Unit:1

Co-operative Banking in India:

Meaning of Cooperative Bank:

Cooperative bank is an institution established on the cooperative basis and dealing in ordinary banking business. Like other banks, the cooperative banks are founded by collecting funds through shares, accept deposits and grant loans.

The cooperative banks, however, differ from joint stock banks in the following manner:

(i) Cooperative banks issue shares of unlimited liability, while the joint stock banks issue shares of limited liability.

(ii) In a cooperative bank, one shareholder has one vote whatever the number of shares he may hold. In a joint stock bank, the voting right of a shareholder is determined by the number of shares he possesses.

(iii) Cooperative banks are generally concerned with the rural credit and provide financial assistance for agricultural and rural activities. Joint stock companies are primarily concerned with the credit requirements of trade and industry.

(iv) Cooperative banking in India is federal in structure. Primary credit societies are at the lowest rung. Then, there are central cooperative banks at the district level and state cooperative banks at the state level. Joint stock banks do not have such a federal structure.

(v) Cooperative credit societies are located in the villages spread over entire country. Joint stock banks and their branches mainly concentrate in the urban areas, particularly in the big cities

History of Cooperative Banking in India:

Cooperative movement in India was started primarily for dealing with the problem of rural credit. The history of Indian cooperative banking started with the passing of Cooperative Societies Act in 1904. The objective of this Act was to establish cooperative credit societies "to encourage thrift, self-help and cooperation among agriculturists, artisans and persons of limited means."

Many cooperative credit societies were set up under this Act. The Cooperative Societies Act, 1912 recognised the need for establishing new organisations for supervision, auditing and supply of cooperative credit. These organisations were- (a) A union, consisting of primary societies; (b) the central banks; and (c) provincial banks.

Although beginning has been made in the direction of establishing cooperative societies and extending cooperative credit, but the progress remained unsatisfactory in the pre-independence period. Even after being in operation for half a century, the cooperative credit formed only 3.1 per cent of the total rural credit in 1951-52.

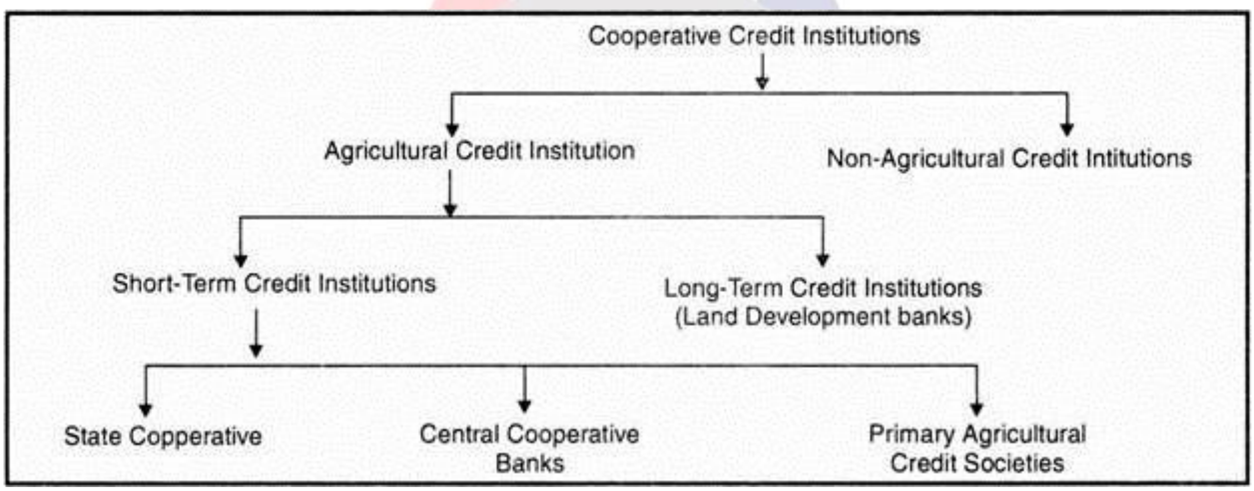
Structure of Cooperative Banking:

There are different types of cooperative credit institutions working in India. These institutions can be classified into two broad categories- agricultural and non-agricultural. Agricultural credit institutions dominate the entire cooperative credit structure.

Agricultural credit institutions are further divided into short-term agricultural credit institutions and long-term agricultural credit institutions.

The short-term agricultural credit institutions which cater to the short-term financial needs of agriculturists have three-tier federal structure- (a) at the apex, there is the state cooperative bank in each state; (b) at the district level, there are central cooperative banks; (c) at the village level, there are primary agricultural credit societies.

Long-term agricultural credit is provided by the land development banks. The whole structure of cooperative credit institutions is shown in the chart given.



Short-Term Rural Cooperative Credit Structure:

In rural India, there exists a 3-tier short-term rural cooperative structure. Tier-I includes state cooperative banks (SCBs) at the state level; Tier-II includes central cooperative banks (CCBs) at the district level; and Tier- III includes primary agricultural credit societies (PACSs).

In 19 states, there exists a 3-tier short-term cooperative credit structure, comprising SCBs, CCBs and PACSs. And in 12 states, there exists a 2-tier short-term cooperative structure. In the north-eastern states, including Sikkim, the structure is 2-tier, comprising only SCBs and PACSs.

As on March 31, 2013, the number of SCBs was 31, of CCBs was 370 and of PACSs was 92432. As on March 31, 2012, the loans advanced by SCBs were Rs. 75600 crore, by CCBs were Rs. 14400 crore and by PACSs were Rs. 91200 crore.

1. State Cooperative Banks (SCBs):

Functions and Organisation:

State cooperative banks are the apex institutions in the three-tier cooperative credit structure, operating at the state level. Every state has a state cooperative bank.

State cooperative banks occupy a unique position in the cooperative credit structure because of their three important functions:

(a) They provide a link through which the Reserve Bank of India provides credit to the cooperatives and thus participates in the rural finance,

(b) They function as balancing centers for the central cooperative banks by making available the surplus funds of some central cooperative banks. The central cooperative banks are not permitted to borrow or lend among themselves,

(c) They finance, control and supervise the central cooperative banks, and, through them, the primary credit societies.

Capital:

State cooperative banks obtain their working capital from own funds, deposits, borrowings and other sources:

(i) Own funds include share capital and various types of reserves. Major portion of the share capital is raised from member cooperative societies and the central cooperative banks, and the rest is contributed by the state government. Individual contribution to the share capital is very small;

(ii) The main source of deposits is also the cooperative societies and central cooperative banks. The remaining deposits come from individuals, local bodies and others.

(iii) Borrowings of the state cooperative banks are mainly from the Reserve Bank and the remaining from state governments and others.

Loans and Advances:

State cooperative banks are mainly interested in providing loans and advances to the cooperative societies. More than 98 per cent loans are granted to these societies of which about 75 per cent are for the short-period. Mostly the loans are given for agricultural purposes.

The number of state cooperative banks rose from 15 in 1950-51 to 21 in 1960-61 and to 28 in 1991-92. The loans advanced by these banks increased from Rs. 42 crore in 1950-51 to Rs. 260 crore in 1960-61, and further to Rs. 7685 crore in 1991-92.

2. Central Cooperative Banks (CCBs):

Functions and Organisation:

Central cooperative banks are in the middle of the three-tier cooperative credit structure.

Central cooperative banks are of two types:

(a) There can be cooperative banking unions whose membership is open only to cooperative societies. Such cooperative banking unions exist in Haryana, Punjab, Rajasthan, Orissa and Kerala.

(b) There can be mixed central cooperative banks whose membership is open to both individuals and cooperative societies. The central cooperative banks in the remaining states are of this type. The main function of the central cooperative banks is to provide loans to the primary cooperative societies. However, some loans are also given to individuals and others.

Capital:

The central cooperative banks raise their working capital from own funds, deposits, borrowings and other sources. In the own funds, the major portion consists of share capital contributed by cooperative societies and the state government, and the rest is made up of reserves.

Deposits largely come from individuals and cooperative societies. Some deposits are received from local bodies and others. Deposit mobilisation by the central cooperative banks varies from state to state.

For example, it is much higher in Gujarat, Punjab, Maharashtra, and Himachal Pradesh, but very low in Assam, Bihar, West Bengal and Orissa. Borrowings are mostly from the Reserve Bank and apex banks.

Loans and Advances:

The number of central cooperative banks in 1991-92 was 361 and the total amount of loans advanced by them in 1991-92 stood at Rs. 14226 crore. About 98 per cent loans are received by the cooperative societies and about 75 per cent loans are short-term. Mostly the loans are given for agricultural purpose.

About 80 per cent loans given to the cooperative societies are unsecure and the remaining loans are given against the securities such as merchandise, agricultural produce, immovable property, government and other securities etc.

