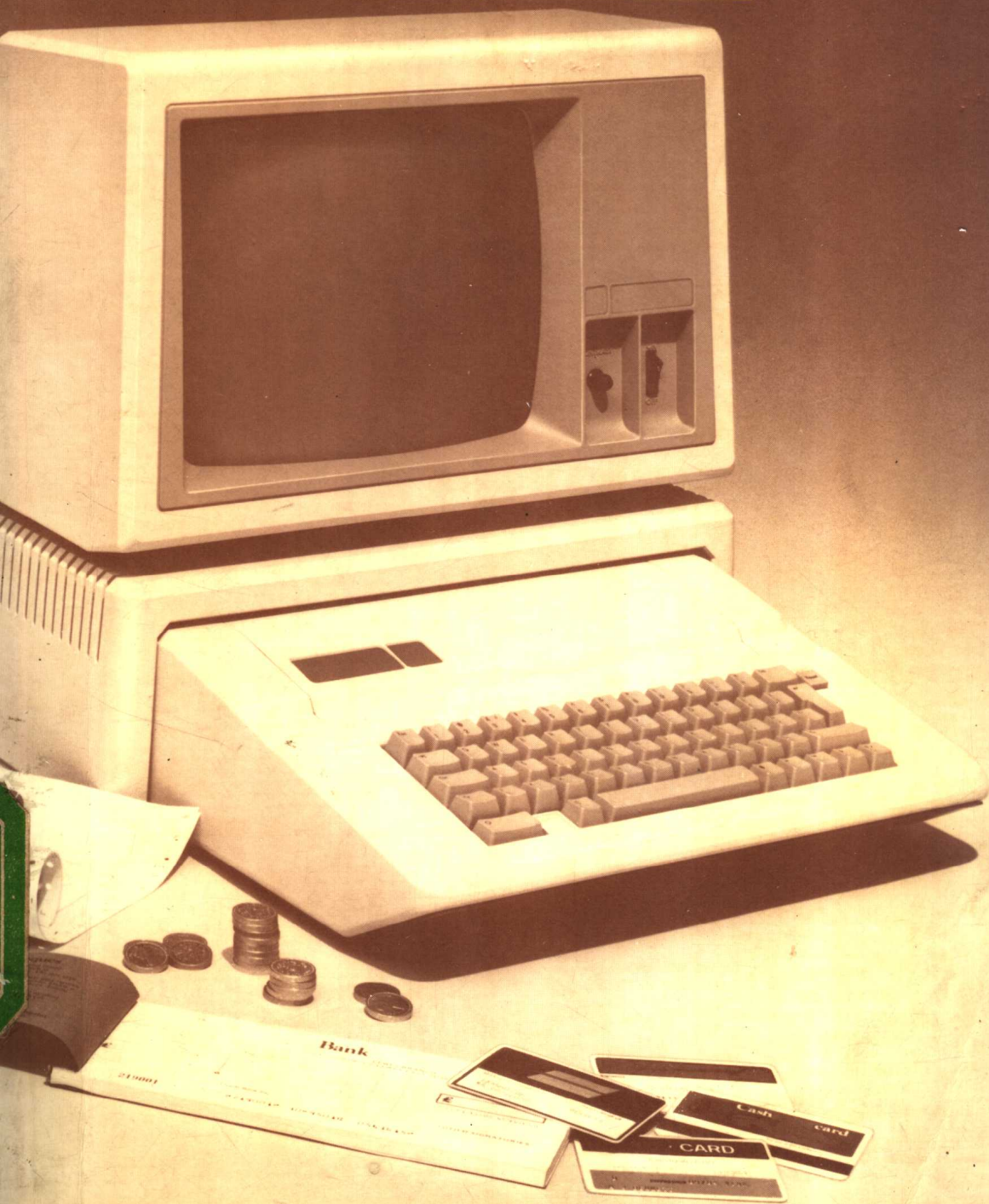


An Introduction to Banking

BRIAN JACOB



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Preface

THE banks of today are, in fact, groups of companies which offer a wide range of financial services for use by personal and company customers. Bank employees are expected to be well informed upon most of the services offered, and to be able to match customers' needs to a particular service. A career in banking requires knowledge and skill in accountancy, economics, the law and management techniques.

