

# **Retail Banking and Household Finance**

## **Module Introduction and Overview**

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# 1 Introduction to the Module

This module has been developed to equip you with the skills and knowledge to manage the financial needs of households. It is intended for professionals and academics, both practicing and aspiring, providing user-friendly technical tools for increased efficiency and effectiveness in your day-to-day professional life.

Central to this module are two core issues:

- What are the financial needs of households (both those raised and those neglected due to financial illiteracy or behavioural biases)?
- How could a bank meet these financial needs, and why is it in its interests to do so?

To begin, we must first determine what the terms *retail banking* and *household finance* refer to.

Let's start with *household finance*. This term refers to the factors that affect the management of households' assets and liabilities. *Retail banking* refers to banking activities that are provided to households and small and medium-sized enterprises (SME). This establishes the link between retail banking and household finance: the financial needs of households tend to be satisfied by retail banks. For example, households demand mortgages to enable them to purchase residential properties, and this demand is met by the supply of loans from retail banks.

The main objective of the module is to enable you to develop the knowledge and set of skills that are required to understand the financial needs of retail banks' clients, and how to successfully provide those clients with services that fulfil their specific financial needs. With this objective in mind, we start this module by explaining the main factors affecting the value of households' assets and liabilities, emphasising the importance of households' financial decisions for the overall economy (Unit 1). In Units 2 and 3 we examine in more detail the determinants of households' asset allocation, focussing in particular on the role of risk aversion, financial literacy, and planning for retirement.

In Units 4 and 5 we investigate how retail banks can offer products and services that aim to fulfil the financial needs of households, both on the liabilities side (credit cards, mortgages), and on the assets side (savings accounts and other investment products). The price of these products and services depends on the degree of competition in the banking system. For this reason, in Unit 6, we discuss how banking competition can be measured and the empirical evidence on the role of banking competition for consumer welfare. Finally, in Units 7 and 8 we focus on relationship lending and private banking. Relationship lending focusses on the effects of long-term relationships between a bank and borrowers. Private banking consists of services provided to the wealthiest customers of retail banks.

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## 2 The Module Authors

**Enrico Onali** is a Senior Lecturer in Finance at Aston University. Dr Onali is a member of the editorial board of *The British Accounting Review* and a Fellow of the Higher Education Academy (UK). His research interests lie mainly in the areas of capital markets, banking, and corporate finance. Dr Onali's research has appeared in leading international journals such as the *Journal of Financial Intermediation*.

**Saverio Stentella Lopes** joined Bangor Business School in January 2015 as a Lecturer in Finance. He received a joint PhD degree from Tilburg University and University of Rome Tor Vergata. The research of Dr Stentella Lopes focusses on banking and corporate finance. He has published in leading academic journals such as the *Journal of Financial and Quantitative Analysis* and the *Journal of Banking & Finance*, amongst other publications.

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## 3 Study Resources

This study guide is your central learning resource as it structures your learning unit by unit. Each unit has recommended reading either from the key text or from supplementary module readings.

### Key text

In addition to the study guide, you will be assigned chapters in the following book:

Pond K (2017) *Retail Banking*. 4th Edition. Hastings, UK, Gosbrook Professional Publishing.

This book focusses in particular on the section of the module related to retail banking products and services. You will find this book very easy to read and it contains interesting case studies that will enhance your understanding of the subject. Sections of the module related to household finance, and other topics that are not covered by the key text, will be supplemented by articles and extracts from other texts.

### Module readings

We also provide you with access to academic articles and other reports, which are assigned as core readings in the study guide. Among these, the following article is the key reading for the sections of the module related to household finance topics:

Guiso L and P Sodini (2013) 'Household finance: An emerging field'. In: GM Constantinides, M Harris and RM Stulz (Eds.) *Handbook of the Economics of Finance*. Volume 2B. Oxford and Amsterdam: North Holland, pp. 1397–1532.

All the articles that are considered as core readings make up the module readings. You are expected to read them as an essential part of the module. You may find some of these academic articles challenging to read, because they may employ more advanced statistical techniques, and the content is different in nature to the material in the textbook. However, in the study guide you will find advice regarding what sections of each reading you are required to focus on.

### **Optional readings**

We also suggest optional readings which you may choose to read if you are especially interested in a particular subject area studied in the module.

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## **4 Module Overview**

### **Unit 1 Household Wealth and Risk Preferences**

- 1.1 Introduction
- 1.2 Household Intangible Wealth
- 1.3 Household Tangible Assets
- 1.4 Household Liabilities and Financial Crises
- 1.5 Household Risk Preferences
- 1.6 Conclusion

### **Unit 2 Household Portfolio Decisions: Allocation and Rebalancing**

- 2.1 Introduction
- 2.2 Household Participation in the Stock Market
- 2.3 Household Portfolio Selection
- 2.4 Household Portfolio Rebalancing
- 2.5 Conclusion

### **Unit 3 Prospect Theory, Retirement Planning, and Financial Literacy**

- 3.1 Introduction
- 3.2 Behavioural Finance and Investor Behaviour
- 3.3 Retirement Planning
- 3.4 Financial Literacy
- 3.5 Conclusion

### **Unit 4 Retail Banking: Banking Products and Channels**

- 4.1 Introduction
- 4.2 Interest-based Products
- 4.3 Non-interest-based Banking Products for Households
- 4.4 Non-interest-based Banking Products for SMEs
- 4.5 Payment Services
- 4.6 Retail Banking Channels
- 4.7 Conclusion

## **Unit 5 Retail Lending and Household Borrowing**

- 5.1 Introduction
- 5.2 Retail Lending
- 5.3 Household Borrowing: Mortgages
- 5.4 Mortgage Refinancing
- 5.5 Strategic Mortgage Default
- 5.6 The Credit Card Debt Puzzle
- 5.7 Conclusion

## **Unit 6 Retail Banking Competition**

- 6.1 Introduction
- 6.2 Models of Competition in Retail Banking
- 6.3 Measuring Competition in Retail Banking
- 6.4 Evidence on Retail Banking Competition
- 6.5 Why Bank Competition Matters
- 6.6 Conclusion

## **Unit 7 Relationship Lending**

- 7.1 Introduction
- 7.2 The Benefit of Long-term Bank-Borrower Relationships
- 7.3 The Cost of Long-term Bank-Borrower Relationships
- 7.4 Hard Information and Soft Information in Loan Pricing
- 7.5 Relationship Banking and Competition
- 7.6 Conclusion

## **Unit 8 Private Banking**

- 8.1 Introduction
- 8.2 Private Banking Clients and Segmentation
- 8.3 Private Banking Products and Services
- 8.4 Tax Considerations
- 8.5 Industry Future and Trends
- 8.6 Conclusion

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## **5 Learning Outcomes**

When you have completed your study of this module and its readings, you will be able to:

- evaluate the role of household characteristics in household portfolio choices
- explain the functions of retail banking products and services
- discuss the principles of retail lending
- analyse the determinants of mortgage choice
- examine the impact of banking competition on consumer welfare
- discuss the benefits and costs of relationship lending
- explain the main features of private banking products and services.