Problem of Overdues:

The most distressing feature of the functioning of the central cooperative banks is heavy and increasing overdue loans. In 1997-98, the percentage of overdues to demand at the central cooperative level was 34.

According to the Review of the Cooperative Movement in India, 1974-76, by the Reserve Bank of India, the main causes of these overdues are:

(a) Natural calamities such as floods, draughts, etc., affecting the repaying capacity of the borrowers;

(b) Inadequate and inefficient supervision exercised by the banks;

(c) The poor quality and management of societies and banks;

(d) Absence of linking of credit with marketing;

(e) Reluctance to coercive measures; and

(f) Where coercive measures were taken, the inability of the machinery to promptly execute the decrees.

For the rehabilitation of the weak Central cooperative banks, the Central Sector Plan Scheme has been formulated under which semi financial help is given to write off the bad debts, losses and irrecoverable overdues against small and marginal farmers.

3. Primary Agricultural Credit Societies (PACSs):

Functions and Organisation:

Primary agricultural credit society forms the base in the three-tier cooperative credit structure. It is a village-level institution which directly deals with the rural people. It encourages savings among the agriculturists, accepts deposits from them, gives loans to the needy borrowers and collects repayments.

It serves as the last link between the ultimate borrowers, i.e., the rural people, on the one hand, and the higher agencies, i.e., Central cooperative bank, state cooperative bank, and the Reserve Bank of India, on the other hand.

A primary agricultural credit society may be started with 10 or more persons of a village. The membership fee is nominal so that even the poorest agriculturist can become a member.

The members of the society have unlimited liability which means that each member undertakes full responsibility of the entire loss of the society in case of its failure. The management of the society is under the control of an elected body.

Capital:

The working capital of the primary credit societies comes from their own funds, deposits, borrowings and other sources. Own funds comprise of share capital, membership fee and reserve funds. Deposits are received from both members and non- members. Borrowings are mainly from central cooperative banks.

In fact, the borrowings form the chief source of working capital of the societies. Normally, people do not deposit their savings with the cooperative societies because of poverty, low saving habits, and non--availability of better assets to the savers in term of rate of return and riskiness from these societies.

Coverage:

In 1999-2000 there were 88 thousand primary agricultural societies covering more than 96 per cent rural areas. The membership of these societies was 8.68 crore. During the past few decades, the Reserve Bank in collaboration with State governments, has been taking various measures to reorganise the viable primary credit societies and to amalgamate non-viable societies with large-sized multipurpose societies.

This work of reorganisation of primary societies into strong and viable units has been completed in almost all the states except Gujrat, Maharashtra, and Jammu and Kashmir. It is because of reorganisation that the number of primary societies which increased from 105 thousand in 1950-51 to 212 thousand in 1960-61, declined to 92 thousand in 1999-2000.

Loans Advanced:

The loans advanced by the primary credit societies have been Showing 3 Continuously increasing trend. They rose from Rs. 23 crore in 1950-51 to Rs. 202 crore in 1960-61 and further to Rs. 13600 crore in 1999-2000.

Only the members of the societies are entitled to get loans from them. Most of the loans are short-term loans and are for agricultural purposes. Low interest rates are charged on the loans.

The societies are expected to increase amounts of loans to the weaker sections of the rural community, particularly the small and marginal farmers. There, however, exists a serious problem of overdue loans of the societies which have increased from Rs. 6 crores in 1950-51 to Rs. 44 crore in 1960-61 and to Rs. 2875 crore in 1991-92.

Land Development Banks (LDBs) or Cooperative Agricultural and Rural Development Banks (CARDBs):

Besides short-term credit, the agriculturists also need long-term credit for making permanent improvements in land, for repaying old debts, for purchasing agricultural machinery and other implements. Traditionally, the long-term requirements of agriculturists were mainly met by money lenders and some other agencies. But this source of credit was found defective and has been responsible for the exploitation of farmers.

Cooperative banks and commercial banks by their very nature are not in a position to provide long-term loans because their deposits are mainly demand (short-term) deposits. Thus, there was a great need for a specialised institution for supplying long-term credit to agriculturists. The establishment of land development banks now known as cooperative and rural development banks (CARDBs) is an effort in this direction.

Structure:

The land development banks are registered as cooperative societies, but with limited liability.

These banks have two-tier structure:

(a) At the state level, there are state or central land development banks, now known as state cooperative agricultural and rural development banks (SCARDBs) generally one for each state. They were previously known as central land mortgage banks,

(b) At the local level, there are branches of the state land development banks or SCARDBs and primary land development banks now known as primary cooperative agricultural and rural development banks (PCARDBs).

In some states, there are no primary land development banks, but the branches of the state land development bank. In Madhya Pradesh, the state cooperative bank itself functions as the state land development bank. In other states like Andhra Pradesh, Kerala and Maharashtra, there are more than one state land development banks.

Similarly, the primary land development banks also vary organisationally in different states. At the national level, the land development banks have also formed a union, called All-India Land Development Banks' Union.

Capital:

Land development banks raise their funds from share capital, reserves, deposits, loans and advances, and debentures. Debentures form the biggest source of finance. The debentures are issued by the state land development banks.

They carry fixed interest, have maturity varying from 20 to 25 years, and are guaranteed by the state government. These debentures are subscribed by the co-operative banks, commercial banks, the State Bank of India and the Reserve Bank of India.

Besides the ordinary debentures, the land development banks also float rural debentures for the period upto 7 years. These debentures are subscribed by farmers, panchayats, and the Reserve Bank. The Reserve Bank substantially contributes to the finance of land development banks by extending funds to the state governments for contributing to the share capital of these banks and by subscribing to ordinary and rural debentures.

Growth:

In India, the first cooperative land mortgage bank was organised in Jhang in Punjab in 1920.But the effective beginning was made in Madras with the establishment of a central land development bank in 1929. Later on other states also established such institutions.

The number of state cooperative agricultural and rural development banks (SCARDBs) which was 5 in 1950-51, rose to 20 in 2013. The number of primary cooperative agricultural and rural development banks (PCARDBs) was 697 in 2013.

Loans and Advances:

The land development banks or SCARDBs provide long-term loans to the agriculturists- (a) for redemption of old debt, (b) for improvement of land and methods of cultivation, (c) purchasing costly machinery, and (d) in special cases, for purchasing land. These banks grant loans against the mortgage of land and the period of loan varies from 15 to 30 years.

In 1999-2000, the loans sanctioned by these banks were Rs.2520 crore and the amount of loans outstanding was Rs. 11670 crore. The amount of loans outstanding at the end-March 2012 was Rs. 19400 crore by SCARDBs and Rs.12000 crore by PCARDBs.

Defects of Land Development Banks:

Although numerically the land development banks have grown over the years, they have not been able to make much progress in providing long-term finance to the farmer.

The following are the factors responsible for the unsatisfactory performance of land development banks:

i. Uneven Growth:

There has been uneven growth of land development banks. These have shown some progress in the states like Andhra Pradesh, Tamil Nadu, Karnataka, Maharashtra, Gujrat. Other states have made very little progress. About half of the states have no land development bank.

ii. Problem of Overdues:

The major problem faced by the land development banks is the existence of heavy overdues. Moreover, the overdues are continuously rising over the years. In 1991-92, the percentage of the overdues 6f the land development banks has been put between 42 to 44 per cent.

Faulty loaning policies, inadequate supervision, over-utilisation of loans, ineffective measures for recovery, willful defaulters, etc. are the main causes of unsatisfactory level of overdues. In view of the seriousness of the problem, the state governments have been advised to draw up and implement time-bound programmes for special recovery drives.

iii. Lack of Trained Staff:

In spite of quantitative growth of the land development banks, they have not shown much qualitative improvements in the field of granting loans largely due to inadequate technical and supervisory staff. Necessary changes in the legislation of cooperative institutions are also required if the lending activities are to be diversified for non-traditional developmental purposes and on the basis of non-landed security.

iv. Other Defects:

Other defects of the land development banks can be summarised below:

(a) These banks charge very high interest rates on the loans provided by them.

(b) There is much delay and red-tapism in the granting of loans,

(c) Second loan is not advanced unless the first is not repaid.

(d) Installments and the period of loans are not fixed on the basis of the repaying capacity of the borrowers.

(e) The procedure of receiving a loan from these banks is so complicated that the agriculturist is forced to seek help from the money lender,

(f) Weaker sections of the rural society such as landless labourers, village artisans and marginal farmers, are generally unable to secure loans from these banks for their productive activities simply because they do not have land or adequate security to offer against loans.