This book is an introductory text to the present-day banking environment. It assumes no prior knowledge on the part of the reader or student and traces the development of the banking system in England and Wales in the following broad stages:

Stage 1 (Chapters 1 to 6)

The origins and development of money and a monetary system. A simple banking system; and the use of money in the form of savings and investment in order to improve the social and economic environment.

Stage 2 (Chapters 7 to 13)

The history and development of English banking companies, the Bank of England, and other associated financial organisations. The current interdependence of these organisations and their collective involvement in the London money market.

Stage 3 (Chapters 14 to 19)

The practical aspects of branch banking. The use of cheques and other payment orders. The various account services available to bank customers and an outline of the range of bank customers using the banking system. An introduction to some basic lending considerations and some of the initial problems to be overcome by banker and customer in this area of banking.

The book is designed to be used with the new two-year Elements of Banking syllabus sponsored by the Business Education Council, and it will also be suitable for those students who study the Institute of Bankers one-year Conversion Course which also includes Elements of Banking. The book will be most suitable for other readers or students who wish to acquire an introductory knowledge covering the history, development and current situation in the British banking sector.

For those students covering an examination course of studies there are a number of short-answer assignments at the end of each broad section together with some additional assignments which will require more thought and application.

I wish to express my thanks to all the companies and organisations who have allowed me to reproduce material in the book. However, I must point out that any mistakes in the book are absolutely for my own account.

BRIAN JACOB

Contents

ACKNOWLEDGEMENTS	v
PREFACE	vii
1 Modern Banking	1
2 Money	8
3 The Issue of Paper Money	16
4 Bank Money: Expansion of the Money Supply through Bank Lending	28
5 Controlling the Size of the Money Supply	37
6 Savings and Investment: Money at Work in Society	45
7 The Development of Banking in Britain	66
8 The Bank of England	86
9 Other City of London Institutions of Importance	97
10 The London Money Market: An Integrated Money Machine	109
11 Money Has a Price	138
12 Stability	147
13 Protecting the Depositors	159
14 Banker and Customer Relationships	163
15 Bills of Exchange, Cheques and Promissory Notes	175
16 Money Transmission Services Provided by the Banks	189
17 Payment of Customers' Cheques and Other Documents	199
18 Introduction to Bank Lending	212
19 Service Banking	232
Appendix — The Institute of Bankers	248
Table of BEC Objectives	252
Glossary	254
INDEX	260

1 Modern Banking

WHEN reading was a skill only acquired by a small part of the population, signs displayed over shops and trading premises were very important; red and white poles outside barber shops, flasks or fine balances outside chemists or herbalists, or the three golden balls outside the pawnbrokers. Some of these signs can still be seen outside the older or more traditional types of shop. In every high street throughout England and Wales we can still see signs of a black spread eagle, a dark horse, and a griffin. They are the company signs of Barclays, Lloyds and Midland Banks. In the case of Barclays and Lloyds the signs date back to the seventeenth century and were the original signs of the early goldsmith bankers who were later to become part of these modern banking companies. The signs of the major commercial banks in England and Wales are illustrated in Fig. 1.1.

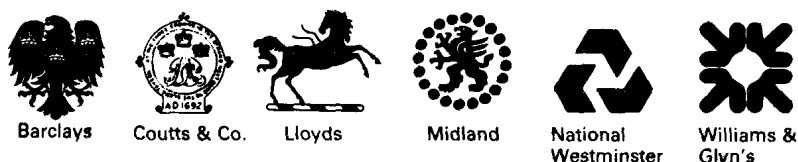


Figure 1.1 *Bank signs.*

Coutts & Co. is now a subsidiary bank within the National Westminster Group; their separate identity is retained for prestige reasons. National Westminster and Williams and Glyn's being banking groups formed in the 1970s have adopted modern signs but the history of individual banks within each group goes back to the same era as Barclays, Lloyds and Midland.

