CHAPTER 1
INTRODUCTION OF BANKING INDUSTRY

1.1. Introduction
1.2. Origin of the word Bank
1.3. Meaning of Bank
1.4. Definition of Bank
   1.4.1. Definition given in Dictionary
   1.4.2. Academicians views for Bank
   1.4.3. Banking Under Law
1.5. History of Banking in India
1.6. Role of reserve bank of India
1.7. Function of reserve bank of India
   1.7.1. Traditional functions
      I. Issue of the currency note
      II. Banker to the banks
      III. Banker to the government
      IV. Exchange rate management
      V. Credit control function
      VI. Supervisory function
   1.7.2. Developmental functions
      I. Development of the financial system
      II. Development of agriculture
      III. Provision of industrial finance
      IV. Provisions of training
      V. Collection of data
      VI. Publication of the reports
      VII. Promotion of the banking habits
      VIII. Promotions of export through re-finance
   1.7.3. Supervisory functions
      I. Granting license to the banks
      II. Bank inspection
      III. Control over NBFIS
      IV. Implementation of the deposit insurance scheme
1.8. Needs of the Bank
1.9. Introduction of Banking Institutions in India
1.10. Composition of Indian Banking System
1.11. Commercial Role of Banks
1.12. Types of Bank
   1.12.1. Nationalized Banks in India
   1.12.2. Public Sector Banks in India
   1.12.3. Subsidiaries of the Public Sector Banks
   1.12.4. List of Public Sector Banks in India
   1.12.5. Private Sector Banks in India
   1.12.6. Old Private Sector Banks
   1.12.7. New Private Sector Banks
1.13. Development of Banks
   1.13.1. Traditional Banking Functions
   1.13.2. Reforms in the Banking Sector
1.14. Banking in the Pre-Independence Period
1.15. Banking Services
   1.15.1. Retail Banking Services
1.16. Some Innovative Services
1.17. Challenges in Banking Sector
1.1 INTRODUCTION

“Development involves not merely economic changes but also social and industrial in many underdeveloped countries call for new sets of values and new concepts of society and government. No path to development is likely to be smooth. Banking is the base for economic development.”

Dr. N. Kumar

As Indian celebrates its 65th anniversary and an amazing growth as one of the fastest growing economies in the World (Second to China), one sector which has played a vital role in prevention from failing up economy is undoubtedly the Banking Sector. The Banking Sector’s performance is seen as the exact copy of economic activities of the nation as a healthy Banking Sector system Acts as the basic facts of solid economic and industrial growth of a nation.

During the past sixty five years, since independence, the Banking Sector has witness significant changes and has surely come a long way from the nationalization and privatization in the post-1997 era. The last two decade has brought about significant changes in the Banking area in the country with technology being a major facilitator of this transformation. ATMs, Internet Banking, CCs, and now Mobile Banking have helped revolutionize the Banking landscape in the country. The old concepts, attitudes and methods in Banking have yield place to new techniques of viability, need base finance and marketing. Instead of the Banks merely moving with the slope into immediately profitable ventures, they are required to participate in the nation building activities and help in bringing about socio-economic changes. Banks are not only financial institutions those mobilize funds from one to another but as social organizations, have to go out the people and assist weaker sections in achieving their aspirations.

Banks are, thus, to act as catalytic agents for the development of the country, mobilizing resources whether these are and canalizing them towards productive persons. New strategies have to be involved for industrial development, both in small-scale and large-scale sectors and, rather than confining to the traditional way of strong and distribution finance of a short nature, developmental finance and term lending

1 Desai, Vasant, “Indian Banking-Nature and Problems” Himalaya Publishing House Bombay,1979,Pg.no 1
have to be taken up by commercial Banks. Similarly opening of branches in Rural and Urban area efficient customer services have assumed great importance.