(g) Mostly loans are given for the repayment of old loans and for development purposes.

v. Report of Rural Credit Survey:

The Report of the Committee of Direction of All-India Rural Credit Survey has pointed out the unsatisfactory performance of the land mortgage banks (now called the land development banks) in the following manner:

(a) These banks raise inadequate funds in a manner ill-rated to demand and usually lend them in a manner uncoordinated with development;

(b) They act as if prior debts and not production had claim on its attention; and

(c) They reach only the large cultivator and reach him late.

Evaluation of Cooperative Banking:

Progress of Cooperative Credit:

As a result of effective steps taken by the government and the Reserve Bank of India, the cooperative banking system in India made tremendous progress after independence. The cooperative credit which was only 3.1 per cent of the total rural credit in 1951-52, rose to 15.5% in 1961-62 and to 22.7 per cent in 1970-71.

The total amount of short-term credit granted by the cooperatives increased from Rs. 23 crore in 1951 - 52 to Rs. 203 crore in 1961-62 and further to Rs. 1425 crore in 1979-80. Thus, during the period of about two decades (i.e., 1960-61 to 1979- 80), the short-term and medium-term loans increased by more than seven times.

Table 1 shows that cooperative credit increased significantly from Rs. 3874 crore in 1985-86 to Rs. 10479 crore in 1995-96, and further to Rs. 24296 crore in 2002-03. Short-term cooperative credit increased from Rs. 2787 crore in 1985-86 to Rs. 8331 crore in 1995-96 and to Rs. 20247 crore in 2002-03. Medium-term and long-term cooperative loans increased from Rs. 1087 crore in 1985-86 to Rs. 2148 crore in 1995-96 and to Rs. 4049 crore in 2002-03.

Table-2 shows that during 10th Five Year Plan (2002-03 to 2006-07), agricultural credit from cooperative banks increased from Rs. 23716 crore (34%) to Rs. 33174 crore (22%). In 2009-10, it was Rs. 32925 crore (20%).

Importance of Cooperative Banks:

The cooperative banking system has to play a critical role in promoting rural finance and is specially suited to Indian conditions.

Various advantages of cooperative credit institutions are given below:

I. Alternative Credit Source:

The main objective of cooperative credit movement is to provide an effective alternative to the traditional defective credit system of the village money lender. The cooperative banks tend to protect the rural population from the clutches of money lenders. The money lenders have so far dominated the rural areas and have been exploiting the poor people by charging very high rates of interest and manipulating accounts.

II. Cheap Rural Credit:

Cooperative credit system has cheapened the rural credit both directly as well as indirectly:

(a) Directly, because the cooperative societies charge comparatively low interest rates, and

(b) Indirectly, because the presence of cooperative societies as an alternative agency has broken money lender's monopoly, thereby enforcing him to reduce the rate of interest.

III. Productive Borrowing:

An important benefit of cooperative credit system is to bring a change in the nature of loans. Previously the cultivators used to borrow for consumption and other unproductive purposes. But, now, they mostly borrow for productive purposes. Cooperative societies discourage unproductive borrowing.

IV. Encouragement to Saving and Investment:

Cooperative credit movement has encouraged saving and investment by developing the habits of thrift among the agriculturists. Instead of hoarding money the rural people tend to deposit their savings in the cooperative or other banking institutions.

V. Improvement in Farming Methods:

Cooperative societies have also greatly helped in the introduction of better agricultural methods. Cooperative credit is available for purchasing improved seeds, chemical fertilizers, modern implements, etc. The marketing and processing societies have helped the members to purchase their inputs cheaply and sell their produce at good prices.

VI. Role of Cooperative Banks before 1969:

Till the nationalisation of major commercial banks in 1969, cooperative societies were practically the only institutional sources of rural credit. Commercial banks and other financial institutions hardly provided any credit for agricultural and other rural activities. Cooperative credit to the agriculturists as a percentage of total agricultural credit increased from 3.1 per cent in 1951-52 to 15.5 per cent in 1961-62 and further to 22.7 per cent in 1970-71.

On the other hand, the agricultural credit provided by the commercial banks as a percentage of total agricultural credit remained almost negligible and fell from 0.9 percent in 1951-52 to 0.6 percent in 1961-62 and then rose to 4 per cent in 1970-71.

VII. Role of Cooperative Banks after 1969:

After the nationalisation of commercial banks in 1969, the government has adopted a multi-agency approach. Under this approach, both cooperative banks and commercial banks (including regional rural banks) are being developed to finance the rural sector.

But, this new approach also recognised the prime role to be played by the cooperative credit institutions in financing rural areas because of the following reasons:

(a) Co-operative credit societies are best suited to the socio-economic conditions of the Indian villages.

(b) A vast network of the cooperative credit societies has been built over the years throughout the length and breadth of the country. This network can neither be duplicated nor be surpassed easily.

(c) The cooperative institutions have developed intimate knowledge of the local conditions and problems of rural areas.

VIII. Suitable Federal Structure of Cooperative Banking System:

Cooperative banking system has a federal structure with- (a) primary agricultural credit societies at the village level, (b) higher financing agencies in the form of central cooperative and state cooperative banks, (c) land development banks for providing long- term credit for agriculture. Such a banking structure is essential and particularly suited for effectively meeting the financial requirements of the vast rural areas of the country.

Considering the great importance of cooperative banks, particularly in the rural areas, it is not surprising that every committee or commission, that has examined the working of the cooperative banking system in India, has expressed the common view that "cooperation remains the best hope of rural India."

Weaknesses of Cooperative Banking:

Various committees, commissions and individual studies that have reviewed the working of the cooperative banking system in India have pointed out a number of weaknesses of the system and have made suggestions to improve the system.

Major weaknesses are given below:

I. General Weaknesses of Primary Credit Societies:

Organisational and financial limitations of the primary credit societies considerably reduce their ability to provide adequate credit to the rural population.

The All India Rural Credit Review Committee pointed out the following weaknesses of the primary credit societies:

(a) Cooperative credit still constitutes a small proportion of the total borrowings of the farmers,

(b) Needs of tenants and small farmers are not fully met.

(c) More primary credit societies are financially weak and are unable to meet the production-oriented credit needs,

(d) Overdues are increasing alarmingly at all levels,

(e) Primary credit societies have not been able to provide adequate and timely credit to the borrowing farmers.

II. Inadequate Coverage:

Despite the fact that the cooperatives have now covered almost all the rural areas of the country, its rural household membership is only about 45 per cent. Thus, 55 per cent of rural households are still not covered under the cooperative credit system.

In fact, the borrowing membership of the primary credit societies is significantly low and is restricted to a few states like Maharashtra, Gujrat, Punjab, Haryana, Tamil Nadu and to relatively rich land owners.

Criteria of determining borrowing membership include:

(a) Borrowing members as a proportion of rural households,

(b) The average amount of loan issued per borrowing member, and

(c) The proportion of loans going to weaker sections.

The banking Commission 1972 has brought out the following reasons for the low borrowing membership cooperative societies:

(a) Inability of the people to provide the prescribed security;

(b) Lack of up-to-date land records;

(c) Ineligibility of certain purposes for loans;

(d) Inadequacy of prescribed credit limits;

(e) Onerous conditions prescribed for loans such as share capital contribution at 10 or 20 per cent of loans outstanding and compulsory saving deposits; and

(f) Default of members to repay loans.

III. Inefficient Societies:

In spite of the fact that the primary agricultural credit societies in most of the states have been reorganised into viable units, their loaning business has not improved. As the Seventh Plan has observed that out of 94089 primary agricultural credit societies in the country in 1982-83, only 66000 societies had full time paid secretaries. About 34000 societies were running at loss.

IV. Problem of Overdues:

A serious problem of the cooperative credit is the overdue loans of the cooperative institutions which have been continuously increasing over the years. In 1991-92, percentage of overdues to demand at the level of land development banks was 57, at the level of central cooperative banks was 41 and at the level of primary agricultural credit societies was 39.

The overdues in the short-term credit structure are most alarming in North-Eastern States. In the long-term loaning sector, the problem of overdues has almost crippled the land development banks in 9 states, viz., Maharashtra, Gujarat, Madhya Pradesh, Bihar, Karnataka, Assam, West Bengal, Orissa and Tamil Nadu.

Large amounts of overdues restrict the recycling of the funds and adversely affect the lending and borrowing capacity of the cooperative societies.

The Banking Commission 1972 pointed out the following reasons for the overdue loans:

(a) Indifferent management or mismanagement of primary societies;

(b) Unsound lending policies resulting in over-lending or lending unrelated to actual needs, diversions of loans for other purposes;

(c) Vested interests and group politics in societies and willful defaulters;

(d) Inadequate supervision over the use of loans and poor recovery efforts;

(e) Lack of adequate control of central cooperative banks over primary societies;

(f) Lack of proper links between credit and marketing institutions;

(g) Failure to take quick action against willful defaulters; and

(h) Uncertain agricultural prices.