These are not the only banks offering services for customers in England and Wales, but they are the banks most familiar to the general public. This book will seek to explain the origins of our modern banking system and its place in British society.

POPULAR MYTHS ABOUT BANKS

Bankers as a group have not always enjoyed a good public image. There are some popular misconceptions and myths present in many people's minds. Some of these are:

1. Banks only lend money to people who do not really need it.
2. They open at times calculated to confound and inconvenience ordinary customers.
3. They earn record profits when all other people and companies in the country are finding things very hard.

THE MYTHS EXPLAINED

Many people save money with the banks and they are free to go to the banks at any time and ask for their money back. These savings are loaned out by the bank, hence the banker's conservative attitude towards prospective borrowers. Would you, as a bank customer, be calm when told that your earlier savings of £50 were now down to £45 due to some optimistic lending which had not quite worked out as planned? Or would you accept, without a murmur, a request by the bank to come back tomorrow please, when we hope to have the cash which you would like to withdraw?

Opening hours are a feature of British banking from a time when the vast majority of customers were business or trading ventures and it was possible for these customers to visit the branch at any time during business hours. Now that the banking habit has spread to a much larger section of the public, banks are introducing a variety of plastic cards and computer-linked arrangements to cut down on the need for personal customers to visit their banks on a regular basis.

Fortunately for the banks they do not control the overall interest rate structure within Britain nor the overall economic climate; this is the province of the government through its agent the Bank of England. But unfortunately periods of economic stringency are accompanied by high interest rates generally and this means that when everybody else is finding money and profits very hard to come by, the banks are earning record amounts through interest charged on loans and overdrafts.

BANKING TODAY (see also Fig. 1.2)

At the centre of Britain's banking and financial structure is the Bank of England. Since 1946 this bank has been in public ownership and its activities are directed towards monitoring and controlling the work of other financial and monetary

