



How do banks make money?

KS2 KS3 Ages 9-14 ⌚ 3 min read

You park your money in a bank. They look after it, give you online banking, a debit card, a phone app, and 2,000 cash machines. They don't charge you a penny for most of this. So what's going on? How are the same banks making billions of pounds in profit every year?

Your savings become someone else's loan

Here's the key thing most people don't realise: when you deposit money in a bank, the bank doesn't just put it in a vault with your name on it. It *lends it out*. Banks take the money sitting in millions of savings accounts and use it to give mortgages, personal loans, business loans, and credit cards to other customers.

Imagine you're a middleman at a market. You borrow apples from 100 farmers at 2p each, then sell them to bakers for 5p each. You keep the 3p difference. You never actually owned the apples — you just sat between the people who had them and the people who needed them. Banks do exactly this with money, at enormous scale.

The interest rate gap

When the bank lends your money to a mortgage customer, they charge that customer, say, 4% interest per year. Meanwhile, they might pay you 1.5% interest on your savings. The bank pockets the difference — that 2.5% gap on potentially billions of pounds. This is called the **net interest margin**, and it's the main engine of bank profitability.

But don't people want their money back?

Yes — and the bank has to be ready for that. Banks keep a fraction of deposits in reserve so they can pay anyone who wants to withdraw. They've done the maths over millions of customers: not everyone wants their money at the same time. This system is called **fractional reserve banking**, and it's how the entire modern financial system works. The rare occasion when lots of people try to withdraw at once is called a "bank run" — and it's one of the few things that can genuinely break a bank.

What else do banks charge for?

Plenty. Arrangement fees on loans. Monthly fees on premium accounts. Currency conversion charges. Overdraft fees. Late payment charges on credit cards. Investment management fees. For a business customer, fees for virtually everything. Banks are very creative at finding ways to monetise financial services. The basic current account is essentially a loss-leader — they make their real money once they've got you through the door.