V. Regional Disparities:

There have been large regional disparities in the distribution of cooperative credit. According to the Seventh Plan, the eight states of Andhra Pradesh, Gujarat, Haryana, Kerala, Madhya Pradesh, Maharashtra, Punjab and Rajasthan account for about 80 per cent of the total credit disbursed. The per hectare short-term credit disbursed varied from Rs. 4 in Assam to Rs. 718 in Kerala.

VI. Benefits to Big Land Owners:

Most of the benefits from the cooperatives have been covered by the big land owners because of their strong socio-economic position. For instance, in 1984-85 the farmers having holdings less than two hectares got only 38.8 per cent of the total loans granted by the primary agricultural credit societies, whereas the land owners with holdings of more than 2 hectare received 55 per cent. The share of the poorest rural population (i.e. tenants, share croppers and landless labours) was only 6.2 per cent.

VII. Lack of Other Facilities:

Besides the provision of adequate and timely credit, the small and marginal farmers also need other facilities in the form of supply of inputs (i.e., better seeds, fertilisers, pesticides, etc), extension and marketing services.

These facilities will enable them to utilise the borrowed credit in a proper way. Therefore, the credit societies should be reorganised into multi-purposes cooperatives.

Reserve Bank and Cooperative Banking:

Strengthening the cooperative credit movement has been the Reserve Bank of India's special responsibility ever since its establishment in 1935.

The following are the various measures undertaken by the Reserve Bank to develop cooperative banking system and to promote cooperative finance in the country:

1. Agricultural Credit Department:

The Reserve Bank has a separate Agricultural Credit Department whose functions are:

(i) To maintain an expert staff to study all questions of agricultural credit and be available for consolation by the central and state governments, state cooperative banks and other banking organisations; and

(ii) To coordinate the operations of the Reserve Bank in connection with agricultural credit and relations with the state cooperative banks and other institutions engaged in the business of agricultural credit.

2**. All-India Rural Credit Survey:**

The Reserve Bank's real role in the cooperative credit movement started with the appointment of All-India Rural Credit Survey Committee in 1951. The objective of this Committee was to study the problems of rural credit and explore possibilities of expanding agricultural credit through cooperative credit system.

The committee submitted its report in December 1954 which highlighted the vital importance of cooperative rural credit.

The Committee found that while private credit agencies, i.e., money lenders and traders supply 70 per cent of the rural credit, the cooperative societies provided only 3 per cent of the total borrowed amount.

The Committee observed that the rural credit in India fell short of the right quantity, was not of right type, did not serve the right purpose, and often fail to go to the right people. Regarding the future of cooperative credit movement the committee said, "cooperation had failed, but cooperation must succeed."

3**. Integrated Scheme of Rural Credit:**

For the success of cooperative credit movement, the Survey Committee suggested an integrated scheme of rural credit based on the following fundamental principles- (a) state partnership in cooperative credit institutions; (b) full coordination between credit and other agricultural activities, particularly, marketing and processing; and (c) administration through adequately trained and efficient personnel, responsive to the needs of the rural population.

4. Provision of Finance:

In pursuance of the recommendations of the Survey Committee and the later committees like the Committee on Cooperative Credit (1960), the Reserve Bank has activity helped the cooperative system to expand rural credit. The Reserve Bank does not provide finance directly to the agriculturists, but only through cooperative sector.

The Reserve Bank provides financial assistance for meeting short-term, medium-term and long-term rural needs.

The needs are explained as under:

(i) Short-Term Finance:

The Reserve Bank provides short-term finance to the state cooperative banks in two ways- (a) through loans and advances; (b) through rediscounting facility. The financial assistance is given for seasonal agricultural operations and for marketing of crops.

In 1950-51, the Reserve Bank sanctioned short- term credit of Rs. 7.6 crore. This amount increased to Rs. 147 crore in 1960-61 and to Rs. 1090 crore in 1981-82.

(ii) Medium-Term Finance:

The Reserve Bank provides medium-term loans to state cooperative banks generally for 3 to 5 years. These loans are provided for- (a) land improvements like bunding, digging of wells and water channels; (b) repair of wells and other irrigational schemes; (c) purchase of livestock, implements and machinery; (d) construction of farm houses and cattle sheds.

The Reserve Bank also provides medium-term loans in scarcity affected areas. Over the years, the amount of medium- term loans sanctioned by the Reserve Bank has considerably increased from Rs. 27 lakh in 1954-55 to Rs. 24 crore in 1970-71 and to Rs. 110 crore in 1981-82.

(iii) Long-Term Finance:

The Reserve Bank provides long-term financial assistance for a maximum period of 20 years for agriculture in there ways- (a) It subscribes a portion of debentures issued by the land development banks. (b) It grants long term loans to such banks, (c) It grants loans to state governments for subscribing to the share capital of cooperative credit institutions. The total long- term loans sanctioned by the Reserve Bank were Rs. 212 crore in 1981-82.

5. Setting Up of Funds:

To meet its financial obligations, the Reserve Bank set up two national funds in 1956, i.e., the National Agricultural Credit (Long-Term Operations) Funds, and the National Agricultural Credit (Stabilisation) Fund.

The Purpose of the Long-Term Operations Funds was- (a) to make long- term loans available to state governments to enable them to subscribe the share capital of cooperative credit institutions; (b) to make medium-term loans to state cooperative banks for agricultural purposes; (c) to make long-term loans to the central land mortgage banks against the guarantee of the state government; and (d) to purchase debentures of central land mortgage banks against the guarantee of state government. The Stabilisation Fund helps the state cooperative banks to convert their short-term loans into medium-term loans in cases of draught, famine or other calamities.

6. Strengthening of Cooperative Banking Structure:

With a view to strengthen cooperative banking structure and promote cooperative credit, the Reserve Bank undertakes the following measures:

(i) It pays special attention towards rehabilitating and revitalising the weaker cooperative units.

(ii) It makes arrangements for maintaining the flow of cooperative credit by involving commercial banks to finance the primary agricultural societies.

(iii) It makes efforts in improving the lending policies and operational efficiency of cooperative credit institutions.

(iv) It provides financial accommodation to cooperative credit institutions.

(v) It conducts special training courses at the Cooperative Bankers' Training Colleges for the personnel of state, central and urban banks.

Unit:2
Development Banking in India

Development Banking in India: Definition and Features!

In the field of industrial finance, the concept of development bank is of recent origin. In a country like India, the emergence of development banking is a post--independence phenomenon.

In the Western countries, however, development banking had a long period of evolution. The origin of development banking may be traced to the establishment of 'Society General Pour Favoriser I' Industrie Nationale' in Belgium in 1822. But the notable institution was the 'Credit Mobiliser' of France, established in 1852, which acted as industrial financier.

In 1920, Japan established the Industrial Bank of Japan to cater to the financial needs of her industrial development. In the post-war era, the Industrial Development Bank of Canada (1944), the Finance Corporation for Industry Ltd. (FCI) and the Industrial and Commercial Finance Corporation Ltd. (ICFC) of England (1945), etc., were established as modern development banks to provide term loans to industry. In 1966, the U.K. Government set up the Industrial Reorganisation Corporation (IRC).

In India, the first development bank called the Industrial Finance Corporation of India was established in 1948.

Definition of Development Bank:

There is no precise definition of development bank. William Diamond and Shirley Bosky consider industrial finance and development corporations as 'development banks' Fundamentally a development bank is a term lending institution.

Development bank is essentially a multi-purpose financial institution with a broad development outlook. A development bank may, thus, be defined as a financial institution concerned with providing all types of financial assistance (medium as well as long term) to business units, in the form of loans, underwriting, investment and guarantee operations, and promotional activities — economic development in general, and industrial development, in particular.

In short, a development bank is a development- oriented bank.

Features of a Development Bank:

Following are the main characteristic features of a development bank:

1. It is a specialised financial institution.

2. It provides medium and long term finance to business units.

3. Unlike commercial banks, it does not accept deposits from the public.

4. It is not just a term-lending institution. It is a multi-purpose financial institution.

5. It is essentially a development-oriented bank. Its primary object is to promote economic development by promoting investment and entrepreneurial activity in a developing economy. It encourages new and small entrepreneurs and seeks balanced regional growth.