1.2 ORIGIN OF THE WORD “BANK”

There seems no uniformity amongst the economist about the origin of the word “Bank” “According to some authors the word “Bank”, itself is derived from the word “Bancus” or “Banque” that is a bench. The early bankers, the Jews in Lombardy, transacted their business on benches in the market place, when, a banker failed, his ‘Banco’ was broken up by the people; it was called ‘Bankrupt’. This etymology is however, ridiculed by mcleod on the ground that “The Italian Money changers as such were never called Banchier in the middle ages.”

It is generally said that the word "BANK" has been originated in Italy. In the middle of 12th century there was a great financial crisis in Italy due to war. To meet the war expenses, the government of that period a forced subscribed loan on citizens of the country at the interest of 5% per annum. Such loans were known as 'Compare', 'minto' etc. The most common name was "Monte'. In Germany the word 'Monte was named as 'Bank' or 'Banke'. According to some writers, the word 'Bank' has been derived from the word bank.

It is also said that the word 'bank' has been derived from the word 'Banco' which means a bench. The Jews money lenders in Italy used to transact their business sitting on benches at different market places. When any of them used to fail to meet his obligations, his 'Banco' or banch or bench would be broken by the angry creditors. The word 'Bankrupt' seems to be originated from broken Banco. Since, the banking system has been originated from money leading business; it is rightly argued that the word 'Bank' has been originated from the word "Banco'. Whatever be the origin of the word ‘Bank’ as Professor Ram Chandra Rao says, “It would trace the history of banking in Europe from the middle Ages."

Actually meaning of bank is not specifies in any regulation or act. In India, different people have different type of meaning for bank. Normal salary earner knows means of bank that it is a saving institution, for current account holder or businessman

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knows bank as a financial institutions and many other. Bank is not for profit making, it creates saving activity in salary earner.

1.3 MEANING OF BANK

Finance is the life blood of trade, commerce and industry. Now-a-days, bank money acts as the backbone of modern business. Development of any country mainly depends upon the banking system.

The term bank is derived from the French word banco which means a bench or money exchange table. In olden days, European money lenders or money changers used to display (show) coins of different countries in big heaps (quantity) on benches or tables for the purpose of lending or exchanging.

A bank is financial institution which deals with deposits and advances and other related services. It receives money from those who want to save in the form of deposits and it lends money to those who need it.⁵

1.4 DEFINITIONS OF BANK

As bank is a very comprehensive word, various definitions have been given of the term bank at various places and in various forms. To understand the basic idea and the meaning of the term bank clearly, few definitions of the term bank are taken in different categories as under:

1.4.1 DEFINITION GIVEN IN DICTIONARY

1. **The Oxford English Dictionary.** “A bank is an establishment for custody of money received from one of behalf of its customers. Its essential duty is to pay their drafts on it. Its profit arises from the use of the money left unemployed by them”.⁶

2. **According to Encyclopedia Britannica.** “Bank is an institution that deals in money and its substitutes and provides other financial services. Banks accept deposits and make loans and drive a profit from the difference in the interest rates paid and charged, respectively. Some banks also have the power to create money”.


⁶ [www.file:///%20Wikipedia,%20the%20free%20encyclopedia.html](www.file:///%20Wikipedia,%20the%20free%20encyclopedia.html)
3. **Greek History**, “Banks means a bench or table for changing money”.

4. **Western’s Dictionary**, “Bank is an institution which traders in money, establishment for money, as also for making loans and discounts and facilitating the transmission of remittances from one place to another”.

5. **Business Dictionary**, “An establishment authorized by a government to accept deposits, pay interest, clear Checks, makes loans, act as an intermediary in financial transactions, and provide other financial services to its customers”. 7

### 1.4.2 ACADEMICIANS VIEWS FOR “BANK”

1. “A bank is an establishment which makes to individuals such advance of money or other means of payment as may be required and safely made and to which individuals entrust money or means of payment when not required by them for use”.

   - **Pro. Kinely**

2. “Bank as an institution which collects money from those who have it to spare or who are saving it out their income, and lends this money out to those who requires it”.

