Notes

Unit 1: Indian Banking System

1.1 EVOLUTION OF BANKING IN INDIA

1.1.1 Banking in India

- Banking in India in the modern sense originated in the last decades of the 18th century. The first banks were Bank of Hindustan (1770-1829) and The General Bank of India, established 1786 and since defunct.
- The largest bank, and the oldest still in existence, is the State Bank of India.
- Three banks merged in 1921 to form the Imperial Bank of India, which, upon India's independence, became the State Bank of India in 1955.

1.1.2 Era's of Indian banking system

1. Colonial era

- During the period of British rule merchants established the Union Bank of Calcutta in 1829, first as a private joint stock association, then partnership. Its proprietors were the owners of the earlier Commercial Bank and the Calcutta Bank, who by mutual consent created Union Bank to replace these two banks.
- Union Bank was incorporated in 1845 but failed in 1848.
- The Allahabad Bank, established in 1865 and still functioning today.
- HSBC established itself in Bengal in 1869.
- The next was the Punjab National Bank, established in Lahore in 1895.

2. Post independence era

- The Reserve Bank of India, India's central banking authority, was established in April 1935, but was nationalised on 1 January 1949 under the terms of the Reserve Bank of India (Transfer to Public Ownership) Act, 1948 (RBI, 2005b).
- In 1949, the Banking Regulation Act was enacted which empowered the Reserve Bank of India (RBI) "to regulate, control, and inspect the banks in India".
- The Banking Regulation Act also provided that no new bank or branch of an existing bank could be opened without a license from the RBI, and no two banks could have common directors.

1.1.3 Nationalization in the 1960s

- Despite the provisions, control and regulations of Reserve Bank of India, banks in India except the State Bank of India or SBI, continued to be owned and operated by private persons. By the 1960s, the Indian banking industry had become an important tool to facilitate the development of the Indian economy.
- At that time The Government of India issued an ordinance ('Banking Companies (Acquisition and Transfer of Undertakings) Ordinance, 1969')) and nationalised the 14 largest commercial banks with effect from the midnight of 19 July 1969. These banks contained 85 percent of bank deposits in the country.
- A second dose of nationalisation of 6 more commercial banks followed 1980.
- In the year 1993, the government merged New Bank of India with Punjab National Bank. It was the only merger between nationalised banks and resulted in the reduction of the number of nationalised banks from 20 to 19.

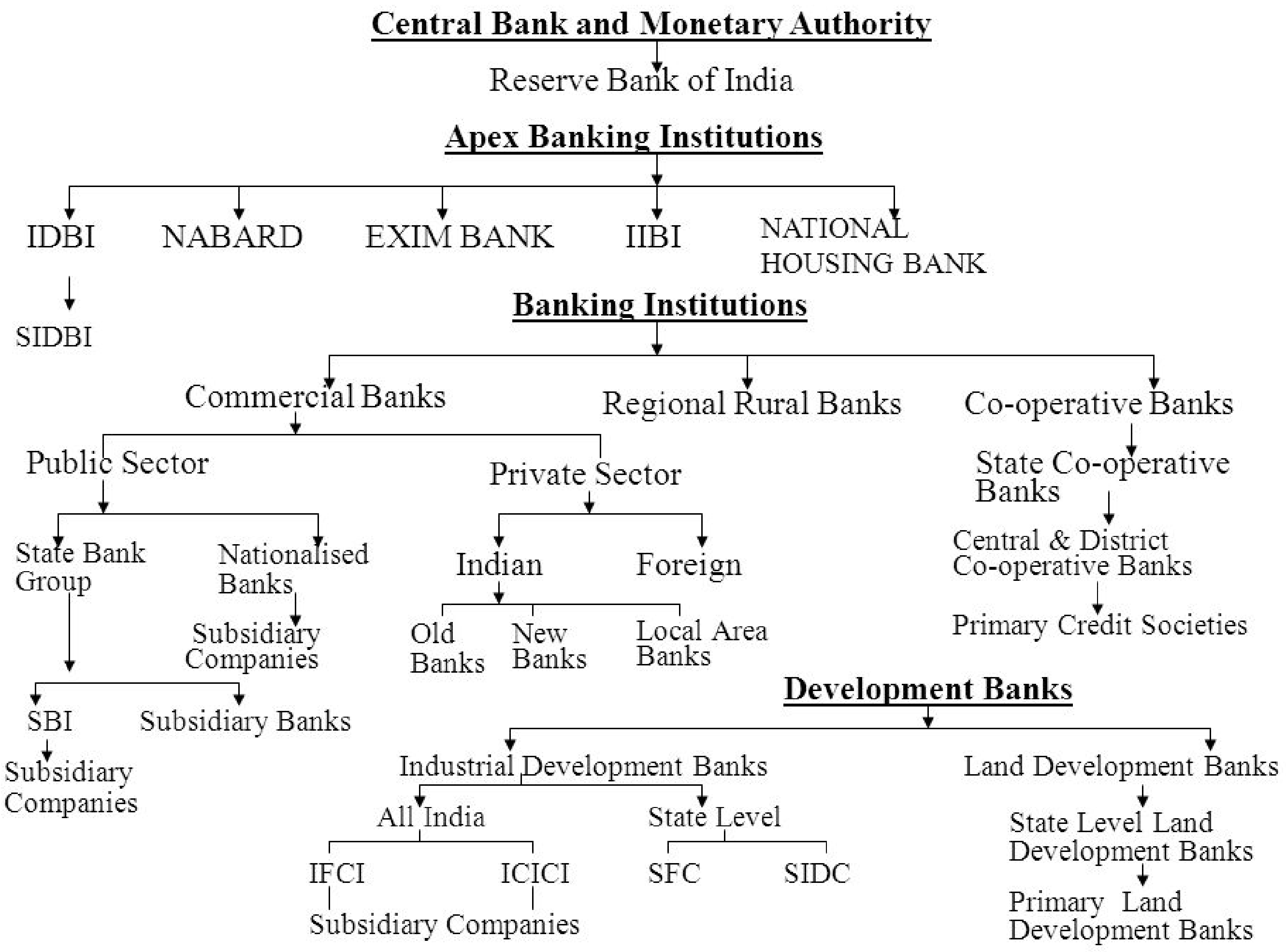
1.1.4 Liberalization in the 1990s

- In the early 1990s, the then government embarked on a policy of liberalization, licensing a small number of private banks. These came to be known as New Generation tech-savvy banks, and included Global Trust Bank (the first of such new generation banks to be set up), which later amalgamated with Oriental Bank of Commerce, UTI Bank (since renamed Axis Bank), ICICI Bank and HDFC Bank.
- The next stage for the Indian banking has been set up with the proposed relaxation in the norms for Foreign Direct Investment, where all Foreign Investors in banks may be given voting rights which could exceed the present cap of 10%, at present it has gone up to 74% with some restrictions.

1.1.5 Adoption of banking technology

- The RBI set up a number of committees to define and co-ordinate banking technology. These have included: -
  1. In 1984 formed the Committee on Mechanisation in the Banking Industry
  2. In 1988, the RBI set up the Committee on Computerization in Banks
  3. In 1994, Committee on Technology Issues relating to Payment systems, Cheque Clearing and Securities Settlement.
  4. In 1995, Committee for proposing Legislation on Electronic Funds Transfer and other Electronic Payments
- Total numbers of ATMs installed in India by various banks as on end June 2012 is 99,218

1.2 STRUCTURE OF BANKING IN INDIA



1. CENTRAL BANK

- RBI (owned & Controlled by the Government)
- Monopoly of note – issue
- Act as a Banker to the Government
- Act as a friend, philosopher & guide to all banks in the country.
- Regulation & Control of credit.
- Does not directly deal with public.
- Indirectly help Agriculture & Industry.

2. COMMERCIAL BANKS

- Directly deal with public.
- Accepting Deposits
- Making business loans.
- Offering basic investment products.

3. CO-OPERATIVE BANKS

- Voluntary Concern
- An enterprise formed and directed by an association of users,
- applying within itself the rules of democracy and
- Directly intended to serve both its own members and the community as a whole.

4. DEVELOPMENT BANKS

(a) IDBI

- Industrial Development Bank of India
- 1964 as subsidiary bank of RBI.
- Direct assistance to large & medium Industries
- Indirect assistance to tiny & small- Scale Industries.
- 1976 de-linked from RBI.
- Resulted in enlargement of its role in functioning.

(b) SIDBI

- Small Industries Development Bank of India
- Started in April 1990
- Subsidiary of IDBI.
- Refinancing after loans granted by other financial Industries.
- Discounting & rediscounting of bills arising out of sale of capital goods produced.
- Rediscounting of short term bills in the small scale sector.

(c) NABARD

- National Bank for Agricultural & Rural Development
- Established in 1982.
- Combining the agricultural credit department and rural planning and credit cell of the RBI & the Agricultural Refinance & Development Corporation.
- Credit Functions.
- Developmental Functions.
- Regulatory Functions.

(d) EXIM BANK

- Export Import Bank
- Established in 1982.
- Foreign Trade
- Financing of exports & imports.
- Financing of Joint ventures in foreign countries.
- Financing of export & import of machinery on lease basis.
- Assisting the Indian party to a joint venture in a foreign country.
- Raise resources through issue of bonds & Debentures in open market & RBI.

(e) IIBI

- Industrial Reconstruction Corporation of India(1971)
- Industrial Reconstruction Bank of India(IRBI) with effect from March 1985.
- March 1987 renamed as IIBI.
- Grants loans & advances to Industries.
- Underwrites stocks, shares, bonds & debentures.
- Guarantees loans & deferred payments on behalf of the industrial concerns.
- Acts as an agent of the central & state Government, RBI, SBI & other financial Institutions.

