider to a solution provider.

Low-Cost and No-Cost Deposits Bank managers are in need of more savings bank and current accounts so that their cost of liability would be less.

- Three AAAs (anytime, anywhere and anyhow banking).
- With the advent of ATMs, 'anytime banking' has become a reality.
- Satellites and telecom networks across the world have made 'anywhere banking' possible.
- Now, it is the turn of 'anyhow banking'.

SWOT Analysis of Retail Banking

The strengths, weaknesses, opportunities and threats of retail banking have been analyzed and given in Table 13.1.

TABLE 13.1 SWOT ANALYSIS OF RETAIL BANKING

Strengths	Weaknesses	Opportunities	Threats
Low level of NPAs			In times of recession, the NPAs can rise manifold, as witnessed during the financial crisis of 2007.
Tendency to default a retail loan is low as these are backed by mortgages of houses in case of housing loans and post-dated cheques in case of other loans like vehicle loans.			However, defaults even in housing loans can be triggered by macro economic factors or tax lending procedures, as shown by the 2007 financial crisis.
The housing loan has been proved as a safe advance as a house is considered as the most sensitive and essential asset of a family.	Longer tenure of loans, ranging from minimum 3 years to 15/20 years (for housing loans) as against the average deposits of less than 3 years.	Growth in retail lending has outperformed other segments in recent years and is expected to continue at much higher rates. Banks have the opportunities to offset the demand of funds from the corporate sector. Banks have more opportunities for cross-selling of products.	Incidences of concurrent borrowings are on an increase in case of retail loans through credit card/other routes. Shrinkage in the kitty of no cost (current account) deposits, thereby increases the average cost of deposits for the bank. Retail loans can be risky when individuals lack purchasing power.

Strategies for Success in Retail Banking

Banks can formulate the following strategies in order to achieve success in the retail banking segment:

- Advanced techno logy and adoption of this latest technology
- Skilled manpower in all branches and offices
- Balanced and sustained growth in deposits and advances
- Strategic cost management
- Market research and market intelligence, in order to formulate competitive and innovative products
- Risk management
- Customers relationship management
- Universal banking/financial supermarkets
- More delivery channels
- Service quality with a human touch

SECTION III

CUSTOMER RELATIONSHIP MANAGEMENT (CRM)

The objectives of this section are:

- To highlight the importance of Customer Relationship Management (CRM).
- To provide inputs on how to market bank products.
- To discuss the increased relevance of CRM in light of the growing competition in the banking sector with the entry of foreign and new generation banks.

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