6. It provides financial assistance not only to the private sector but also to the public sector undertakings.

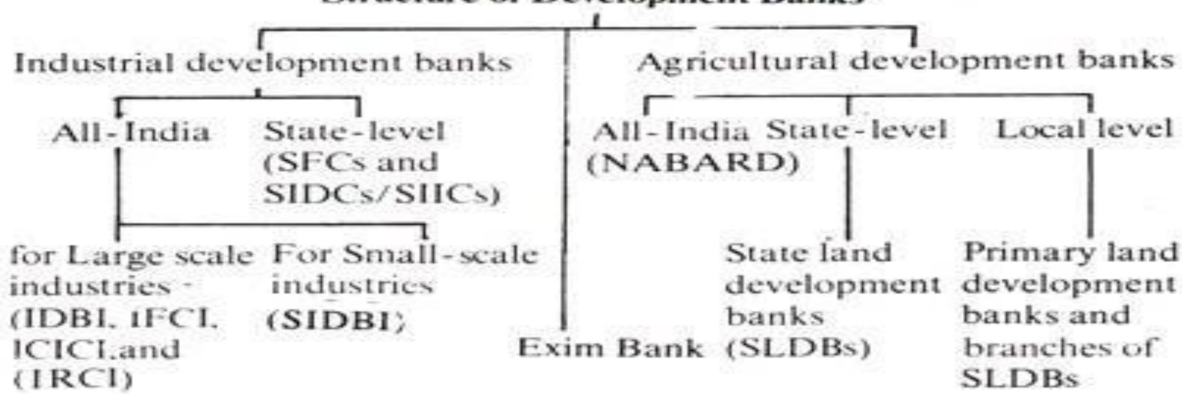
7. It aims at promoting the saving and investment habit in the community.

8. It does not compete with the normal channels of finance, i.e., finance already made available by the banks and other conventional financial institutions. Its major role is of a gap-filler, i. e., to fill up the deficiencies of the existing financial facilities.

9. Its motive is to serve public interest rather than to make profits. It works in the general interest of the nation.

Figure 8.1

Structure of Development Banks



Unit:3
Selective Important Concepts of Banking

Central Banking

In almost all countries of the world, there is a central bank today. It differs from the ordinary commercial banks on account of its distinctive functions.

It is the supreme monetary and banking authority. According to De Kock, "a central bank is a bank which constitutes the apex of the monetary and banking structure."

Shaw believes that the central bank is that bank which controls credit. Hawtrey expressed the view that the central bank is the lender of the last resort.

According to D.C. Rowan, "The Central Bank is an institution, often but not always owned by the state, which has the overriding duty of conducting the monetary policy of the government." According to R.P. Kent, "Central Bank is an institution charged with the responsibility of managing an expansion and contraction of the volume of money in the interest of general public welfare." Central bank has been a matter of slow and gradual evolution. At present, there is no country in the world, save a few exceptions, which has not set up a central bank.

Central banks were started as privately owned and privately managed joint stock banks. But on account of their influence on economic activities and their power to control credit, governments show great willingness to participate in the affairs of the central banks. At present, central banks in most of the countries are either completely nationalized or government owns 50 per cent or more interest in the shares, only in a few countries like USA, the governments do not have any interest in the ownership of central banks.

Difference between Commercial Banks and Central Bank:

According to Prof. R.S. Sayers, "The distinction between central and commercial banks turns essentially on their objects. The commercial bank thinks primarily of profit making, whereas the central banks thinks of the effects of its operations on the working of the economic system…………. The commercial banks may be a few or many. They trade with the general public. There is only one central bank in each country, and it does little, if any, ordinary banking business for the general public, it restricts itself, in the main, to controlling the operation of the banking system." Thus, we find that the activities of central banks are quite different from those of commercial banks.

The former are constituted for public service, while the latter aim at profit motive. Moreover, central bank acts as the banker to the government and as such stands in a special relation to the government. Again, the central bank functions as a banker's bank and as such does not deal with public directly.

Drawing a distinction between the functions of a central bank and commercial bank, De Kock remarks, "A further requisite of a real central bank is that it should not, to any great extent, perform such banking functions as accepting deposits from the general public and accommodating regular commercial customers with discounts and advances. It is now almost generally accepted that a central bank should conduct direct dealings with the public only in such forms and to such extent as, in the circumstances of a particular country it considers absolutely necessary for the purpose of carrying out its monetary and banking policy."

Direct Action, Rationing of Credit and Publicity:

Direct action and rationing of credit followed by publicity are extensively used methods of credit control. Direct action refers to all those directions and restrictive measures which the central bank may enforce on all the banks concerning lending and investment. Under it, the central bank may even refuse rediscounting facilities and may even penalize the offending bank. The Reserve Bank of India made use of this method and issued directions in 1956, 1958 and 1988 prohibiting the commercial banks to grant excessive advances against commodities like wheat and rice to stop speculation in them.

But, the method of friendly advice is considered better because direct action may compel member banks to resort to illegal methods and underhand means with a view to ignoring the directives of the central bank. As non-deposits bank and other financial institutions have grown in importance, direct controls have been applied to them and also to the deposit banks. Finally, 'requests' concerning the level and direction of bank lending have been a regular feature of monetary control in Britain.

Commercial Banking

The term commercial bank refers to a financial institution that accepts deposits, offers checking account services, makes various loans, and offers basic financial products like certificates of deposit (CDs) and savings accounts to individuals and small businesses.

The two primary characteristics of a commercial bank are lending and borrowing. The bank receives the deposits and gives money to various projects to earn interest (profit). The rate of interest that a bank offers to the depositors is known as the borrowing rate, while the rate at which a bank lends money is known as the lending rate.

Function of Commercial Bank:

The functions of commercial banks are classified into two main divisions.

(a) Primary functions

Accepts deposit : The bank takes deposits in the form of saving, current, and fixed deposits. The surplus balances collected from the firm and individuals are lent to the temporary requirements of the commercial transactions.

Provides loan and advances : Another critical function of this bank is to offer loans and advances to the entrepreneurs and business people, and collect interest. For every bank, it is the primary source of making profits. In this process, a bank retains a small number of deposits as a reserve and offers (lends) the remaining amount to the borrowers in demand loans, overdraft, cash credit, short-run loans, and more such banks.

Credit cash: When a customer is provided with credit or loan, they are not provided with liquid cash. First, a bank account is opened for the customer and then the money is transferred to the account. This process allows the bank to create money.

(b) Secondary functions

Discounting bills of exchange: It is a written agreement acknowledging the amount of money to be paid against the goods purchased at a given point of time in the future. The amount can also be cleared before the quoted time through a discounting method of a commercial bank.

Overdraft facility: It is an advance given to a customer by keeping the current account to overdraw up to the given limit.

Purchasing and selling of the securities: The bank offers you with the facility of selling and buying the securities.

Locker facilities: A bank provides locker facilities to the customers to keep their valuables or documents safely. The banks charge a minimum of an annual fee for this service.

Paying and gathering the credit : It uses different instruments like a promissory note, cheques, and bill of exchange.

Branch banking

Branch banking is the operation of storefront locations away from the institution's home office for the convenience of customers. Since the 1980s, branch banking in the U.S. has gone through significant changes in response to a more competitive and consolidated financial services market.

Branch Bank is a type of banking system under which the banking operations are carried with the help of branch network and the branches are controlled by the Head Office of the bank through their zonal or regional offices. Each branch of a bank will be managed by a responsible person called branch manager who will be assisted by the officers, clerks and sub-staff. In England and India, this type of branch banking system is in practice. In India, State Bank of India (SBI) is the biggest public sector bank with a very wide network of 16000 branches.

According to Gold field and chandler,” A branch bank is a baking corporation that directly own two or more banking agencies.”

Thus branch banking is a system in which a bank renders its banking activities at two or more places. Head office has the overall control over the working of various branches.

Advantages of Branch Banking: Branch banking system has the following advantages:

1. Economies of Large Scale operations: Branch banking enjoys the advantages and economies of large scale operations. Under branch banking system economies can maintained through large scale of operations and wider geographical coverage increase public confidence in the banking system.

2. Economy of Cash Reserves: Under branch banking system a particular branch can operate without keeping large amounts of reserves. In time of need, resources can be transferred from one branch to another. It is not easy for a .unit bank to draw on another unit bank.

3. Proper use of capital: There is a proper use of capital under the branch banking system. Since the resources are transferred from one branch to another. So the capital can be properly used by investing in the profitable branches.

3. **Economy of Costs**: Branch banking has the advantage of effecting remittances of funds from one place to another with greater ease and at a lesser cost than unit banking, for inter-office indebtedness can be far more easily adjusted.

4. Risks-spreading Economy: The spreading of risks geographically is another major advantage of the branch banking system. In branch banking, losses incurred one branch can be offset by profits earned by the profit making branches which is not possible in case of unit banking.

5. Easy and cheaper transfer of funds: Since the branches of bank under branch banking are spread all over the country, it is easier and cheaper, for it to transfer funds from one place to another.

6. Greater Safety and Liquidity: Branch banking also offers a wider scope for the selection of diverse securities and varied investments, so that a higher degree of safety and liquidity can be maintained.