5. Regional Rural Banks

- Credit to weaker sections of the rural area i.e. to landless agricultural labourers, rural artisans, small & marginal farmers etc.

6. Local Area Banks

- Started in 1996.
- With an objective to provide institutional mechanism in rural & semi urban areas for promoting saving & also for making credit facility available in such areas.
- Established as Public Ltd. Co. in the Private Sector & promoted by individual, Company, trusts & Societies with minimum paid up capital Rs. 5 Crore.

7. State Bank & Other Public Sector Banks

- The State Bank of India with its Seven Subsidiaries are often referred to as the State Bank group of Public Sector Banks, while the other 20 Public Sector (14 Nationalised on July 19, 1969 & 6 more Nationalised on April 15, 1980) are the other Public Sector Banks.

1.3 ROLE OF BANKING IN ECONOMIC DEVELOPMENT

(A) Importance of Banking System in an Economy

- Functioning as an Intermediary.
- Channelization of Savings & Investment.
- Helping Economic Development
- Imparting Liquidity to Non- liquid Assets
- Mobilization of Capital
- Creating & Dealing in Bank Money
- Encouragement to trade & Industry.
- Equitable Distribution of Funds
- Promotion of the habit of thrift
- Influence on Rates of Interest

(B) Role of Banking System in the Economic Growth & Development

- Capital Formation
- Promotion of Enterprise
- Monetization of Debts
- Development of Trade & Commerce
- Regional Balance
- Influence on Interest on Interest Rates
- Elastic Money Supply
- Regulation of Economic Activity
- Modernisation of Business
- Consultancy Services

1.4. SCHEDULED BANKS AND NON SCHEDULED BANKS

- In accordance with the RBI Act, 1934, all banks listed in the second schedule are known as Scheduled Banks. Every Scheduled Bank has to minimum Rs. 5 lakhs as the prescribed minimum limit for fully paid-up capital and free reserves taken together.
- Those not included in the Second Schedule are Non- Scheduled banks.

Difference between Scheduled and Non- Scheduled Banks

	SCHEDULED BANKS	NON SCHEDULED BANKS
Meaning	Scheduled banks is a banking corporation whose minimum paid up capital is Rs. 25 lakhs and does not harm the interest of the depositors.	Non-scheduled banks are the banks which do not comply with the rules specified by the Reserve Bank of India, or say the banks which do not come under the category of scheduled banks.
Second Schedule	Listed in the second schedule.	Not-listed in the second schedule.
Cash Reserve Ratio	Maintained with RBI.	Maintained with themselves.
Borrowing	Scheduled banks are allowed to borrow money from RBI for regular banking purposes.	Non-Scheduled banks are not allowed to borrow money from RBI for regular banking purposes.
Returns	To be submitted periodically.	No such provision of submitting periodic returns.
Members of clearing house	It can become a member of clearing house.	It can not become a member of clearing house.

1.5 CHALLENGES BEFORE BANKING IN INDIA

Lack of product expertise

- Traditionally focused on limited range of products
- Primarily for corporate clients
- Need for acquiring skills in Retail, structured finance Retail, structured finance

Lack of distribution expertise

- Reliance on branch channel and human intervention
- Relatively high unit cost of delivery given small transaction sizes

Limited use of technology

- Across both customer--facing and internal functions

Competition in market

- Post office
- Insurance
- Financial Institution
- Foreign Banks

1.6 IMPACT OF COVID-19 ON BANKING SECTOR IN INDIA

- Credit risk assessment
- Liquidity
- Going concern and impact of subsequent events
- Revisiting hedging strategies
- Adverse impact on specific loan covenant ratios being triggered
- Decrease in Revenue

Unit 2: Central Banking

2.1 INTRODUCTION

- It is the Central Bank of India Established in "1st April 1935" under the "RESERVE BANK OF INDIA ACT".
- Its head quarter is in Mumbai (Maharashtra). Its present governor is "MR. SHAKTIKANTA DAS".
- It has 4 Zonal offices at Mumbai, Kolkata, Delhi and Chennai.
- It has "19 Regional Offices", most of them in State capitals.

2.1.1 DEFINITION OF CENTRAL BANKING

- "It is a bank of banker" – **Samuelson**
- "Bank which has monopoly over note issue" -- **Vera Smith**
- "Central bank is the government's bank" – **Sayers**

2.2 EVOLUTION OF RESERVE BANK OF INDIA

2.2.1 Proposed Setup of General Bank

- The evolution process of RBI may be traced to the efforts to set up a banking institution in 1773 when Warren Hastings, Governor of Bengal in British India proposed his Plan for a 'General Bank in Bengal and Bihar', which was set up in April 1773.
- The project was, however, short-lived and the bank closed in 1975

2.2.2 Recommendations of Champerlain Commission, 1914

- There were prolonged debates, without reaching a conclusion or consensus, on proposals of amalgamation of the three presidency banks and the establishment of a separate central bank.
- It was in the early 20th century that consequent to the recommendations of the Champerlain commission (1914), the Imperial Bank of India was constituted in 1921 to carry out the functions of central banking in addition to commercial banking.

2.2.3 Recommendations of the Hilton Young Commission

- The recommendations of the Hilton Young Commission, which submitted its Report in 1926, took the central banking philosophy in India close to international thinking. It recommended the establishment of a central bank to be designated the Reserve Bank of India, to solely perform central banking functions.
- Accordingly, a bill to establish RBI was introduced in Parliament & passed in 1934 & the RBI Act came into force on January 1, 1935.
- The Reserve Bank was inaugurated on April 1,1935 as a shareholder's institution. The RBI was nationalised on January 1, 1949 in terms of the Reserve Bank of India (Transfer to Public Ownership) Act, 1948.

2.2.4 BRIEF HISTORY

- It was set up on the recommendations of the HILTON YOUNG COMMISSION.
- It was started as Share-Holders Bank with a paid up capital of 5 Crs.
- It was established on 1st of April 1935.
- Initially it was located in Kolkata.
- It moved to Mumbai in the year 1937.
- Initially it was privately owned.
- It was the 1st bank to be nationalized in 1949.
- Since nationalization in 1949, the Reserve Bank is fully owned by the Government of India
- Its First governor was Sir Osborne A.Smith(1st April 1935 to 30th June 1937)
- The First Indian Governor was "Sir Chintaman D.Deshmukh"(11th August 1943 to 30th June 1949)
- On 27th June 2006, the Union Government of India reconstituted the Central Board of Directors of the Reserve Bank of India(RBI) with 13 Members, including Azim Premji and Kumar Mangalam Birla

2.2.5 PREAMBLE

The Preamble of the Reserve Bank of India describes the basic functions of the Reserve Bank as :
"To regulate the issue of Bank Notes and keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage."

2.3 FUNCTIONS OF RBI

- Issue of currency
- Development role
- Banker to government
- Banker to bank
- Role of RBI in inflation control
- Formulate monetary policy
- Manager of foreign reserve
- Clearing house functions
- Regulations of banking system

(1) Issue of Currency

- To ensure adequate quantity of supplies of currency notes and coins of good quality.
- Issues new currency and destroys currency and coins not fit for circulation.
- It has to keep in forms of gold and foreign securities as per statutory rules against notes & coins issued.

(2) Developmental Role

- To develop the quality of banking system in India.
- Performs a wide range of promotional functions to support national objectives.
- To establish financial institutions of national importance, for e.g: NABARD, IDBI etc.

(3) Banker to the Government

- Performs all banking function for the central and the state governments and also acts as their banker excepting that of Jammu and Kashmir.
- It makes loans and advances to the States and local authorities.
- It acts as adviser to the Government on all monetary and banking matters.

(4) Banker to banks

- Maintains banking accounts of all scheduled banks.
- RBI also regulates the opening /installation of ATM Fresh currency notes for ATMs are supplied by RBI.
- RBI regulates the opening of branches by banks.
- It ensures that all the N.B.F.S follow the Know Your Customer guidelines.
- The Reserve Bank of India also regulates the trade of gold. Currently 17 Indian banks are involved in the trade of gold in India.
- RBI has invited applications from more banks for direct import of gold to curb illegal trade in gold and increase competition in the market.
- Collection and publication of data.
- It issues guidelines and directives for the commercial banks.

(5) Role of RBI in inflation control

- Inflation arises when the demand increases and there is a shortage of supply There are two policies in the hands of the RBI.
- Monetary Policy: It includes the interest rates. When the bank increases the interest rates than there is reduction in the borrowers and people try to save more as the rate of interest has increased.
- Fiscal Policy: It is related to direct taxes and government spending. When direct taxes increased and government spending increased than the disposable Income of the people reduces and hence the demand reduces.

(6) Formulate monetary policy

- Maintain price stability and ensuring adequate flow of credit in the economy.
- It formulates implements and monitors the monetary policy.
- Instruments: qualitative & quantitative.

(7) Manager of Foreign Exchange

- To facilitate external trade and payment and promote orderly development and maintenance of foreign exchange market in India.
- It acts as a custodian and Manages the Foreign Exchange Management Act,(FEMA) 1999.
- RBI buys and sells foreign currency to maintain the exchange rate of Indian Rupee v/s foreign currencies like the US Dollar, Euro, Pound and Japanese yen.

(8) Clearing House Functions

- The RBI operates clearing houses to settle banking transactions.
- The RBI manages 14 major clearing houses of the country situated in different major cities.
- The State Bank of India and its associates look after clearing houses function in other parts of the country as an agent of RBI.