   - **Pro. Crowter**

3. “Banker or Bank is a financial institutions that act as a payment agents for customers, and borrows and lends money”.

4. “No one and nobody corporate or otherwise can be a banker who does not (1)take deposits account; (2)take current accounts; (3)issue and pay Cheque drawn upon himself; (4)collect Cheque crossed and uncrossed for his customers and it might be said that even if all the above functions are performed by a person body corporate, he or it may not be a banker or bank unless he fulfills the following conditions;
   - Banking is his or its known occupation
   - He or it must profess to be a banker or bank and the public him or it as such,
   - He or it has an intention of earning by so doing.
   - This business is not subsidiary.

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7 [http://www.businessdictionary.com/definition/bank.html#ixzz1jDlTOuO1](http://www.businessdictionary.com/definition/bank.html#ixzz1jDlTOuO1)
1.4.3 BANKING UNDER LAW

The Banking Regulation Act-1949 defines in Sec.5 (1) (c):

“Any company which is transacts the business of banking in India”. However, the acceptance of deposits by companies for the purpose of financing their own business is not regarded as banking within the meaning of the act. The essential characteristics of the banking business as define in section 5(b) of the banking Regulation Act is as follows:

1. Acceptance of deposits from the public
2. For the purpose of lending or investment
3. Repayable on demand or otherwise, and
4. Withdrawable by means of any instrument whether a Cheque or otherwise.8

1.5 HISTORY OF BANKING IN INDIA

The first bank in India, though conservative, was established in 1786. From 1786 till today, the journey of Indian Banking System can be segregated into three distinct phases:

- Early phase of Indian banks, from 1786 to 1969
- Nationalization of banks and the banking sector reforms, from 1969 to 1991
- New phase of Indian banking system, with the reforms after 1991

**Phase 1**

The first bank in India, the General Bank of India, was set up in 1786. Bank of Hindustan and Bengal Bank followed. The East India Company established Bank of Bengal (1809), Bank of Bombay (1840), and Bank of Madras (1843) as independent units and called them Presidency banks. These three banks were amalgamated in 1920 and the Imperial Bank of India, a bank of private shareholders, mostly Europeans, was established. Allahabad Bank was established, exclusively by Indians, in 1865. Punjab National Bank was set up in 1894 with headquarters in Lahore. Between 1906 and 1913, Bank of India, Central Bank of India, Bank of Baroda, Canara Bank, Indian Bank, and Bank of Mysore were set up. The Reserve Bank of India came in 1935.

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During the first phase, the growth was very slow and banks also experienced periodic failures between 1913 and 1948. There were approximately 1,100 banks, mostly small. To streamline the functioning and activities of commercial banks, the Government of India came up with the Banking Companies Act, 1949, which was later changed to the Banking Regulation Act, 1949 as per amending Act of 1965 (Act No. 23 of 1965). The Reserve Bank of India (RBI) was vested with extensive powers for the supervision of banking in India as the Central banking authority. During those days, the general public had lesser confidence in banks. As an aftermath, deposit mobilization was slow. Moreover, the savings bank facility provided by the Postal department was comparatively safer, and funds were largely given to traders.

Phase 2
The government took major initiatives in banking sector reforms after Independence. In 1955, it nationalized the Imperial Bank of India and started offering extensive banking facilities, especially in rural and semi-urban areas. The government constituted the State Bank of India to act as the principal agent of the RBI and to handle banking transactions of the Union government and state governments all over the country. Seven banks owned by the Princely states were nationalized in 1959 and they became subsidiaries of the State Bank of India. In 1969, 14 commercial banks in the country were nationalized. In the second phase of banking sector reforms, seven more banks were nationalized in 1980. With this, 80 percent of the banking sector in India came under the government ownership.