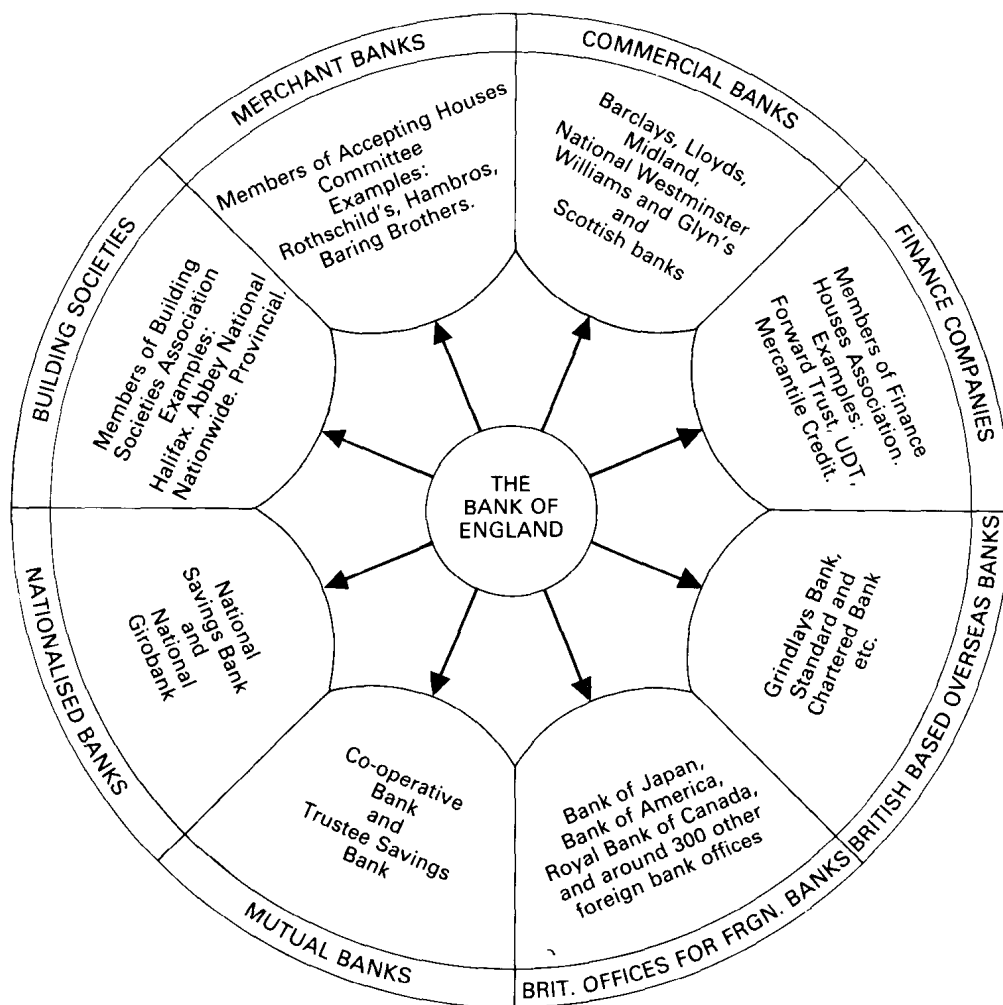


Figure 1.2 Types of financial organisations in Britain.

organisations. (A more detailed study of the Bank of England is covered in Chapter 8.)

The *commercial* banks, sometimes referred to as 'the high street banks' or 'the clearing banks', are large public limited companies having many shareholders throughout Britain and in some cases in countries outside Britain. These banks operate through a network of branches covering the whole of England and Wales. (Scotland's banking companies are similar in organisation and structure but they have developed under a different set of rules and will not be covered in this book.) All *commercial* banks are *profit-seeking* companies and in order to earn money they provide services for their customers.

Another major group of banks is that of merchant banks sometimes called 'accepting houses' or issuing houses'. These banks are centred in the City of London, though some have branch offices in other cities and also some have offices in important overseas financial centres. The work of these banks is very specialised. In most cases, because the founders of these banks were merchants who came from overseas countries to settle in London their trading was virtually always in overseas markets. Subsequently they abandoned their trading activities in favour of accepting financial commitments in exchange for a commission fee, on behalf of other merchants both in Britain and overseas, in respect of trading contracts. Nowadays their work also involves company financial advice to clients intending to expand their companies and the issue of loan stocks or shares in new companies to members of the general public. (A more detailed study of these banks is in Chapter 9.)

Britain has a long history as an international trading nation and through this trading developed an empire. As a result of trade and empire-building some commercial banking companies specialised in opening branches in overseas countries while maintaining their head offices in London.

London has always been an important financial centre, and in recent years its position has been confirmed by many overseas banks opening branch offices there. There are presently between three and four hundred foreign bank branch offices in London.

The Co-operative and Trustee Savings Bank (*mutual banks*) offer a complete service for personal customers and a limited service to smaller business customers. These banks are primarily *non-profit-seeking* organisations, being concerned with providing a service for their customers and seeking to cover only the costs of supplying these services through the charges made. These two banking groups are now providing some competition for customer accounts to the larger commercial banks, though the branch network and business customer appeal of the mutual banks is not as comprehensive as their larger competitors.

Finance houses are now either partly or wholly owned by one or more of the larger commercial banking companies. Finance company services are also being expanded from the traditional hire-purchase lending into the wider field of personal loan finance, where the loan is not tied to financing a particular consumer item. Finance companies now seek deposits in order to support their lending from a wider section of the general public than was the case in earlier years. (The development of banking companies is covered in Chapter 7 while the development of building societies is covered in Chapter 9.)

Finally there is the National Savings Bank and the newer National Giro Bank. Both of these banks are government-backed organisations and are not really a major force in the banking scene, except for small personal savings.