(9) Regulation of Banking System

The prime duty of the reserve Bank is to regulate the banking system of our country in such a way that the people of the country can trust in the banking Up to perform its duty. The Reserve Bank has following powers in this regard:

- **Licensing:** According to the section 22 of the Banking Regulation Act, every bank has to obtain license from the Reserve Bank. The Reserve Bank issues such license only to those banks which fulfill condition of the bank.
- **Management:** Section 10 of the Banking Regulation Act embowered the Reserve Bank to change manager or director of any bank if it considers it necessary or desirable.
- **Branch Expansion:** Section 23 requires every bank to take prior permission from Reserve Bank to open new places of business in India.
- **Power of inspection of Bank:** Under Section 35, the Reserve Bank may inspect any bank and its books and accounts either at its own initiative or at the instance of the Central Government.

2.4 PRESENT CURRENCY SYSTEM IN INDIA

- The present currency system in India (i.e., after World War II) is managed by the Reserve Bank of India and is based on inconvertible paper currency system. It has two aspects:

  (a) Internal aspect, and

  (b) External aspect.
- The internal aspect deals with the circulation of coins and currency notes, while the external aspect deals with the external value of currency and the way it is regulated.

The main features of the present currency system in India are given below:

1. Coins:

The main developments in Indian coins, particularly after independence, are as follows:

- (i) The Indian rupee coin is a token coin and is made of nickel.
- (ii) From April 1, 1957, decimal coins system was introduced in India. Under this system, the Indian rupee was divided into 100 naya paisa. The nomenclature of naya paisa has now been changed to simply paisa.
- One rupee coin, one rupee note and the coins of lower denomination are issued by the Ministry of Finance, Government of India.
- The rupee and the half rupee coin are unlimited legal tender, while other coins are limited tender up to Rs.10

2. Currency Notes:

- With the exception of one-rupee notes, all other notes are issued by the Reserve Bank of India.
- The Reserve Bank of India maintains a separate Issue Department which deals with issuing of the currency notes.
- At present, notes of rupees 1, 5, 10, 20, 50,100, 200, 500 and 2000 denominations are in circulation. All these notes are convertible into each other and are unlimited legal tender.

3. System of Notes Issue:

- Originally, the Reserve Bank of India Act 1934 provided for the proportional reserve system of note issue.
- According to this system, the Reserve Bank had to maintain not less than 40% reserves (against note issue) in gold coins, bullion, and foreign securities with the provision that gold coins and bullion were not at any time to be less than Rs. 40 crores.
- The remaining 60% of the reserves were to be covered by rupee coins, rupee securities of Government of India, approved bills of exchange and promissory notes payable in India.
- After independence, with the introduction of economic planning, it was felt that the proportional reserve system was not adequately elastic to meet the developmental needs of the country.
- In the beginning of Second Five Year Plan, India had to face foreign exchange difficulties.
- Its foreign exchange reserves fell from Rs. 950 crores in 1950-51 to Rs. 825 crores in 1955-56.
- Consequently, the Reserve Bank of India Act was amended in 1956 and the proportional system of note issue was replaced by the minimum reserve system.
- According to this amendment, the Issue Department of the Reserve Bank was required to keep a minimum of Rs. 400 crores of foreign securities and Rs. 115 crores in gold coins and bullion.
- In November 1957, the Reserve Bank of India Act was again amended to reduce the minimum currency reserve in foreign securities. Under the second amendment, the value of overall minimum reserve to be

maintained by the Reserve Bank is Rs. 200 cores, of which not less than Rs 115 crores should be kept in gold coins and bullion.

- Thus, the present system of issuing notes in India is based on the minimum reserve method. The chief merit of this system is that it is perfectly elastic; supply can be increased up to any limit. But, there is also the danger of over-issue and inflation under such a purely managed system.

4. Expansion of Indian Currency:

- There has been a continuous expansion of Indian Currency since independence. The main reason for this expansion is deficit financing to meet the growing needs of money supply during the planning period.
- Total currency is circulation (i.e., notes in circulation plus circulation of rupee coins plus circulation of small coins) has increased from Rs. 4553 crores in 1970-71 to Rs. 48601 crores in 1989-90.
- Of this total currency, notes in circulation increased from Rs. 4169 crores in 1970-71 to Rs. 47046 crores in 1989-90, circulation of rupee coins from Rs. 247 crores to Rs. 916 crores and circulation of small coins from Rs.137 crores to Rs. 639 crores. In 1989-90, notes accounted for 96.8%, rupee coins 1.9% and small coins 1.3% of the total currency in circulation.

5. External Value of Rupee:

The important developments as regard to the external value of rupee:

- Prior to the establishment of the International Monetary Fund (IMF), India had the sterling exchange standard and the Reserve Bank maintained the external value of rupee in terms of sterling at the rate 1 Rupee = Is. 6d.
- From March 1, 1947, India became the member of the IMF. Every member of the IMF has to declare the parity value of its currency in terms of gold (or U.S. dollar). India fixed the value of I Rupee = 0.268601 gram of fine gold (or 30.23 cents in terms of the U. S. dollar) in 1947. But this gold parity was such that the old rate of Is. 6d was maintained.
- Despite India's membership of the IMF, the rupee's link with the pound sterling continued. This link was considered beneficial for India because about 30% of India's trade was with the sterling block and the exchange rate of rupee in terms of pound was helpful in maintaining the competitive position of India's exports.
- In September 1949, the rupee was devalued by 30.5% following the devaluation of pound. New gold parity was declared as 1 Rupee = 0.186621 grams (or 1 Rupee = 21.00 U. S. cents).
- Indian rupee was further devalued on June 6, 1966 to the extent of 36.5% and the new gold parity rate was fixed at 1 Rupee = 0.118489(or 1 Rupee = 13.33 U. S. cents.). This time, the devaluation was necessitated by the balance of payments difficulties faced by India.
- In September 1975, Indian rupee was delinked from pound sterling. Since then, the external value of the rupee is expressed in terms of a basket of selected currencies and fluctuates according to the market forces.

- In a recent attempt to deal with the grave balance of payments crisis facing the country, the Reserve Bank of India, in two stages, i.e., on July 1 and 3, 1991, devalued Indian rupee by 8.97 % to 10.15% and 10.58% to 12.31 % respectively against the four major world currencies, i:e. the U. S. dollar, the pound sterling, the Deutsch mark and the Japanese yen.
- Thus, together the devaluation in two phases worked out to be more than 20%. Consequently, the dollar increases in value in terms of Indian rupee from Rs. 21.14 to Rs. 25.88; the pound from Rs. 34.36 to Rs. 41.50; the mark from Rs.11.75 to Rs. 14.10; and the yen from 15.22 paise to 1862.
- The broad policy goals of devaluation were (a) to boost Indian exports, (b) to reduce Indian imports, (c) to encourage import substitution and (d) to check the flight of capital from the country.

6. Exchange Control:

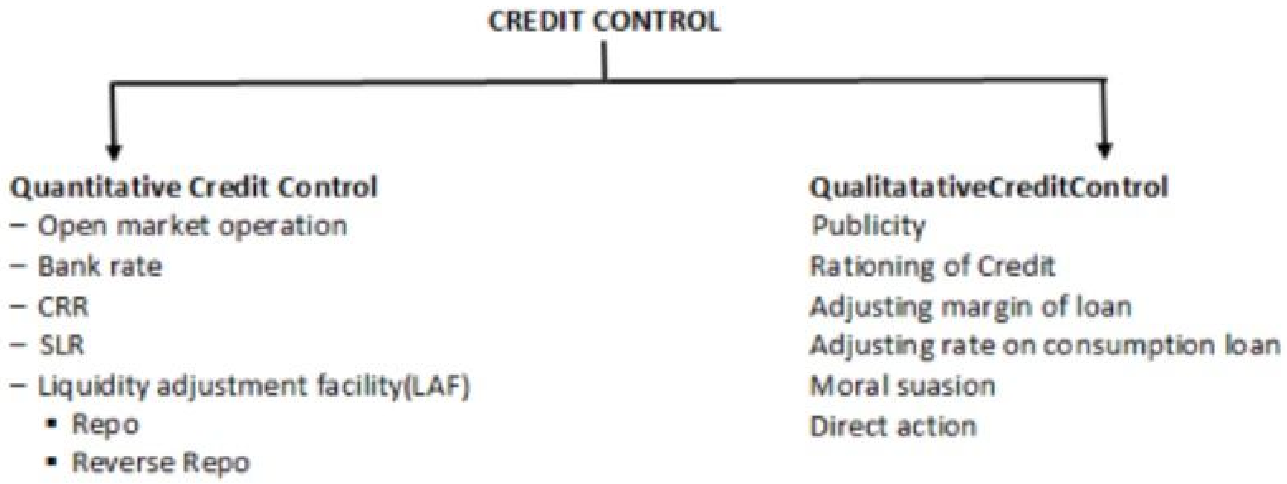
- Exchange control was introduced in India during the World war II. But, even after independence, the policy of strict exchange control continued. The shortage of foreign exchange and the need for the same necessitated the adoption of this measure.
- The purpose of exchange control after independence was to conserve country's foreign exchange resources and to permit their proper use for the country's economic development.
- Under the system of exchange control, all foreign exchange payments are to be made through the Reserve Bank of India; exporters must surrender all foreign exchange earnings to the RBI in exchange for Indian currency; imports are strictly restricted and foreign exchange is made available to the selected importers through rationing.

7. Liberalisation of Exchange Rate:

- Since 1992, in a phased manner, all exchange restrictions have been removed and Indian rupee has been made fully convertible,
- (a) In 1992-93, partial convertibility of rupee was introduced through Liberal Exchange rate Mechanism System (LERMS).
- (b) In 1993-94, convertibility of rupee on trade account was introduced,
- (c) In 1994-95 current account convertibility was announced.