7. Balanced economical growth: Under branch banking, the banking facilities can be made available to all cities, towns, and even backward areas in the country. Thus, branch banking is very helpful in achieving a balanced growth of the country's economy.

8. Convenient for the Central Bank's Supervision: Under a system of branch banking it is more convenient for the central bank or the government to regulate and supervise the activities of banks, as control becomes more effective and easier since only the head office is to be dealt with for the purpose.

9. Provision for Training the Personnel: Finally, branch banking provides the best training ground for personnel. A person may be trained in a small branch Where the pressure of work is less and he may be transferred later to an active branch.

Disadvantages or Demerits of Branch Banking: Branch banking generally suffers from the following limitations:

1. Danger of Mismanagement: Under the branch banking system a number of difficulties as regards management, supervision and control, a number of branches undue expansions lead the danger of mismanagement.

2. Delays in Decision-making: The system of branch banking also suffers from red tape and delay on account of the inadequate authority of branch managers. Usually, application for big credits has to be referred to the head office by the branch manager. This causes delay and gives little initiative to branch managers.

3. Lack of Personal Contact: A large bank tends to become more and more impersonal in its dealings. The general managers have hardly any personal contact with the local people or the staff of different branches.

4. High operating and maintenance expenses: Branch banking is very expensive, because with the opening of too many branches, establishment and maintenance charges of the branches are bound to be high and, as a result, profits may shrink.

5. Concentration of Monopoly Power in the hands of few banker: Branch banking sometimes creates monopoly power in the hands of few large bankers. Such a monopoly power in the hands of a few big bankers is a source of danger to the community whose goal is a socialistic pattern of society.

6. Lack of initiative: Branch banking lacks initiative. No branch office can take independent decisions and also branch manager has limited powers.

7. Regional imbalances: Branch banking encourages regional imbalances. The financial resources of economically backward areas tend to get transferred to industrial and business centres. Due to which backward areas continue to be neglected and remain over backward.

Unit Banking

Unit banking refers to a bank that is a single, usually small bank that provides financial services to its local community. A unit bank is independent and does not have any connecting banks — branches — in other areas.

Unit Bank is a type of bank under which the banking operations are carried by a single branch with a single office and they limit their operations to a limited area. Normally, unit banks may not have any branch or it may have one or two branches. This unit banking system has its origin in United State of America (USA) and each unit bank has its own shareholders and board of management.

According to Shapiro, Soloman and White,” An independent unit bank is a corporation that operates one office and that is not related to other banks through either ownership or control.”

Advantages of Unit Banking: Unit banking system has the following advantages:

1. Easy Management: The management and control of unit banks is much easier and effective due to the small size and operations of the banks. There are less chances of fraud and irregularities in the financial management of the unit banks.

2. Localised Banking: Unit banking is localized banking. The unit bank has the specialised knowledge of the local problems and serves the requirements of the local people in a better manner than branch banking. Since the bank officers of a unit bank are fully acquainted with the local needs, they cannot neglect the requirements of local development.

3. Quick Decision: A great advantage of unit banking is that there is no delay of any kind in taking decisions on important problems concerning the unit bank.

4. No Monopolistic Tendencies: Unit banks are generally of small size. Thus, there is no possibility of generating monopolistic tendencies under unit banking system.

5. Promotes Regional Balance: Under unit banking system, there is no transfer of resources from rural and backward areas to the big industrial commercial centres. This tends to reduce regional in balance.

6. Initiative in Banking Business: Unit banks have full knowledge of and greater involvement in the local problems. They are in a position to take initiative to tackle these problems through financial help.

7. Flexibility in operation: The unit banks are more flexible. The manager of the unit bank can use his discretion and arrive at quick decision.

8. No Inefficient Branches: Under unit banking system, weak and inefficient branches are automatically eliminated. No protection is provided to such banks.

9. No diseconomies of Large Scale Operations: Unit banking is free from the diseconomies and problems of large-scale operations which are generally experienced by the branch banks.

Disadvantages of Unit Banking: The following are the disadvantages of unit banking system:

1. Limited Scope: The scope of unit banking is limited. They do not get the benefits of large scale operations.

2. No. Distribution of Risks: Under unit banking, the bank operations are highly localised. Therefore, there is little possibility of distribution and diversification of risks in various areas and industries.

3. Inability to Face Crisis: Limited resources of the unit banks also restrict their ability to face financial crisis. These banks are not in a position to stand a sudden rush of withdrawals.

4. Lack of Specialization: Unit banks, because of their small size, are not able to introduce, and get advantages of, division of labor and specialization. Such banks cannot afford to employ highly trained and specialized staff.

5. Operates only in urban areas and big towns: Unit banks, because of their limits resources, cannot afford to open uneconomic banking business is smaller towns and rural area. As such, these areas remain unbanked.

6. Costly Remittance of Funds: A unit bank has no branches at other place. As a result, it has to depend upon the correspondent banks for transfer of funds which is very expensive.

7. Difference in Interest Rates: Since easy and cheap movement of does not exist under the unit banking system, interest rates vary considerably at different places.

8. Local Pressures: Since unit banks are highly localised in their business, local pressures and interferences generally disrupt their normal functioning.

9. Undesirable Competition: Unit banks are independently run by different managements. This results in undesirable competition among different unit banks.

Wholesale banking

Wholesale banking refers to banking services that are offered just to other institutional customers, huge companies with strong balance sheets, government agencies, local governments, and pension funds.

It contrasts with retail banking, also called consumer banking, which is the provision of banking services to individual people.

Wholesale banking also includes the lending and borrowing among banks and large financial institutions in the inter-bank market. In such cases, the borrowing-and-lending is done on a vast scale.

Wholesale banking services include large trade transactions, working capital, underwriting, M&A (mergers and acquisition), currency conversion, fleet and equipment leasing, loan participation, merchant banking, and trust services.

Put simply, wholesale banking is the financial practice of borrowing and lending money between large institutions on a large scale.

According to Deposits.org:

"Wholesale Banking is specialized banking division that provides integrated credit and capital markets products and advisory expertise for funding, risk management and investment services and products to large corporate clients locally and abroad."

"These services and products include specialized finance, structured transactions, loan syndications, credit structuring, securitization and project finance, wholesale equities, merchant banking and public sector infrastructure financing."

Features of Wholesale Banking

As the name signifies, wholesale banking operates to serve the large scale business objectives.

To know more about the concept, let us understand its various characteristics:

Large Scale Operations: Wholesale banking majorly meets the enormous financial requirements of the large scale companies and the government.

Low Operational Cost: The cost of carrying out transactions and other banking operations is quite low due to a limited customer base and few numbers of transactions.

High Risk Involved: The risk level involved in wholesale banking is very high. T the failure of the borrower company can lead to the collapse of all the parties associated with it.

Control Over Financial Transaction Monitoring and Recovery: Due to limited customers, it becomes convenient for the banks to monitor the financial transactions and recover the loans and advances.

Huge Impact on Non-Performing Asset: If there is delay or default in the repayment of loans and advances provided under wholesale banking, the non-performing assets of the bank increases.

High Cost of Deposit: The interest rates paid by the banks on the deposits made by the substantial business entities is high.

Retail Banking

Retail banking provides financial services for individuals and families. The three most important functions are credit, deposit, and money management.

First, retail banks offer consumers credit to purchase homes, cars, and furniture. These include mortgages, auto loans, and credit cards. The resulting consumer spending drives almost 70% of the U.S. economy. They provide extra liquidity to the economy this way. Credit allows people to spend future earnings now.

Second, retail banks provide a safe place for people to deposit their money. Savings accounts, certificates of deposit, and other financial products offer a better rate of return compared to stuffing their money under a mattress. Banks base their interest rates on the fed funds rate and Treasury bond interest rates. These rise and fall over time. The Federal Deposit Insurance Corporation insures most of these deposits.

Third, retail banks allow you, the customer, to manage your money with checking accounts and debit cards. You don't have to do all your transactions with dollar bills and coins. All of this can be done online, making banking an added convenience.

Functions of Retail Banks

1. Provide more liquidity by influencing the money supply in an economy

This is usually done by adjusting interest rates and periodically reviewing creditworthiness protocols.

2. Reduce the probability of default on loans by pooling together the risks of lending money

The institutions are also in better positions to cope with defaults due to federally-mandated reserve ratios. The ratio ensures that banks always have a minimum amount of cash on hand that is a percentage of total consumer deposits.

3. Lower the cost of borrowing by offering competitive interest rates

Economies that follow a Keynesian monetary policy increase profits during economic booms by increasing interest rates on loans and building cash reserves. Then, during a recession, banks are expected to lower interest rates in order to spur consumer spending and stimulate economic growth.

WHAT IS SOCIAL BANKING?