Phase 3
This phase has introduced many more products and facilities in the banking sector as part of the reforms process. In 1991, under the chairmanship of M Narasimham, a committee was set up, which worked for the liberalization of banking practices. Now, the country is flooded with foreign banks and their ATM stations. Efforts are being put to give a satisfactory service to customers. Phone banking and net banking are introduced. The entire system became more convenient and swift. Time is given importance in all money transactions.

The financial system of India has shown a great deal of resilience. It is sheltered from crises triggered by external macroeconomic shocks, which other East Asian countries often suffered. This is all due to a flexible exchange rate regime, the high foreign
exchange reserve, the not-yet fully convertible capital account, and the limited foreign exchange exposure of banks and their customers.\textsuperscript{9}

1.6 ROLE OF RESERVE BANK OF INDIA

The Reserve Bank of India (RBI) is the central banking system of India and controls the monetary policy of the Rupee as well as currency reserves. The institution was established on 1 April 1935 during the British Raj in accordance with the provisions of the Reserve Bank of India Act, 1934 and plays an important part in the development strategy of the government. It is a member bank of the Asian Clearing Union. The Reserve Bank of India was constituted under the reserve Bank of India Act, 1934 to regulate the issue of bank notes and the maintenance of reserves with a view to securing the monetary stability in India and generally to operate the currency and credit system of the country to its advantage.\textsuperscript{10}

The central bank was founded in 1935 to respond to economic troubles after the First World War. The Reserve Bank of India was set up on the recommendations of the Hilton Young Commission. The commission submitted its report in the year 1926, though the bank was not set up for another nine years. The Preamble of the Reserve Bank of India describes the basic functions of the Reserve Bank as to regulate the issue of bank notes, to keep reserves with a view to securing monetary stability in India and generally to operate the currency and credit system in the best interests of the country. The Central Office of the Reserve Bank was initially established in Kolkata, Bengal but was permanently moved to Mumbai in 1937. The Reserve Bank continued to act as the central bank for Myanmar till Japanese occupation of Burma and later up to April 1947, though Burma seceded from the Indian Union in 1937. After partition, the Reserve Bank served as the central bank for Pakistan until June 1948 when the State Bank of Pakistan commenced operations. Though originally set up as a shareholders’ bank, the RBI has been fully owned by the government of India since its nationalization in 1949.

Between 1950 and 1960, the Indian government developed a centrally planned economic policy and focused on the agricultural sector. The administration nationalized commercial banks and established, based on the Banking Companies

\textsuperscript{9}http://www.ftkmc.com/banking.html
Act, 1949 (later called Banking Regulation Act) a central Bank regulation as part of the RBI. Furthermore, the central bank was ordered to support the economic plan with loans. As a result of bank crashes, the reserve bank was requested to establish and monitor a deposit insurance system. It should restore the trust in the national bank system and was initialized on 7 December 1961. The Indian government founded funds to promote the economy and used the slogan Developing Banking. The Gandhi administration and their successors restructured the national bank market and nationalized a lot of institutes. As a result, the RBI had to play the central part of control and support of this public banking sector.

Between 1969 and 1980 the Indian government nationalized 20 banks. The regulation of the economy and especially the financial sector was reinforced by the Gandhi administration and their successors in the 1970s and 1980s. The central bank became the central player and increased its policies for a lot of tasks like interests, reserve ratio and visible deposits. The measures aimed at better economic development and had a huge effect on the company policy of the institutes. The banks lent money in selected sectors, like agri-business and small trade companies.\(^{11}\)

The branch was forced to establish two new offices in the country for every newly established office in a town. The oil crises in 1973 resulted in increasing inflation, and the RBI restricted monetary policy to reduce the effects. A lot of committees analyzed the Indian economy between 1985 and 1991. Their results had an effect on the RBI. The Board for Industrial and Financial Reconstruction, the Indira Gandhi Institute of Development Research and the Security & Exchange Board of India investigated the national economy as a whole, and the security and exchange board proposed better methods for more effective markets and the protection of investor interests. The Indian financial market was a leading example for so-called "financial repression" (Mackinnon and Shaw). The Discount and Finance House of India began its operations on the monetary market in April 1988; the National Housing Bank, founded in July 1988, was forced to invest in the property market and a new financial law improved the versatility of direct deposit by more security measures and liberalization.