2.5 INSTRUMENTS OF CREDIT CONTROL

- Quantitative or General Methods
- Qualitative or Selective Methods



(A) Quantitative Measures

1. BANK RATE

- It's the interest rate that is charged by a country's central bank on loans and advances to control money supply in the economy and the banking sector.
- This is typically done on a quarterly basis to control inflation and stabilize the country's exchange rates.
- A fluctuation in bank rates Triggers a Ripple-Effect as it impacts every sector of a country's economy.
- A change in bank rates affects customers as it influences Prime Interest Rates for personal loans.
- The present bank rate is 4.65%.

2. REPO RATE

- Whenever the banks have any shortage of funds they can borrow it from the central bank. Repo rate is the rate at which our banks borrow currency from the central bank.
- A reduction in the repo rate will help banks to get Money at a cheaper rate.
- When the repo rate increases borrowing from the central bank becomes more expensive.
- In order to increase the liquidity in the market, the central bank does it.
- The present repo rate is 4.00%.

3. REVERSE REPO RATE

- It's the rate at which the banks park surplus funds with reserve bank.
- While the Repo rate is the rate at which the banks borrow from the central bank.
- It is mostly done, when there is surplus liquidity in the market by the central bank.
- The present reverse repo rate is 3.35%.

4. CRR (Cash Reserve Ratio)

- Cash Reserve Ratio (CRR) is the amount of Cash(liquid cash like gold)that the banks have to keep with RBI.
- This Ratio is basically to secure solvency of the bank and to drain out the excessive money from the banks.
- The present CRR rate is 3.00%.

5. SLR (Statutory Liquidity Ratio)

- It is the amount a commercial bank needs to maintain in the form of cash, or gold or govt. approved securities (Bonds) before providing credit to its customers.
- SLR rate is determined and maintained by the RBI (Reserve Bank of India) in order to control the expansion of bank credit.
- The present SLR rate is 18.50%.

(B) Qualitative Measures

- **1. Direct Action:** The central bank may take direct action against commercial banks that violate the rules, orders or advice of the central bank. This punishment is very severe of a commercial bank.
- **2. Moral persuasion:** It is another method by which central bank may get credit supply expanded or contracted. By moral pressure it may prohibit or dissuade commercial banks to deal in speculative business.
- **3. Legislation:** The central bank may also adopt necessary legislation for expanding or contracting credit money in the market.
- **4. Publicity:** The central bank may resort to massive advertising campaign in the news papers, magazines and journals depicting the poor economic conditions of the country suggesting commercial banks and other financial institutions to control credit either by expansion or by contraction.

Unit 3: Private Banking

3.1 INTRODUCTION

- The private-sector banks in India represent part of the Indian banking sector that is made up of both private and public sector banks. The "private-sector banks" are banks where greater parts of stake or equity are held by the private shareholders and not by government. Banking in India has been dominated by public sector banks since the 1969 when all major banks were nationalised by the Indian government. However since liberalisation in government banking policy in 1990s, old and new private sector banks have re-emerged.

- They have grown faster and bigger over the two decades since liberalisation using the latest technology, providing contemporary innovations and monetary tools and techniques.

- The private sector banks are split into two groups by financial regulators in India, old and new. The old private sector banks existed prior to the nationalisation in 1969 and kept their independence because they were either too small or specialist to be included in nationalisation. The new private sector banks are those that have gained their banking license since the liberalisation in the 1990s.

3.1.1 History and Evolution

- Private-sector banks have been functioning in India since the very beginning of the banking system. Initially, during 1921, the private banks like bank of Bengal, bank of Bombay and bank of Madras were in service, which all together formed Imperial Bank of India.

- Reserve Bank of India (RBI) came in picture in 1935 and became the centre of every other bank taking away all the responsibilities and functions of Imperial bank. Between 1969 and 1980 there was rapid increase in the number of branches of the private banks. In April 1980, they accounted for nearly 17.5 percent of bank branches in India. In 1980, after 6 more banks were nationalised, about 10 percent of the bank branches were those of private-sector banks. The share of the private bank branches stayed nearly same between 1980 and 2000.

- Then from the early 1990s, RBI's liberalisation policy came in picture and with this the government gave licenses to a few private banks, which came to be known as new private-sector banks.

- There are two categories of the private-sector banks: "old" and "new".

- The old private-sector banks have been operating since a long time and may be referred to those banks, which are in operation from before 1991 and all those banks that have commenced their business after 1991 are called as new private sector banks.

- Housing Development Finance Corporation Limited was the first private bank in India to receive license from RBI as a part of the RBI's liberalization policy of the banking sector, to set up a bank in the private-sector banks in India.

- Historically, the private sector banks played a crucial role in the growth of joint stock banking in India. The first half of the 20th century witnessed phenomenal growth of private sector banks. As a result in 1951, there were 566 private banks of which 474 were non-scheduled and 92 scheduled classified on the basis of their capital size.

- The role of private sector banking started declining when the Government of India entered banking business with the establishment of State Bank of India in 1955 and subsequently two rounds of bank nationalization one in July 1969 (14 major banks), another in April 1980 (takeover of 6 banks). Consequently, the presence of public sector banks has increased.

- At present, there are 32 private banks comprising of 24 old banks, which existed prior to 1993-94 and eight new private banks, which were established during 1993- 94 and onwards after the RBI announced guidelines in January 1993 for establishment of new banks in private sector following the recommendations of Narasimham Committee-I (1991). Compared to New private sector banks, the old banks are smaller in size.

- For example, at end March 2000, the average net worth of the 24 Old Private Banks (OPBs) was Rs.179.67 Crore per OPB compared to that of the New Private Bank (NPB) at Rs. 479.88 Crore per NPB. The OPBs are essentially regional in character although some of them have scattered presence in areas other than in and around the areas of their origin. The number of branches of the NPBs was 999 at end March 2003, while those of OPBs 3491.

- The paid-up capital shall not be 113 less than Rs. 100 Crore. The new guidelines issued in 2001 raised the minimum paid-up capital to Rs. 200 Crore, which shall be enhanced to Rs. 300 Crore within three years after the commencement of business. The promoters' share shall not be less than 40 per cent and the voting right of a shareholder shall not exceed 10 per cent. The new banks should avoid shortcomings such as unfair concentration of credit, cross-holding of industrial groups, etc.

- Those banks which intent to establish main office in a centre where no banking is having such office is to be preferred. These banks are required to observe priority sector lending targets as applicable to other domestic banks. The guidelines aim at ensuring that the new entrants are ab initio financially viable and technologically up-to-date While granting approvals for OPBs, one of the considerations before the RBI was that the new banks would start functioning in a professional manner giving clear signals to the effect that would improve the image of commercial banking system and give confidence to the depositing public.

- Accordingly, nine banks were set-up in private sector including some by development financial institutions. Prominent among them are ICICI Bank, GTB, HDFC and IDBI bank. Another interesting development was merger of some banks. Bareily Corporation Ltd merged with Bank of Baroda in 1999, Times Bank merged with HDFC Bank in 1996, Bank of Madura Ltd merged with ICICI bank in 2001 and Nedungadi Bank Ltd merged with Punjab National Bank in 2003.

- With regard to branch expansion, banks attaining capital adequacy norms and prudential accounting standards can set up new branches without the prior approval of RBI. Banks have the freedom to rationalize their existing branch network by relocating branches, opening of specialized branches, spinning off business, setting up of controlling offices, etc.

- The New Private Sector Banks started publishing balance sheets since 114 1995-96. In that year the share of OPBs in total assets was 6.2 per cent while that of NPBs was 1.4 per cent. The NPBs had improved their market share to 5.3 per cent by 1999-2000 at the cost of PSBs. The share of private sector banks in the total number of branches in 1992-93 was only 8.33 percent. In 2002-03, the share of private sector banks in total bank branches is 8.75 percent.

3.1.2 Meaning of Private Sector Banks

The "**private-sector banks**" are **banks** where greater parts of stake or equity are held by the **private** shareholders and not by government. **Banking in India** has been dominated by public **sector banks** since the 1969 when all major **banks** were nationalized by the **Indian** government.

3.1.3 Features of Private Sector Banks

- Private ownership and control
- Profit motive
- No state participation
- Independent Management
- Wide variety of specialized Banking services
- Exempted from priority sector lending norms for the first 3 years

- Emphasis on service & technology
- Use modern Technology
- Required to maintain the net worth of Rs. 300 Crores at all times.
- Shareholding or control, in any bank, in excess of 10%, by any single entity, would require prior approval of RBI.
- Other banks (including foreign banks having branches in India) would not be allowed to any fresh stake of more than 5% of equity capital of Bank.
- RBI may allow a higher level of shareholding, on its discretion, for restructuring or for the interest of consolidation in banking sector.
- Aggregate foreign investment in private bank from all sources (FII, FDI, and NRI) cannot exceed 74% of paid up capital.

3.2 CLASSIFICATION OF PRIVATE BANKING:

- Old private banks
- New private banks
- Foreign banks

(i) Old Private Banks:

The banks, which were not nationalized at the time of bank nationalization that took place during 1969 and 1980's are known to be the old private-sector banks. These were not nationalized, because of their small size and regional focus. Most of the old private-sector banks are closely held by certain communities their operations are mostly restricted to the areas in and around their place of origin.

Their Board of directors mainly consists of locally prominent personalities from trade and business circles. One of the positive points of these banks is that, they lean heavily on service and technology and as such, they are likely to attract more business in days to come with the restructuring of the industry round the corner.

List of the old private-sector banks in India:

- Bank of Rajasthan Ltd.
- Catholic Syrian Bank Ltd.
- City Union Bank Ltd.
- Dhanalakshmi Bank Ltd.
- Federal Bank Ltd.
- ING Vysya Bank Ltd.
- Jammu and Kashmir Bank Ltd.
- Karnataka Bank Ltd.
- Karur Vysya Bank Ltd.
- Lakshmi Vilas Bank Ltd.