DEVELOPMENT OF THE PRESENT-DAY BANKING GROUPS

The modern commercial banking companies have developed from very simple beginnings in the seventeenth century into the complex national and international

groups of today and a complete account of this development is covered in a later chapter. Banks began, initially, simply as places where customers could leave money and valuables for safe keeping. Only later, when the new bankers realised that some customers were content to leave money undisturbed for long periods of time, did lending become part of the banking pattern. As the working population increased and through the Industrial Revolution we became a nation of wage earners and entrepreneurs, so the pattern and scope of banking expanded and developed. Demands for loans increased in both monetary terms and the length of time before repayment. As well as requiring a skilled manufacturing and trading community, Britain also needed people of vision and substance, with sometimes a little of the gambler's instinct, to support our trading and manufacturing ventures.

The strength of today's banking groups and the world acclaimed expertise of British bankers has been built and developed over the last 250 years. During this period necessity has proved the spur to change and innovation, but also a tradition has been built up which is the envy of all other financial centres.

SERVICE BANKING TODAY

Present-day commercial banks offer a wide range of services suitable for individual customers who have modest expectations and requirements of their bankers, through to the complicated and exacting requirements of the large multinational company with banking operations on a worldwide basis. The whole range of these services are available through the smallest bank branch which is the front line or point of sale for every service offered by the whole bank group.

Fig. 1.3 illustrates the broad areas of operations and services offered by a large, modern banking company and its associated companies and subsidiary companies.

BANKING CAREERS

A career in banking today is not limited to the management of customers' accounts (though this is every bank's life blood), lending decisions, and the usual crop of letters to 'big spenders' requesting a slowing down in the rate of issuing cheques. Openings include the following specialist careers:

- executor and trustee business
- overseas trade developments
- unit trusts and investment management
- computer systems
- credit card operations
- company financial management
- organisation and method management

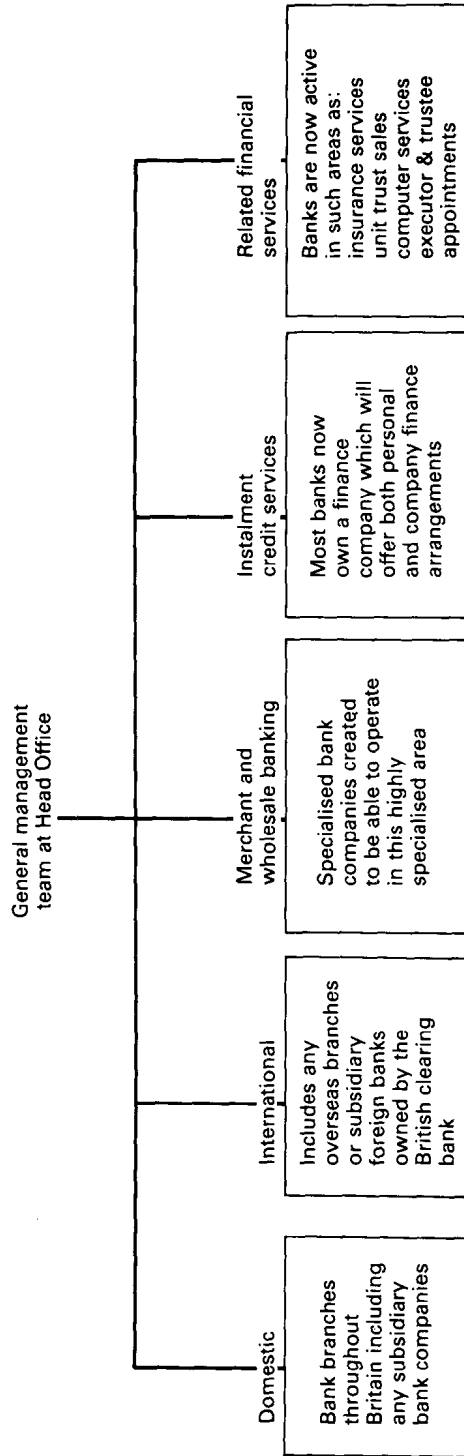


Figure 1.3 The broad areas of operations in a modern banking group.