The term 'social banking' has been around since the 1950s, and traditionally referred to sustainable investment. Now, however, the term is more likely to mean banking through social media, peer-to-peer (P2P) lending or the development of online financial communities. These types of lending are seen as a democratisation of finance, and are often presented as solutions to problems that the traditional banking system can't or won't address.

Unit:4
Banking Sector Reforms

The banking sector is the heart of all the economic activity of a country and a small change in its regulation affects the entire economy.

The example we all have seen is demonetization and how it influenced every one of us. In this article, we are going to discuss all the major Banking sector Reforms took place in India.

The banks are the institutions that impinge on the economy and affect their performance for better or worse. The banking system helps in

Capital accumulation

Growth by encouraging savings

Mobilising the capital

Allocating the capital for alternative uses, etc.

History of Banking Sector Reforms in India

Modern banking in India started way back to 1786, with the establishment of the General Bank of India. In 1806, the East India Company established the first Presidency Bank in Kolkata.

Two more banks were established in 1840 and 1843 named Bank of Bombay and Bank of Madras.

Reserve Bank of India (RBI) came into formation on April 1, 1935, with the enactment 50 of the Reserve Bank of India Act, 1934.

The objective of establishing the Reserve Bank, as stated in the preamble to the RBI Act, was to "regulate the issue of banknotes and the keeping of reserves with a view of securing monetary stability in India".

Post Independence

Even after independence, the banks were mainly urban-oriented and were beyond the reach of the rural population. A large section of the rural population still had to look upon the moneylenders as their resort for credit.

That's why the government decided to nationalize all the major banks in India. The first Nationalization took place in 1969 and the second one in 1985.

Reasons behind the Banking Reforms in India

The main reason behind the banking sector reforms in India is as follows.

The Indian economy witnessed a series of difficulties like uncertain political situation, persistent fiscal imbalance, double-digit inflation, the balance of payments crisis, etc.

The fiscal situation, which was under strain throughout the 1980s, reached a critical situation in 1990-91, the external payment crisis and the high rate of inflation both, reached their peak level in the middle of 1991.

Growth of real GDP decelerated partly because of lower industrial growth and partly because of the slowdown in agriculture.

The industries were affected because of lower government investment, non-availability of inputs due to import squeeze, recession prevailed in the industrial economy due to the collapse of demand in the markets of Kuwait and Iraq in the wake of Gulf crisis, and the collapse of the erstwhile Soviet Union.

Objectives of Banking Sector Reforms in India

Banking sector reforms started with the objective to improve the overall performance of the Indian banking sector. The various objectives of banking sector reforms in India are as follows.

Reforms were aimed at bringing a transformation change in the structure, efficiency and stability of the banking system, and also integration with the international markets.

To make Indian banks, internationally competitive and encourage them to play an effective role in accelerating the process of growth.

The reforms in the banking sector in India intended to enhance the stability and efficiency of banks

To remove the operational rigidities in the credit delivery system to ensure allocation efficiency and achievement of social objectives. To place the Indian banking system on par with international standards in respect of capital adequacy and other prudential norms.

The strengthening measures aimed at reducing the vulnerability of banks in the face of fluctuations in the economic environment. These included capital adequacy, income recognition, asset classification, provisioning norms, exposure norms, improved levels of transparency, and disclosure standards.

First Phase of Reforms – The Narasimham Committee I

To rebuild the financial health of commercial banks and to make their functioning efficient and profitable, the Government of India appointed a High-Level Committee. The name of the committee was "The Committee on Financial System" (CFS) under the Chairmanship of M. Narasimham.

It was a committee of nine members along with Mr. M, Narasimham.

The committee gave its recommendation in Nov 1991 which was the blueprint of the first-generation banking sector reforms in India. The objectives of the committee were given below

To make recommendations for improving and modernising the organisational systems and procedures as well as managerial policies

Make recommendations for infusing greater competitive viability into the system so as to enable the banks and financial institution to respond more effectively to the emerging credit needs of the economy

To examine the cost, composition and adequacy of the capital structure of the various financial institutions and to make suitable recommendations in this regard

To review the relative roles of different types of financial institutions in the financial system and to make recommendations for their balanced growth.

Many of the recommendations of the committee have been accepted and implemented by the Government of India.

Improvement in Financial Health: The first necessary step was to improve the financial health of banks. These measures aimed at reducing the vulnerability of banks in the face of fluctuations in the economic environment. These included the introduction of prudential norms more or less in keeping with international thinking.

Transparency on Financial Statement: The Committee was of the view that the balance sheets of banks and financial institutions should be made transparent and full disclosures are made in the balance sheets as required by the International Accounting Standards Committee. In conformity with this recommendation, RBI modified the format of balance sheets of banks in 1992.

Institutional Strengthening: Institutional framework conducive to the development of banks needs to be developed so, an important aspect of banking sector reform was to strengthen the institutional base of the banking system. These included a variety of measures such as the licensing of new banks in private sector, enabling the public sector banks to go to the market and augment their capital base, creation of Debt Recovery Tribunals to deal with loans owed to the commercial banks.

Asset Reconstruction Fund: The Committee suggested the setting up of an ARF to take over bad and doubtful assets of the balance sheets of the banks and DFIs at a discount so that the banks could recycle the funds realised through this process into new productive assets. The rate of discount will be determined by independent auditors on the basis of clearly stipulated guidelines.

Second Phase of Reforms – Narasimham Committee-II

In 1998, the Government set up Committee on Banking Sector Reforms in India under the chairmanship of M. Narasimham in order to review the progress of banking sector reforms to date and chart a programme of financial sector reforms necessary to strengthen the Indian Financial System and make it internationally competitive.

The Committee recommended that by 2000 the entire portfolio of government securities should be marked to the market and there should be 5% weight for market risk for government and approved securities which was zero earlier. The report also mentioned that the risk weight for a government guaranteed advance should be the same as for other advances.

The benefits of the Second Phase of Banking Sector Reforms India by Narasimham committee recommendations are as follows.

Deregulation of Branch Licensing: With the Narasimham Committee's recommendations governing branch licensing restrictions, the RBI changed its licensing policy in 1992 in order to give banks the operational autonomy to rationalise their branch networks.

The Committee recommended that branch licensing be abolished and the matter of opening branches or closing of branches (other than branches for the present) be left to the commercial judgments of the individual banks. Banks were allowed to shift their existing branches within the same locality, open certain types of specialised branches, convert existing nonviable rural branches into satellite offices, a spin-off the business of a branch, and open extension counters and administrative units without prior approval of the RBI.

Prudential Norms and Disclosure Requirements: With regard to income recognition, the Committee recommended the introduction of the norm of 90 days i.e. income stops accruing when interest on or instalment of principal is not paid within 90 days, in a phased manner by the year 2002, which was 180 days previously. It also suggested for a general provision on standard assets which was not there previously. As far as the future loans were concerned, prudential norms as income recognition asset classification and provisioning norms should be applied to government guaranteed advances in the same manner as for any other advances. The Banking Sector Reforms in India helped to transform the Indian economy.

Capital Adequacy: Taking the present financial scenario of the economy into account, the Committee recommended that market risk which is defined as the risk of losses with respect to on and off-balance sheet positions arising from movements in market prices, should be given greater attention.

The report suggested that RBI should work towards implementing the amendment to the Basel norms which is the standard measurement method which uses a building block approach in which specific risk and 86 general market risk arising from debt and equity positions are calculated separately

Banking Reform Measures

1. **Cash Reserve Ratio (C.R.R.) and Statutory Liquidity Ratio**

Cash Reserve Ratio, or popularly known as CRR is a compulsory reserve that must be maintained with the Reserve Bank of India. Every bank is required to maintain a specific percentage of their net demand and time liabilities as cash balance with the RBI.

CRR is the percentage of total deposits, which a commercial bank has to keep as reserves in the form of cash with the RBI. The banks are not allowed to use that money, kept with RBI, for economic and commercial purposes. It is a tool used by the apex bank to regulate the liquidity in the economy and control the flow of money in the country.

Therefore, if the RBI wants to increase the money supply in the economy, it will reduce the rate of CRR while, if RBI seeks to decrease the money supply in the market then it will increase the rate of CRR.
On the other hand, Statutory Liquidity Ratio, shortly called as SLR also an obligatory reserve to be kept by the banks, as prescribed securities, based on a certain percentage of net demand and time liabilities.
SLR is a percentage of Net Time and Demand Liabilities kept by the bank in the form of liquid assets. It is used to maintain the stability of banks by limiting the credit facility offered to its customers. The banks hold more than the required SLR and the purpose of maintaining the SLR is to hold a certain amount of money in the form of liquid assets, so as to fulfill the demand of the depositors when arises.
Here, Time Liabilities mean the amount of money which is made payable to the customer after a period of time while the demand liabilities means the amount of money which is made payable to the customer at the time when it is demanded.