(ii) New Private-Sector Banks

The banks, which came in operation after 1991, with the introduction of economic reforms and financial sector reforms are called "new private-sector banks". Banking regulation act was then amended in 1993, which permitted the entry of new private-sector banks in the Indian banking s sector. However, there were certain criteria set for the establishment of the new private-sector banks, some of those criteria being: The bank should have a minimum net worth of Rs. 200 Crores.

1. The promoters holding should be a minimum of 25% of the paid-up capital.
2. Within 3 years of the starting of the operations, the bank should offer shares to public and their net worth must increased to 300 crores.

List of the new private-sector banks in India:

- Bank of Punjab Ltd. (since merged with Centurian Bank)
- Centurian Bank of Punjab (since merged with HDFC Bank)
- Development Credit Bank Ltd.
- HDFC Bank Ltd.
- ICICI Bank Ltd.
- IndusInd Bank Ltd.
- Kotak Mahindra Bank Ltd.
- Axis Bank (earlier UTI Bank)
- Yes Bank Ltd.

(iii) Foreign banks:
A foreign bank is a type of International Bank that is obligated to follow the regulations of both the home and host countries. Foreign banks are defined as banks from a foreign country working in India through branches. RBI has provided rules and guidelines for a foreign bank to establish and operate in India.

Functions of Foreign Banks:
- The foreign banks performs all the major functions of commercial banks, viz. acceptance of deposits from the public, lending, clearing of cheques, remittance of money etc.
- The foreign banks use state of the art technology and they offer a wide variety of services/ products to the customers, viz. Credit Cards (Credit Banking) , Debit Cards, Net Banking, Telephone Banking, Core Banking Services etc.
- The foreign banks perform the major functions of financing the foreign trade of the country.

List of the foreign banks in India:
- Citi Bank
- Standard Chartered Bank
- HSBC Bank
- Deutsche Bank
- Royal Bank of Scotland
- DBS Bank
- Barclays Bank
- Bank of America
- Bank of Bahrain and Kuwait
- Doha Bank

3.3 ROLE OF PRIVATE BANKING IN ECONOMIC DEVELOPMENT

- **Banks help in Capital Formation:** Banks mobilize the idle and dormant capital of a community and make it available for productive purposes. In fact, banks have designed a number of schemes to attract the prospective customers to encourage the habit of savings among the people.

- **Banks are the Creator of Money:** Banks are described as factories of credit. They have the power to create money and it helps in the economic development of the country.

- **Banks act as a link between the organized and unorganized sectors:** In India, money market consists of organized and unorganized sectors. Both of them are required to be linked for economic development of the country and this function is performed by banks.

- **Banks help in the effective implementation of monetary policy:** The effective implementation of monetary policy can be done only through properly organized banking system of the country.

- **Banks help in the development of agriculture and industries:** The development of a country not only depends on the industrial development but also on the development of agriculture. The banks cater to the financial needs of these sectors which result in the economic development of the country.

- **Banks act as catalyst in social change:** In India banks are regarded as catalysts in bringing the desired social change in community. Banks are able to achieve the desired change through it sectoral priorities and other social development programmes.

- **Banks help in the development of entrepreneurship:** Banks have special drives and specific schemes for the development of entrepreneurship. Banks help in boosting their strength and health.

- **Banks regulate the flow of national savings:** Banks regulate the flow of national savings. They ensure the diversion of national savings into productive purposes.

- **Banks help in mitigating the effects of trade cycles:** The effective banking system can help the government in controlling the circulation of money. It helps in mitigating the effects of trade cycles in a country.

- **Banks help in maintaining the positive balance of trade:** Banks also help in promoting import and maintaining the balance of trade at a favourable position.

3.4 PERFORMANCE OF PRIVATE BANKS IN INDIA

No.	Particulars	Old Private Sector Banks as on 31.03.2008	New Private Sector Banks as on 31.03.2008
(a)	Number of Branches	4,450	3,525
(b)	Number of ATMs	2,100	9,867
(c)	Deposits (Rs. Crores)	N.A.	46,19,373
(c)	Advances (Rs. Crores)	1,11,670	4,06,733

3.5 CHALLENGES BEFORE PRIVATE SECTOR BANKS IN INDIA

- **1. Regulatory Procedure and Related Delays:**
  Too many regulatory measures imposed by the Government on the private sector has resulted in lengthy procedure and delays in getting final clearance of a new industrial project. On the Government level, decision making system is so poor that it normally takes 7 to 8 years for large investment project to complete its gestation period.
  Delegation of decision making in the Government bureaucracy is so poor that even the simple decisions are rolled back to the top level leading avoidable procedural delays, huge cost escalation, increasing interest burden and higher burden on consumers.

- **2. Unnecessary Control:**
  From the beginning, the private sector of the country is subjected to unnecessary Government control. Price controls imposed by the Government on certain goods have resulted in disincentive to increase production. Rather competition among the rival producers can enlarge the production base and thereby can reduce the prices automatically.
  But in India, under the conditions of shortage, price controls,.dual pricing etc. has resulted in black marketing and hoarding of such commodities. Moreover, the system of licensing of capacity as a capacity restraint has also resulted in undesirable effects on the investors instead of preventing monopolistic tendencies. It is only since 1980, unnecessary controls on the utilisation of excess capacity and on the creation of new capacities have been either abolished or liberalized.

- **3. Inadequate Diversification:**
  The private sector has been suffering from inadequate diversification as the Government did not allow them to participate in those basic, heavy and infrastructural sectors which were earlier reserved for the public sector. It is only in post-1991 period, some of these areas are now opened for the private sector participation.

- **4. Reservation for the Small Sector:**
  From the initial stage of development, the Government is providing necessary support to the small industrial sector in the form of reservation of certain products exclusively for the small sector so as to save it from unfair competition of large units and also by providing excise exemption or lower excise duties on the goods produced by the small sector. But for the proper development of the small sector, modernization of their production techniques, proper product-mix, updating of designs must be given adequate priority.

- **5. Lack of Finance and Credit:**
  Although the large scale industrial corporate units of the private sector are mobilizing their fund from banks, development financial institutions and from the market through sale of their equities or debentures but the small scale units are facing acute problem in raising fund for their expansion.

- **6. Low Ratio of Profit:**
  Another important problem of the private sector enterprises is the declining trend in its net profit ratio. Accordingly, the net profit to turnover ratio of these total Indian private sector enterprises has been declining from 6.1 per cent in 1994-95 to 3.2 per cent in 1996-97 and then to 2.3 per cent in 1997-98.
  Moreover, the net profit to net worth (NP/NW) reflecting on return on investment, of the total private sector enterprises also declined considerably from 15.2 per cent in 1994-95 to 6.5 per cent in 1996-97 and then to 4.7 per cent in 1997-98 as compared to that of 5.4 per cent of the Central Public Sector Enterprises (CPSEs).

Unit 4: Public sector Banking

4.1 INTRODUCTION

- A Public Sector bank is one in which, the Government of India holds a majority stake. It is as good as the government running the bank. Since the public decide on who runs the government, these banks that are fully/partially owned by the government are called public sector banks.

- Public Sector bank means any Government Sector Bank/Institute that goes public means that issues it share to general public. It also has a greater share of government (more than 50%) so that the main motto of social welfare other than Maximizing Profit remains.

- Whereas Private Sector Banks are those Banks where the management is controlled by Private individuals and Government does not have any say in the management of these banks. Maximizing profit is the basic motto.

4.1.1 MEANING OF PUBLIC SECTOR BANKS

- Public Sector Banks (PSBs) are a major type of bank in India, where a majority stake (i.e. more than 50%) is held by the government. The shares of these banks are listed on stock exchanges. There are a total of 12 Public Sector Banks alongside 1 state-owned Payments Bank in India.

- Public Sector Bank is the bank that is owned by the Government or is the major shareholder of more than 51% on the bank.

4.1.2 FEATURES OF PUBLIC SECTOR BANKS

- State Ownership: Public undertakings are fully owned by the Government or some public authority
- Government Control
- Service Motive
- State Financing
- Bureaucratic Management
- Public Accountability

4.2 CLASSIFICATION OF PUBLIC SECTOR BANKS

- State Bank of India & Associate Banks
- Nationalized Banks
- Regional rural Banks
- Lead Bank Scheme

4.2.1 STATE BANK OF INDIA

(A) Evolution

- Before 1921, there were three Presidency Banks of Bombay, Calcutta and Madras. In 1921, by the amalgamation of these three banks the Imperial Bank was established. It was governed by the Imperial Bank of India Act of 1920. The Imperial Bank was mainly a commercial bank owned by private shareholders.
- But it was simultaneously performing some of the functions of Central Bank such as the banker to the government, bankers' bank and national clearing house. But it was not given the powers to issue notes or to engage in foreign business.
- The Imperial Bank was functioning on this line till 1934 when a separate central bank i.e., RBI was established. Then the Imperial Bank of India Act was amended by the Imperial Bank (Amendment) Act of 1934.
- The State Bank of India is the biggest commercial bank and holds a special position in the modern commercial banking system in India. It came into existence on July 1, 1955 after the nationalisation of Imperial Bank of India. The Imperial Bank of India was established in 1921 by amalgamating the three Presidency Banks of Madras, Bombay and Bengal.
- Until the establishment of the Reserve Bank of India in 1935, the Imperial Bank of India, in addition to its normal commercial banking functions had been performing certain central banking functions. It used to act as the banker to the government, as banker's bank and as the clearing house.
- After the establishment of the Reserve Bank of India, the Imperial Bank of India left its central banking functions, but continued to serve as the agent of the Reserve Bank in the areas where the latter did not have its branches. In 1955, on the recommendations of the Rural Credit Survey Committee, the Imperial Bank of India was nationalised and renamed as the State Bank of India through the State Bank of India Act 1955.