The national economy came down in July 1991 and the Indian rupee was devalued. The currency lost 18% relative to the US dollar, and the Narsimham Committee advised restructuring the financial sector by a temporal reduced reserve ratio as well as the statutory liquidity ratio. New guidelines were published in 1993 to establish a private banking sector. This turning point should reinforce the market and was often called neo-liberal. The central bank deregulated bank interests and some sectors of the financial market like the trust and property markets.

The National Stock Exchange of India took the trade on in June 1994 and the RBI allowed nationalized banks in July to interact with the capital market to reinforce their capital base. The central bank founded a subsidiary company—the Bharatiya Reserve Bank Note Mudran Limited—in February 1995 to produce banknotes. The Foreign Exchange Management Act from 1999 came into force in June 2000. It should improve the foreign exchange market, international investments in India and transactions. The RBI promoted the development of the financial market in the last years, allowed online banking in 2001 and established a new payment system in 2004-2005 (National Electronic Fund Transfer). The Security Printing & Minting Corporation of India Ltd., a merger of nine institutions, was founded in 2006 and produces banknotes and coins.12

### 1.7 FUNCTION OF RESERVE BANK OF INDIA

As a central bank, the Reserve Bank has significant powers and duties to perform. For smooth and speedy progress of the Indian Financial System, it has to perform some important tasks. Among others it includes maintaining monetary and financial stability, to develop and maintain stable payment system, to promote and develop financial infrastructure and to regulate or control the financial institutions.

#### 1.7.1 TRADITIONAL FUNCTIONS

Traditional functions are those functions which every central bank of each nation performs all over the world. Basically these functions are in line with the objectives with which the bank is set up. It includes fundamental functions of the Central Bank. They comprise the following tasks.

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I. ISSUE OF THE CURRENCY NOTES

The RBI has the sole right or authority or monopoly of issuing currency notes except one rupee note and coins of smaller denomination. These currency notes are legal tender issued by the RBI. Currently it is in denominations of Rs. 2, 5, 10, 20, 50, 100, 500, and 1,000. The RBI has powers not only to issue and withdraw but even to exchange these currency notes for other denominations. It issues these notes against the security of gold bullion, foreign securities, rupee coins, exchange bills and promissory notes and government of India bonds.

II. BANKER TO THE BANKS

The RBI being an apex monetary institution has obligatory powers to guide, help and direct other commercial banks in the country. The RBI can control the volumes of banks reserves and allow other banks to create credit in that proportion. Every commercial bank has to maintain a part of their reserves with its parent's viz. the RBI. Similarly in need or in urgency these banks approach the RBI for fund. Thus it is called as the lender of the last resort.

III. BANKER TO THE GOVERNMENT

The RBI being the apex monetary body has to work as an agent of the central and state governments. It performs various banking function such as to accept deposits, taxes and make payments on behalf of the government. It works as a representative of the government even at the international level. It maintains government accounts, provides financial advice to the government. It manages government public debts and maintains foreign exchange reserves on behalf of the government. It provides overdraft facility to the government when it faces financial crunch.

IV. EXCHANGE RATE MANAGEMENT

It is an essential function of the RBI. In order to maintain stability in the external value of rupee, it has to prepare domestic policies in that direction. Also it needs to prepare and implement the foreign exchange rate policy which will help in attaining the exchange rate stability. In order to maintain the exchange rate stability it has to bring demand and supply of the foreign currency (U.S Dollar) close to each other.
V. CREDIT CONTROL FUNCTION
Commercial bank in the country creates credit according to the demand in the economy. But if this credit creation is unchecked or unregulated then it leads the economy into inflationary cycles. On the other credit creation is below the required limit then it harms the growth of the economy. As a central bank of the nation the RBI has to look for growth with price stability.