CRR is the percentage of money, which a bank has to keep with RBI in the form of cash. On the other hand, SLR is the proportion of liquid assets to time and demand liabilities.
The next difference between these two is that CRR is maintained in the form of cash while the SLR is to be maintained in the form of gold, cash, and government-approved securities.
CRR regulates the flow of money in the economy whereas SLR ensures the solvency of the banks.
The liquidity of the country is regulated by CRR while SLR governs the credit growth of the country.
The RBI is required to keep the supply of money in the economy and for this purpose, it uses tools, like Bank Rate, Repo Rate, Reverse Repo Rate, CRR, and SLR.
CRR and SLR are the form of reserves, in which the money is blocked in the economy and is not used for further lending and investment purposes.
So it is clear that CRR is purely a liquid or a cash component that the banks have to maintain with RBI, under the SLR requirement apart from cash, other assets such as gold and government securities viz. Central and State government securities are required to be parked with the regulator.
Through CRR, the RBI controls excess money flow in the economy whereas the SLR requirement ensures meeting out the unexpected demand of any depositor by selling the bonds.
In short, CRR helps to regulate liquidity while SLR regulates credit growth in the economy

Prudential Norms (NPA)

An account remaining irregular continuously for 90 days is classified as Sub-standard/Non-Performing Asset (NPA). Thus, in line with the international practices on prudential norms for banks, an asset is defined as non-performing when it ceases to generate income for the bank.
A loan asset of a bank is considered as a Standard Asset as long as the borrower is paying the interest, instalments and other charges as and when debited to his account. A period of 30 days is generally allowed to the borrower to make such payments to the bank. In case the borrower fails to pay or service the account within 30 days from the data of charging, the borrowal account is termed as Irregular/Out of Order.

An account remaining irregular continuously for 90 days is classified as Sub-standard/Non-Performing Asset (NPA). Thus, in line with the international practices on prudential norms for banks, an asset is defined as non-performing when it ceases to generate income for the bank. Availability of security is never a criterion for deciding whether a loan asset is performing or non-performing.

Thus, Non-Performing Asset (NPA) is a loan or advance where:

(i) Interest and/or installment of principal remaining overdue for a period of more than 90 days in respect of a Term Loan;

(ii) The bill remains overdue for a period of more than 90 days in case of bills purchased and discounted;

(iii) When an advance is disbursed in the form of overdraft/cash credit and the account remains out of order for more than 90 days. An overdraft/ cash credit account is considered to be out of order when the outstanding balance remains continuously in excess of the sanctioned limit/drawing power.
The account shall also be treated as out of order if there is no credit in the account continuously for a period of 90 days or more or the credits are not enough to cover the interest debited during the period of last 90 days. Non-submission of inventory and receivable statements for 90 days for computation of drawing power will also render the account out of order.

In terms of the prudential norms, an overdue amount means any amount due to the bank under any credit facility, which is not paid by the borrower on the due date fixed by the bank. Further, any amount to be received for use of credit cards, debits in suspense account, etc., from a customer and if it remains overdue for a period of more than 90 days, the same is also to be treated as NPA.

Ideally, a bank should have all its assets performing all the time and there should not be any non-performing asset. But it is extremely difficult to maintain a zero-NPA level. Like any other business activity, the banking business also witnesses a certain percentage of NPA in its asset (Credit) portfolio. However, the banks always endeavour to keep the NPA level to zero or the bare minimum. This is done by a structured NPA management in the bank.

Capital Adequacy Norms

The Basel III norms stipulated a capital to risk weighted assets of 8%. However, as per RBI norms, Indian scheduled commercial banks are required to maintain a CAR of 9% while Indian public sector banks are emphasized to maintain a CAR of 12%.

Along with profitability and safety, banks also give importance to Solvency. Solvency refers to the situation where assets are equal to or more than liabilities. A bank should select its assets in such a way that the shareholders and depositors' interest are protected.

Prudential Norms

The norms which are to be followed while investing funds are called "Prudential Norms." They are formulated to protect the interests of the shareholders and depositors. Prudential Norms are generally prescribed and implemented by the central bank of the country. Commercial Banks have to follow these norms to protect the interests of the customers.

For international banks, prudential norms were prescribed by the Bank for International Settlements popularly known as BIS. The BIS appointed a Basle Committee on Banking Supervision in 1988.

2. Basel Committee

Basel committee appointed by BIS formulated rules and regulation for effective supervision of the central banks. For this it, also prescribed international norms to be followed by the central banks. This committee prescribed Capital Adequacy Norms in order to protect the interests of the customers.

3. **Definition of Capital Adequacy Ratio**

Capital Adequacy Ratio (CAR) is defined as the ratio of bank's capital to its risk assets. Capital Adequacy Ratio (CAR) is also known as Capital to Risk (Weighted) Assets Ratio (CRAR).

India and Capital Adequacy Norms

The Government of India (GOI) appointed the Narasimham Committee in 1991 to suggest reforms in the financial sector. In the year 1992-93 the Narasimhan Committee submitted its first report and recommended that all the banks are required to have a minimum capital of 8% to the risk weighted assets of the banks. The ratio is known as Capital to Risk Assets Ratio (CRAR). All the 27 Public Sector Banks in India (except UCO and Indian Bank) had achieved the Capital Adequacy Norm of 8% by March 1997.

The Second Report of Narasimham Committee was submitted in the year 1998-99. It recommended that the CRAR to be raised to 10% in a phased manner. It recommended an intermediate minimum target of 9% to be achieved by the year 2000 and 10% by 2002.

Concepts of Capital Adequacy Norms

Capital Adequacy Norms included different Concepts, explained as follows

1. Tier-I Capital

Capital which is first readily available to protect the unexpected losses is called as Tier-I Capital. It is also termed as Core Capital.

Tier-I Capital consists of :-

1. Paid-Up Capital.
2. Statutory Reserves.
3. Other Disclosed Free Reserves : Reserves which are not kept side for meeting any specific liability.
4. Capital Reserves : Surplus generated from sale of Capital Assets.

2. Tier-II Capital

Capital which is second readily available to protect the unexpected losses is called as Tier-II Capital.

Tier-II Capital consists of :-

1. Undisclosed Reserves and Paid-Up Capital Perpetual Preference Shares.
2. Revaluation Reserves (at discount of 55%).
3. Hybrid (Debt / Equity) Capital.
4. Subordinated Debt.
5. General Provisions and Loss Reserves.

There is an important condition that Tier II Capital cannot exceed 50% of Tier-I Capital for arriving at the prescribed Capital Adequacy Ratio.

3. Risk Weighted Assets

Capital Adequacy Ratio is calculated based on the assets of the bank. The values of bank's assets are not taken according to the book value but according to the risk factor involved. The value of each asset is assigned with a risk factor in percentage terms.

Assets	Value	Risk Weight (%)	Value to be taken for CRAR
1) Cash and Cash with RBI	50 Crs	0	0
2) Loans and Advances	50 Crs	100	50 Crores
3) Investment in Government Securities	50 Crs	20	10 Crores
4) Other Assets	50 Crs	100	50 Crores
Total	200 Crs		110 Crores

Risk Weighted Assets

Suppose CRAR at 10% on Rs. 150 crores is to be maintained. This means the bank is expected to have a minimum capital of Rs. 15 crores which consists of Tier I and Tier II Capital items subject to a condition that Tier II value does not exceed 50% of Tier I Capital. Suppose the total value of items under Tier I Capital is Rs. 5 crores and total value of items under Tier II capital is Rs. 10 crores, the bank will not have requisite CRAR of Rs. 15 Crores. This is because a maximum of only Rs. 2.5 Crores under Tier II will be eligible for computation.

4. Subordinated Debt

These are bonds issued by banks for raising Tier II Capital.

They are as follows :-

1. They should be fully paid up instruments.
2. They should be unsecured debt.
3. They should be subordinated to the claims of other creditors. This means that the bank's holder's claims for their money will be paid at last in order of preference as compared with the claims of other creditors of the bank.
4. The bonds should not be redeemable at the option of the holders. This means the repayment of bond value will be decided only by the issuing bank.

Credit Deposit Ratio (C.D.Ratio)

This shows how much a bank lends out of its deposits or how much of its core funds are used for lending.

A high credit-deposit ratio suggests an overstretched balance sheet, and may also hint at capital adequacy issues.

Credit-deposit ratio, popularly CD ratio, is the ratio of how much a bank lends out of the deposits it has mobilized. RBI does not stipulate a minimum or maximum level for the ratio, but a very low ratio indicates banks are not making full use of their resources.

The fall in CD ratio is an indicator of excess liquidity because of higher deposits with the banking system