(B) Organisation of State Bank of India:

i. Capital: The state Bank of India has an authorised capital of Rs. 20 crore which has been divided into 20 lakh shares of Rs. 100 each. The issued capital of the State Bank is Rs. 5.6 crore. The shares of the State Bank are held by the Reserve Bank, insurance companies and the general public. At the end of March 2001, the paid-up capital and the reserves of the State Bank were Rs. 13461 crore.

ii. Management: The management of the State Bank of India is under the control of a Central Board of Directors consisting of 20 members.

- **The break-up of the Central Board is as given below:**

(a) A Chairman and a Vice-Chairman are to be appointed by the Central Government in consultation with Reserve Bank.

(b) Two Managing Directors are to be appointed by the Central Board with the approval of the Central Government,

(c) Six directors are to be elected by the private shareholders.
(d) Eight directors are to be nominated by the Central Government in consultation with the Reserve Bank to represent territorial and economic interests. Not less than two of them should have special knowledge in the working of cooperative institutions and of the rural economy,
(e) One director is to be nominated by the Central Government,
(f) One director is to be nominated by the Reserve Bank.

(C) Subsidiary Banks:

- Through the State Bank of India (Subsidiary Banks) Act, 1959, major state- associated banks were converted into subsidiary banks of State Bank of India.
- At present, there are seven subsidiary banks of the State Bank of India:
  (a) The State Bank of Bikaner and Jaipur;
  (b) The State Bank of Hyderabad;
  (c) The State Bank of Mysore;
  (d) The State Bank of Patiala;
  (e) The State Bank of Saurashtra;
  (f) The State Bank of Travancore; and
  (g) The State Bank of Indore.

(D) Functions of State Bank of India

The functions of the State Bank of India are largely divided into two main categories. These are ordinary banking functions and central banking functions. Both these categories are broadly divided into many subcategories.

(a) Central Banking Functions

SBI acts as an agent to the RBI, where there are no branches RBI available. Accordingly, there are many functions which are rendered by the SBI. These are :

- Maintaining the currency
- Government's bank
- Bank's banker
- Acts as a clearinghouse

i. Maintaining the currency

RBI is reporting for maintaining its own currency. But the offices of RBI are only available in big cities. But the branches of SBI are available everywhere in the country. The network of SBI works in rural as well as urban areas.

In such places, RBI maintains its currency with SBI. The currency is withdrawn from these branches whenever required by RBI.

ii. Government's Bank

SBI caters to the needs of the government, central as well as the state. On behalf of the government, it receives the money and deposits it. It collects the charges on behalf of government like tax collection and other payments. It also grants advances and loans to the government.

iii. Bank's Bankers

Many commercial banks have their accounts with SBI. These banks resort to help SBI whenever they face the financial shortage. It also discounts the bills for these commercial banks. Due to this function, SBI is also considered as the banker's bank but only in a limited sense.

iv. Acts as a Clearinghouse

In places where RBI has no branches, SBI acts as a clearinghouse for them. There, it facilitates the services of interbank settlements and many other services. All the banks have accounts with SBI, so the process of clearing becomes easier for SBI.

(b) General Banking Functions

There are many functions that SBI beyond the above-mentioned services. These services are rendered by SBI under section 33A. These are:

- It accepts the deposits from the people in the form of savings, fixed, current, and recurring deposit accounts.
- Based on the security of stocks, securities, SBI gives advances and loans to the public.
- SBI gives the facility of drawings, accepting, and buying and selling the bills of exchange.
- It also issues and circulates the letters of credit.
- SBI also invests in funds or any special kind of security.
- The bank also acts as a trustee, executor, or otherwise, based on the circumstances.
- It is also entrusted with selling and purchasing of either movable or immovable properties that come in the bank.
- SBI also functions for selling and buying of gold and silver.
- For the general public, it helps in the opening of public provident fund accounts.
- It underwrites any issue related to the securities or the debentures that are authorized.
- It provides the facility of shipping finance as well as various factoring services.
- There are many leading bank schemes in which SBI participates.

4.2.2 NATIONALISED BANKS

(A) INTRODUCTION

- In 1947, partition of Hindustan & Pakistan hurt the banking sector as well.
- The average capital of the failed banks between 1947 and 1955 was significantly lower than the average size of paid up capital of reporting banks in the industry.
- 1948- worst years for the relatively larger banks-45 institutions were closed down.
- Bank deposits mobilised by commercial banks were largely lent out to security based borrowers in trade and industry.
- After independence the government of India (GOI) adopted planned economic development for the Country. Accordingly Five Year plans came into existence since 1951.
- In 1950-51 there were 430 Commercial Banks. The GOI had some social objectives of planning. These commercial Banks failed helping the Government in attaining these objectives.
- Banks were controlled by business houses, failed to cater need of cottage industry, poor people etc.
- Thus, the Government decided to Nationalise 14 major BANKS with a deposit base over Rs.50 crores were nationalised.
- First bank to be nationalised was RESERVE BANK OF INDIA on 1January, 1949.
- Nationalisation of Imperial Bank of India and its conversion into State Bank of India in July, 1955.
- Conversion of 8 major states associates banks into subsidiary banks in 1959.
- Nationalisation of 14 other Indian scheduled banks in July, 1969.
- Nationalisation of 6 more banks in April, 1980.
- At present, there are 26 scheduled banks in public sector. Out of these,19 banks are nationalised.

- SBI & Its 5 ASSOCIATES According to government orders issued on February 22,2017 under the State Bank of India Act,1955, the entire undertaking of-
  1. STATE BANK OF BIKANER & JAIPUR,
  2. STATE BANK OF MYSORE,
  3. STATE BANK OF TRAVANCORE,
  4. STATE BANK OF PATIALA,
  5. STATE BANK OF HYDERABAD
- Will stand transferred to and vested in STATE BANK OF INDIA from April 1,2017.
- Also BHARATIYA MAHILA BANK (BMB) has merged with the country's largest lender STATE BANK on April 1,2017 to ensure greater banking outreach to WOMEN.
- PUNJAB NATIONAL BANK acquired NEW BANK OF INDIA in 1993.

(B) Meaning

- Nationalisation is a process by which the government takes over private assets and brings them under public ownership.
- Nationalisation refers to an act of taking an industry or assets into the public ownership. It is the opposite of privatisation.
- In the context of banks, it means that banks which were earlier in private sector were transferred to the public sector by the act of nationalisation.

(C) Objectives of Nationalisation of Banks:

- The specific objectives which the nationalised banks were expected to pursue were outlined by the then Prime Minister Mrs. Indira Gandhi in her statement to the Parliament on 21 July, 1969.

  1. Social Welfare: It was the need of the hour to direct the funds for the needy and required sectors of the Indian economy. Sector such as agriculture, small and village industries were in need of funds for their expansion and further economic development.

  2. Controlling Private Monopolies: Prior to nationalisation many banks were controlled by private business houses and corporate families. It was necessary to check these monopolies in order to ensure a smooth supply of credit to socially desirable sections.

  3. Expansion of Banking: In a large country like India the numbers of banks existing those days were certainly inadequate. It was necessary to spread banking facilities to unbanked village areas across the country.

  4. Reducing Regional Imbalance: In a country like India where we have urban-rural divide; it was necessary for banks to go in the rural areas where the banking facilities were not available. In order to reduce this regional imbalance nationalisation was justified.

  5. Priority Sector Lending: In India, the agriculture sector and its allied activities were the largest contributor to the national income. So, these were treated as the priority sectors. But unfortunately they were deprived of their due share in the credit. Thus, Nationalisation of bank was urgently needed for catering funds to them.

6. Developing Banking Habits: In India more than 70% population used to stay in rural areas. It was necessary to develop the banking habit among such a large population.

7. Monetisation Issue: Commercial banks accumulate deposits from the public. They are in a position to bring changes in the supply of money. Such an important power should not be in the private sector. It is the public sector that should have the control over money supply.

8. Integration Issue: Central Banks are established by the Govt, for overall monetary control in the economy and is not aiming at profit. But commercial banks were started mainly to earn profit. Thus, there are contradicting objectives between central bank & commercial banks.

In this situation, the central bank may find it difficult to implement its policies when the commercial banks oppose them. Therefore, in the interest of coordination and cooperation between them, commercial banks were nationalised.

(D) Arguments for Nationalisation

1. It would enable the government to obtain all the large profits of the banks as its revenue.
2. Nationalization would safeguard interests of public and increase their confidence thereby bringing about a rapid increase in deposits. Thus, preventing bank failures.
3. It would remove the concentration of economic power in the hands of a few industrialists.
4. It would help in stabilizing the price levels by eliminating artificial scarcity of essential goods.
5. It would enable the banking sector to diversify its resources for the benefit of the priority sector.
6. Eliminates wasteful competition and raises the efficiency of the working of banks.
7. Enables rapid increase in the number of banking offices in rural & semi-urban areas & helped considerably in deposit mobilization to a great extent.
8. Necessary for the furtherance of socialism and in the interest of community
9. Enables the Reserve Bank to implement its monetary policy more effectively.
10. It would replace the profit motive with service motive
11. It would secure standardization of banking services in the country
12. Would check the incidence of tax evasion and black money
13. Through public ownership and control, banks function like other public utility services by catering to the financial need of the common man.
14. Like other countries, India should also get profit by nationalizing her banking industry.
15. Essential for successful planning and all-round progress of the national economy, community development and for the welfare of the people.