VI. SUPERVISORY FUNCTION
The RBI has been endowed with vast powers for supervising the banking system in the country. It has powers to issue license for setting up new banks, to open new branches, to decide minimum reserves, to inspect functioning of commercial banks in India and abroad, and to guide and direct the commercial banks in India.

1.7.2 DEVELOPMENTAL FUNCTIONS
Along with the routine traditional functions, central banks especially in the developing country like India have to perform numerous functions. These functions are country specific functions and can change according to the requirements of that country. The RBI has been performing as a promoter of the financial system since its inception. Some of the major development functions of the RBI are maintained below.13

I. DEVELOPMENT OF THE FINANCIAL SYSTEM
The financial system comprises the financial institutions, financial markets and financial instruments. The sound and efficient financial system is a precondition of the rapid economic development of the nation. The RBI has encouraged establishment of main banking and non-banking institutions to cater to the credit requirements of diverse sectors of the economy.

II. DEVELOPMENT OF AGRICULTURE
In an agrarian economy like ours, the RBI has to provide special attention for the credit need of agriculture and allied activities. It has successfully rendered service in this direction by increasing the flow of credit to this sector. It has earlier the Agriculture Refinance and Development Corporation (ARDC) to look after the credit, National Bank for Agriculture and Rural Development (NABARD) and Regional

13 URL/Http://Finance India market.com/investment. In-India/RBI.Htm, 17, June 2010
Rural Banks (RRBs).

III. PROVISION OF INDUSTRIAL FINANCE
Rapid industrial growth is the key to faster economic development. In this regard, the adequate and timely availability of credit to small, medium and large industry is very significant. In this regard the RBI has always been instrumental in setting up special financial institutions such as ICICI Ltd, IDBI, SIDBI and EXIM BANK etc.

IV. PROVISIONS OF TRAINING
The RBI has always tried to provide essential training to the staff of the banking industry. The RBI has set up the bankers' training colleges at several places. National Institute of Bank Management i.e NIBM, Bankers Staff College i.e BSC and College of Agriculture Banking i.e CAB are few to mention.

V. COLLECTION OF DATA
Being the apex monetary authority of the country, the RBI collects process and disseminates statistical data on several topics. It includes interest rate, inflation, savings and investments etc. This data proves to be quite useful for researchers and policy makers.

VI. PUBLICATION OF THE REPORTS
The Reserve Bank has its separate publication division. This division collects and publishes data on several sectors of the economy. The reports and bulletins are regularly published by the RBI. It includes RBI weekly reports, RBI Annual Report, Report on Trend and Progress of Commercial Banks India., etc. This information is made available to the public also at cheaper rates.

VII. PROMOTION OF THE BANKING HABITS
As an apex organization, the RBI always tries to promote the banking habits in the country. It institutionalizes savings and takes measures for an expansion of the banking network. It has set up many institutions such as the Deposit Insurance Corporation-1962, UTI-1964, IDBI-1964, NABARD-1982, NHB-1988, etc. These organizations develop and promote banking habits among the people. During economic reforms it has taken many initiatives for encouraging and promoting banking in India.
VIII. PROMOTION OF EXPORT THROUGH RE-FINANCE
The RBI always tries to encourage the facilities for providing finance for foreign trade especially exports from India. The Export-Import Bank of India (EXIM Bank India) and the Export Credit Guarantee Corporation of India (ECGC) are supported by refinancing their lending for export purpose.

1.7.3 SUPERVISORY FUNCTIONS
The reserve bank also performs many supervisory functions. It has authority to regulate and administer the entire banking and financial system. Some of its supervisory functions are given below.

I. GRANTING LICENSE TO THE BANKS
The RBI grants license to banks for carrying its business. License is also given for opening extension counters, new branches, even to close down existing branches.