All these divisions require staff at all levels of responsibility, thus offering a varied career structure. We shall see later how the early banking companies merged and amalgamated over time to form the large present-day groups. Since 1945 banks have formed or purchased additional specialist companies in other associated financial areas. Today each bank can offer, on a worldwide scale, a complete service of integrated financial services. A look at any bank's annual report will amply illustrate the size and scope of their operations.

THE FUTURE

The history of British banking illustrates a continuous role of development to suit customers' changing requirements. The increased use of credit cards in place of cash, real-time computer systems using automatic cash transfers and cutting down the use of cheques, are pointers to improvements in personal business. Term lending and more involvement with company customers will be the name of the banking game on the corporate side in the future. The future, however, stems from earlier historical developments. To give some perspective to this and to a study of banking we must start at a time before banking evolved. In fact we must start with the banker's stock-in-trade — money.

ASSIGNMENTS

As this is only an introductory chapter no specific assignments have been included. Readers are recommended to obtain an up-to-date copy of any commercial banking group's annual report and read it in order to obtain an overall view of the group's total area of activity and the group structure.

2 Money

OBJECTIVE: *to trace the evolution of money, identifying its functions and the characteristics required of whatever is used as money to enable it to perform its functions satisfactorily.*

FROM an early age most people realise the importance of money. As young children we liked to receive money, to save it or to spend it. We soon learned that it was money which was used to buy sweets and presents, but what *is* money? Who invented it? Why is it called money? Has it always been used? If not, what happened before money was used?

WHAT IS MONEY?

Most people would answer this question in two parts. First, money is represented by the coins and notes which we use in our daily lives, it is the commodity readily acceptable by all people wishing to trade. Second, money is a means of expressing a value for any kind of article or service. Goods and services are valued in monetary terms so we can easily compare one article or service to another entirely different article or service. Additionally we know from the monetary price how much is required in order to obtain any particular article or service.

Money is a very useful tool or aid to our society; it has value in exchange and it has utility.

ORIGINS OF MONEY

Power and wealth are strong driving and motivating forces in many individuals, and this was just as true in our ancestors as it is now. Today money, land and property

identify the wealthy or the powerful people in our society. In ancient times it was the possession of wheat, land, animals, scarce sea shells, salt or various types of rare metals which gave their owners the same kind of power and wealth. These items were highly prized and valued, in other words, they were the equivalent of present-day money.

In this ancient world communication and travel between different settlements or countries was very difficult and hazardous. Trade and exchange were, therefore rather restricted. Most groups pooled their resources in an effort to become self-sufficient. Any trading which did take place was on a goods-for-goods basis, which we call *direct exchange* or *barter*. This type of trade and exchange is not suited to a wide variety of goods. The limiting factors can be summarised as follows:

- (1) Difficulty in cross valuing the items to be exchanged:

How many axe-heads are equivalent to a canoe?

How much wheat is equivalent to a sheep?

The quality of the goods to be traded obviously affects the deal, therefore, no standard measure for axe-heads and canoes, or wheat and sheep can be established. Every trading deal must be separately negotiated to suit the quality, size and condition of the commodities to be exchanged.

- (2) There has to be a double coincidence of wants. Whatever one person has to exchange, they have also to find:

(a) Somebody who requires their particular product and (b) has a product which they particularly want.

- (3) It is virtually impossible to give change:

Only complete articles can be exchanged and where large items are exchanged for fresh produce it will be, in many cases, impracticable to take large quantities of the fresh produce as it will rot or perish before it can be used.

Some commodity was required which would overcome these drawbacks found in direct exchange.

A MONEY COMMODITY

The commodity required must be

1. Universally acceptable and desirable for its own sake by the society using it.
2. Reasonably scarce.
3. Stable in its state.

(1) Universally acceptable and desirable

The only way this could come about would be if the commodity had value. Its appeal will be limited to the society who are using it, so that in times of limited travel and