(E) Arguments against Nationalisation

1. Political purpose rather than for Productive purpose: The government has acquired the strength of a giant and there is the danger of using the financial resources for political purposes rather than for productive purpose.

2. Beginning of state capitalism: Such a drastic step of nationalisation of about 90% of the banking resources is wholly unnecessary, especially if we take into consideration the enormous powers vested in the Reserve Bank of India for controlling banks' resources. It is considered as the beginning of state capitalism and not socialism in India.

3. Scope for inefficiency: Some are of the opinion that after nationalisation banks will degenerate to the level of agricultural co-operatives, which are known for their inefficiency and corrupt practices.

4. Less attractive customer's service: Inefficiency, indecision, corruption, and lack of responsibility are the evils with which the government undertakings are suffering. A government bank may not care to attach importance to the customer service.

5. Secrecy of customer's accounts: In spite of the assurances given and provisions made in the Act, businessmen still fear about the maintenance of the secrecy of the customer's accounts. As such, they may be forced to withdraw their deposits and go to some bank in the private sector and foreign banks. Thus nationalisation of big Indian banks .will diverts some of the deposits of Indian banks to the foreign banks which is not at all desirable.

6. Branch expansion: To argue that nationalisation will help to facilitate branch expansion to rural areas much more rapidly than the private banks cannot be supported by facts. Weather it is private bank or nationalised bank; it has to go by business principles and satisfy itself that the new branch is economically viable. In other words, branch expansion can be achieved by private banks as well, without nationalisation.

7. Burden of compensation: Nationalisation leads to the payment of heavy compensation to the shareholders. This gives additional financial burden on the government. Moreover, it is also argued that nationalisation will not bring much income to the government.

In spite of these criticisms, we cannot ignore the fact that at present, nationalisation of banks is an accomplished fact. By and large this measure received support from almost all sections of the public. It was welcomed by the middle class people and small industrialists and small traders.

(F) Achievements of Nationalized Banks

A banking revolution occurred in the country during the post-nationalization era. There has been a great change in the thinking and outlook of commercial banks after nationalization. There has been a fundamental change in the lending policies of the nationalized banks. Indian banking has become development-oriented. It has changed from class banking to mass-banking or social banking. This system has improved and progressed appreciably.

Various achievements of banks in the post-nationalization period are explained below:

1. Branch Expansion: Initially, the banks were conservative and opened branches mainly in cities and big towns. Branch expansion gained momentum after nationalization of top commercial banks. This expansion was not only in urban areas but also in rural and village areas.

2. Expansion of Bank Deposits: Since nationalization of banks, there has been a substantial growth in the deposits of commercial banks. Thus bank deposits had increased by 200 times. Development of banking habit among people through publicity led to increase in bank deposits.

3. Credit Expansion: The expansion of bank credit has also been more spectacular in the post-bank nationalization period. At present, banks are also meeting the credit requirements of industry, trade and agriculture on a much larger scale than before.

4. Investment in Government Securities: The nationalized banks are expected to provide finance for economic plans of the country through the purchase of government securities. There has been a significant increase in the investment of the banks in government and other approved securities in recent years.

5. Advances to Priority Sectors: An important change after the nationalization of banks is the expansion of advances to the priority sectors. One of the main objectives of nationalization of banks to extend credit facilities to the borrowers in the so far neglected sectors of the economy. To achieve this, the banks formulated various schemes to provide credit to the small borrowers in the priority sectors, like agriculture, small-scale industry, road and water transport, retail trade and small business. The bank lending to priority sector was, however, not uniform in all states.

6. Social Banking - Poverty Alleviation Program: Commercial banks, especially the nationalized banks have been participating in the poverty alleviation Program launched by the government.

7. Differential Interest Scheme: With a view to provide bank credit to the weaker sections of the society at a concessional rate the government introduced the "Differential interest rates scheme" from April 1972. Under this scheme, the public sector banks have been providing loans at 4% rate of interest to the weaker sections of the society.

8. Growing Importance of Small Customers: The importance of small customers to banks has been growing. Most of the deposits in recent years have come from people with small income. Similarly, commercial banks lending to small customers has assumed greater importance.

9. Diversification in Banking: The changes which have been taking place in India since 1969 have necessitated banking companies to give up their conservative and traditional system of banking and take to new and progressive functions.

10. Globalization: The liberalization of the economy, inflow of considerable foreign investments, frequency in exports etc., have introduced an element of globalization in the Indian banking system.

11. Profit making: After nationalization, banks are making profits in addition to achieving economic and social objectives.

12. Safety: The government has given importance to safety of the banks. The RBI exercises tight control over banks and safeguards depositors interest

13. Advances under self-employment scheme: Public sector banks play a significant role in promoting self employment through advances to unemployed through various schemes of the government like IRDP, JGSY, etc.

4.2.3 REGIONAL RURAL BANKS

(A) Introduction

- Regional Rural Banks are the Scheduled Commercial banks in India conducting banking activities for the rural regions at the state level.
- There were established with an objective of providing easily accessible banking and credit services to the rural population and mobilising financial resources from the urban areas to rural districts of India. Hence, RRBs form a vital component of the financial service sector in India.
- RRBs operate at the district level in the states, and they may cover multiple districts within that state.
- Just like any other commercial banks, the organisation of Regional Rural Bank comprises of a Board of Directors, Chairperson, Managing Director, Manager, Regional Managers, and the assistant's staff.

(B) Sponsorship of Regional Rural Banks:

- Each Regional Rural Bank is sponsored by a Public Sector Bank. A sponsor bank in relation to a Regional Rural Bank is a Bank by which such a RRB is sponsored. It is duty of a sponsor bank to aid and assist the RRB sponsored by it.
- A sponsor bank helps RRB by:
  a) Subscribing to the share capital.
  b) Training personnel of Regional Rural Bank.
  c) Providing managerial and financial assistance to RRB.
- A sponsor bank provides such managerial (staff) and financial assistance during the first 5 years of its functioning. The central government may, either on its own motion or on the recommendations of NABARD extend such period of 5 years for such further period(not exceeding 5 years at a time) as may be deemed fit.
- The authorized capital of Regional Rural Banks is Rs. 5 crores which is contributed by Central Government, State Government and the Sponsor Bank in ration of 50:15:35.

(C) History of Regional Rural Banks

- The Narasimhan Committee on Rural Credit under the rule of PM Indira Gandhi made certain recommendations for formation RRBs, which would be beneficial for the rural population as compared to commercial banks.

- An Ordinance for the establishment of Regional Rural Banks was passed on September 26, 1975, this being the date of establishment of RRBs.
- The Regional Rural Banks Act (RRB Act) was passed in 1976.
- Five RRBs were first established on the occasion of Gandhi Jayanti, on October 2nd, 1975. Later, many RRBs were established by the Government of India and respective state governments.
- The RRB Act 1976 states the functions of RRBs to provide financial assistance to farmers, Medium and Small Enterprises (MSMEs), local craftsmen and artisans, for agriculture, industries, trade, commerce, and their economic development. 25 RRBs were established within a year from the passing of this Act.
- *There are currently 43 Regional Rural Banks in India.*

(D) Objectives of Regional Rural Banks:

The objectives and activities of RRBs can be briefed as under:

- Bridging the credit gaps in rural areas.
- To develop such measures which could restrict the outflow of rural deposits to urban areas?
- To reduce regional imbalances and increase rural employment generation activities.
- To provide cheap and liberal credit facilities to small and marginal farmers, agriculture labourers, artisans, small entrepreneurs and other weaker sections.
- To save the rural poor from the moneylenders.
- To act as a catalyst element and thereby accelerate the economic growth in the particular region.
- To cultivate the banking habits among the rural people and mobilize savings for the economic development of rural areas.
- To increase employment opportunities by encouraging trade and commerce in rural areas.
- To encourage entrepreneurship in rural areas.
- To cater to the needs of the backward areas which are not covered by the other efforts of the Government?
- To develop underdeveloped regions and thereby strive to remove economic disparity between regions.
- **For achieving its objectives the RRBs provide financial assistance to different segments of rural population engaged in rural activities.**

(E) Capital

- **Authorised capital :** The authorised capital of each Regional Rural Bank shall be five crores of rupees dividend into five lakhs of fully paid-up shares of one hundred rupees each. Provided that the Central Government may, after consultation with the National Bank and the Sponsor Bank, increase or reduce such authorised capital; so, however, that the authorised capital shall not be reduced below twenty-five lakhs of rupees, and the shares shall be, in all cases, fully paid-up shares of one hundred rupees each.

- **Issued capital :** The issued capital of each Regional Rural Bank shall, in the first instance , be such as may be fixed by the Central Government in this behalf, but it shall in no case be less than twenty-five lakhs of rupees or exceed one crore of rupees.
- Out of the capital issued by a Regional Rural Bank under sub- section (1), fifty per cent. shall be subscribed by the Central Government; fifteen per cent. by the concerned State Government and thirty-five per cent. by the Sponsor Bank.

(F) Organizational Structure

The Organizational Structure for RRB's varies from branch to branch and depends upon the nature and size of business done by the branch. The Head Office of an RRB normally had three to seven departments.

The following is the list of officers in decreasing order of their rank in the organization.

- Chairman & Managing Director
- Executive Director
- General Manager
- Deputy General Manager
- Assistant General Manager
- Chief Manager
- Senior Manager
- Manager
- Officer
- Assistants

(G) Functions of Regional Rural Banks

Functions of RRBs are as follows:

- RRBs grant loans and advances to small farmers and agricultural laborers so that they can start their own farming activities including purchase of land, seeds and manure.
- RRBs provides banking services at the doorsteps of the rural people ,particularly in those area which are not served by any commercial Bank
- The RRBs charges a lower rate of Interest and thus they reduce the cost of credit in the rural areas.
- RRBs provide loan and other financial assistance to entrepreneurs in villages, sub-urban areas and small towns .So that they become able to enlarge their business.
- Loans to artisans to encourage them for the production of artistic and related goods.
- Encourage the saving habit among the rural and semi-urban population.

(H) Major problems of RRBs

The following were the main problems faced by the RRBs till recently.

- **(i) Running into losses:** During 1997-98, out of 196 RRBs, 70 RRBs incurred losses amounting to Rs. 230.76 crore in total. The accumulated losses of all RRBs up to the end of March 1998 amount to Rs. 3116.00 crore. This may be due to heavy overhead costs, reduction in lending rates, lower profit margins, heavy increase in salaries and allowances of staff, etc. During 2001-02, out of 196 RRBs, 167 made net profit of Rs. 699.93 crore while 29 suffered losses amounting to Rs. 92.05 crore. The accumulated losses of all RRBs declined to Rs. 2792.59 crore as on March, 2001.
- **(ii) Slow progress:** The progress of RRBs is not up to the expectation and is slow when comparing with other types of banks because of many restrictions on their operations. For example till 1996, RRBS were permitted to lend only under priority sector schemes.
- **(iii) Limited scope of investment:** The basic objective of RRBs was to provide credit facilities to poor and weaker sections of society, i.e., to small and marginal farmers and other weaker sections. They were originally having limited scope to invest their surplus funds freely.
- ***(iv)* Delay in decision making:** The RRBs are controlled directly and indirectly by various agencies, i.e., the sponsoring bank, NABARD, RBI, besides Central Government. Thus, it takes long time to take decisions on some important issues. This, in turn affects the progress of RRBs. However, since end 1997, the operational responsibility of RRBs has been passed on to sponsor bank.
- ***(v)* Lack of co-ordination:** Lack of co-ordination between the RRBs and sports or banks regarding branch expansion, policy making, etc., are also the important causes for the slow progress of RRBs.
- **(vi) Difficulties in deposit mobilization:** The RRBs are aiming at catering to the needs of poor and are not serving the needs of the rich. So, the RRBs are not able to attract the deposit from that potential sector.
- **(vii) Lack of training facilities:** Generally the staff of RRBs is urban-oriented and they may not know the problems and conditions of rural areas. Lack of training facility concerning these areas also affects the growth of RRBs.
- ***(viii)* Poor recovery rate:** The recovery performance of the RRBs is not up to the mark. The /ate of recovery in respect of many RRBs is around 55 per cent only.
- ***(ix)* Capital inadequacy:** The capital adequacy is the very basis to financial soundness. There is capital inadequacy in RRBs as most of the RRBs have huge losses in their 3alance Sheet eating away all the Capital of RRBs.

4.2.4 LEAD BANK SCHEME

(A) Introduction

- Introduction Lead Bank Scheme (LBS) was introduced in 1969, based on the recommendations of the Gadgil Study Group.
- National Credit Council (NCC) in Lead Bank Scheme:
- The National Credit Council was set up in December 1967.
- To determine the priorities of bank credit among various sectors of the economy.
- The NCC had appointed a study group in October 1968 under the chairmanship of Prof. D. R. Gadgil – to suggest an appropriate organisational framework for effective implementation of social objectives.
- Report was submitted in October 1969.

Gadgil Study Group – outcome & recommendation

- **Outcome of the Study Group: as on June 1967**
- Nationalized banks provide 83% of total credit.
- Banking facilities not available to 617 of 2700 towns.
- Commercial Banks had penetrated only 5000 villages (negligible @ 1%)
- Besides, the credit needs of Agriculture, SSI and allied activities – neglected.
- **Recommendation:**
- 1) Banks should provide integrated banking facilities in unbanked areas.
- 2) Adoption of 'Area Approach'- in unbanked areas – each bank should adopt an area.
- 3) Help agriculture and SSI.
- 4) 'District' identified as the smallest geographical unit for the scheme.

(B) Objectives of Lead Bank Scheme

- Sri. F. K. F. Nariman Committee appointed by RBI – In the same year.
- Same recommendations were given.
- Nationalized Banks should act as a 'Lead Bank'.
- 336 Districts to be distributed between nationalized banks.

- **Objectives of Lead Bank Scheme:**
- 1) Eradication of unemployment and under employment.
- 2) Appreciable rise in the standard of living for the poorest of the poor.
- 3) Provision of some of the basic needs of the people who belong to poor sections of the society.

(C) LB – as a Consortium Leader

- Each district had been assigned to different banks (public & private).
- co-ordinating the efforts of all credit institutions
- a. for expansion of branch banking facilities
- b. for meeting the credit needs of the rural economy

- **Allotment of Districts:**
- All the districts in the country.
- Except – metropolitan cities of Mumbai, Kolkata, Chennai and Union Territories of Chandigarh, Delhi and Goa.
- Later on, Union Territories of Goa, Daman and Diu, Delhi & Chandigarh – also brought into purview of LBS.

- **Banks were allotted Districts in the basis of:**
- 1. The capacity of the Bank – popularity of the bank in the area.
- 2. Geographical continuity of the Districts forming clusters.
- 3. If possible each Bank to operate in more than 1 State.
- 4. If possible to have more than 1 Bank in one State.
- Lead Banks were to first undertake an impression survey of whole District.
- Then a detailed survey regarding saving potential, credit requirement, credit gaps or surplus.

District Consultative Committee (DCC's):

- Constituted in the lead districts during 1971-73.
- To facilitate co-ordination of activities of all the Banks and the Financial Institutions & Govt. departments.

(D) Functions

- 1) Survey resources and development of banking in the area.
- 2) Survey the dependency on money lenders by industrial units, farms etc.,
- 3) Survey the facilities for storing (fertilizers & agricultural inputs), marketing, credit facilities for marketing.
- 4) Offering training to staff for advice to small borrowers & farmers in priority sectors.
- 5) Assist other agencies and involve co-operative banks, RRB's, SFC's, KVIB, NABARD.

(E) Advantages

- 1. Spread the availability of banking facilities all over the country.
- 2. Inter link the Commercial and Cooperative banks.
- 3. More effective Branch Expansion.
- 4. Better relationship between Govt. and Banks.
- 5. Integration of credit activities of banks.
- 6. Bottlenecks in the development of a District can be located and removed.
- 7. Lead Bank Scheme would assist in implementation of the District Plan.

(F) District Credit Plan (DCP's)

- First implemented in 1974.
- DCP – consists of technically & economically viable schemes which can be taken up for financing.
- It is a plan of bankable schemes in agriculture, industry and service sectors of the District.
- The schemes can be taken up by different financial institutions in the District.
- Implement the programme in collaboration with other institutions.
- Monitor progress & evaluate progress in achieving targets.

(G) Progress of Lead Bank Scheme

- By 1974 - 90% of geographical areas in Assam, Bihar, W. Bengal, Orissa, M.P., U.P covered.
- 2 study groups appointed by RBI in Gujarat & Maharastra concluded:
- a) Lead Banks were successful in identifying potential area for new branches.
- b) Formulation & implementation of DCP's was slow.
- ✓ They suggested preparation of Annual Action Plans followed by Annual Credit Plans (ACP's)
- ✓ By mid 90's the Lead Bank Scheme covered 493 Districts.
- ✓ As on June 30, 2014, 25 public sector banks and one private sector bank have been assigned lead bank responsibility in 671 districts of the country.

(H) Problems – Lead Bank Scheme

- Confusion regarding the concept of Lead Bank especially for opening branches – ambiguous scope & objectives.
- Co-ordination & effective functioning between banks & F.I's – not just providing finance.
- Problems in allotment of Districts.
- Expertise – knowledge on the district, agriculture, projects, etc.,
- Problems in preparation and uniformity of DCP's.
- Other Infrastructure.
- Did not consider the role of co-operatives – important source of institutional finance.

(I) Service Area Approach (SAA)

- 1980's shortcomings of LBS identified.
- SAA introduced in April 1989.
- Every branch and RRB allotted 15 to 25 districts = Service Area.
- Survey of villages, then village-wise credit plans prepared.
- Credit plan to be monitored by Lead Bank.

- **Advantages:**
- 1. Branch can be concentrate on development of a village.
- 2. Duplication can be avoided.
- 3. Lending can be organized and planned.
- 4. End – use better controlled.

4.3 CHALLENGES BEFORE PUBLIC SECTOR BANKS IN INDIA

1. Generalisation in jobs

Anyone can do any task in public sector banks. The rationale behind this is to ensure that people join the banks in masses by giving competitive exam. However, I think that instead of this, people should be hired on the basis of their knowledge. For example, credit matters must be dealt by a CA or a person with an MBA in finance, marketing matters should be handled by MBA graduates, and so on.

2. More bad debts

Banks, especially PSBs, lent too much to the mighty corporates – at a time when they were already over-borrowed.

3. Lack of competition

In any industry, people compete with each other for the rewards and promotions. But in public sector banks, it seems that promotions are still being given on the basis of seniority.

4. Social burden

The execution of any government's scheme falls mainly to public sector banks.

5. Their functioning

The functioning of public sector banks seems to be totally copy-pasted from private sector banks – at least, the core banking system, that is.

6. Political pressure

The heads of public sector banks are often chosen by the government. And sometimes, they (the heads) have to return the favour.

7. Job security

Job security is ironically one of the reasons behind the low productivity in public sector banks. The employees here are relatively at ease in comparison to their private counterparts, who are always on the edge.

These are a few issues which should be sorted out in a better way, slowly and steadily. Only then will we see a drastic improvement in the public sector banks in the coming years.

........................THANKS........................