II. BANK INSPECTION
The RBI grants license to banks working as per the directives and in a prudent manner without undue risk. In addition to this it can ask for periodical information from banks on various components of assets and liabilities.

III. CONTROL OVER NBFIS
The Non-Bank Financial Institutions are not influenced by the working of a monitory policy. However RBI has a right to issue directives to the NBFIs from time to time regarding their functioning. Through periodic inspection, it can control the NBFIs.

IV. IMPLEMENTATION OF THE DEPOSIT INSURANCE SCHEME
The RBI has set up the Deposit Insurance Guarantee Corporation in order to protect the deposits of small depositors. All bank deposits below Rs. One lakh are insured with this corporation. The RBI work to implement the Deposit Insurance Scheme in case of a bank failure.¹⁴

1.8 NEEDS OF THE BANK
Before the establishment of banks, the financial activities were handled by money lenders and individuals. At that time the interest rates were very high. Again there were no security of public savings and no uniformity regarding loans. So as to

overcome such problems the organized banking sector was established, which was fully regulated by the government. The organized banking sector works within the financial system to provide loans, accept deposits and provide other services to their customers. The following functions of the bank explain the need of the bank and its importance:

- To provide the security to the savings of customers.
- To control the supply of money and credit
- To encourage public confidence in the working of the financial system, increase savings speedily and efficiently.
- To avoid focus of financial powers in the hands of a few individuals and institutions.
- To set equal norms and conditions (i.e. rate of interest, period of lending etc.) to all types of customers.

1.9 INTRODUCTION OF BNKING INSTITUTIONS IN INDIA

In India, ancient Indus Scriptures refer to the money lending activities in the Vedic period though it was unlike to banking of modern times. In India, during the Ramayana and Mahabharata eras, banking had become a full-fledged business activity, and during the Smriti period which followed the Vedic period, and the Epic age the business of banking was carried on by the members of Vaishya community.  

Manu, the great law-giver of the time speaks of earning of interest as the business of Vaishyas. The most of the functions were performed by the banker of Smriti during those days, which banks perform in today. The most of the functions were the acceptance of deposits, granting secured and unsecured loans, acting as their customers’ bailee, granting loans to kings in times of grave crisis, acting as the treasurer and banker to the state and issuing and the currency of the country.

Bankers played an important role during the Moghul period and then after British era. Thus, the first bank in India, though conservative, was established in 1786. The first bank was The General Bank of India which started in 1786 and the Bank of Hindustan, both of which are now defunct. The oldest bank in existence in

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15http://shodhganga.inflibnet.ac.in/bitstream/10603/2031/10/10_chapter%201.pdf
India is the State Bank of India, which originated in the Bank of Calcutta in June 1806, which almost immediately became the Bank of Bengal.

**Bank of Bengal H.O.**

This was one of the three presidency banks the other two being the Bank of Bombay and the Bank of Madras, all three of which were established under charters from the British East India Company. For many years the Presidency Banks acted as quasi-central banks, as did their successors. The three banks merged in 1921 to form the Imperial bank of India, which upon India’s independence, became the State Bank of India.

**PRESIDENCY BANKS ACT**

The presidency Banks Act came into operation on 1 May 1876. This brought the three presidency banks under a common statute with similar restrictions on business. The proprietary connection of the Government was, however, terminated, though the banks continued to hold charge of the public debt offices in the three presidency towns, and the custody of a part of the government balances.
Bank of Madras

The decision of the Government to keep the surplus balances in Reserve Treasuries outside the normal control of the presidency banks and the connected decision not to guarantee minimum government balances at new places where branches were to be opened effectively checked the growth of new branches after 1876. The pace of expansion witnessed in the previous decade fell sharply although, in the case of the Bank of Madras, it continued on a modest scale as the profits of that bank were mainly derived from trade dispersed among a number of port towns and inland Centers of the presidency.

Bank of Bombay

Presidency Banks of Bengal

The presidency Banks of Bengal, Bombay and Madras with their 70 branches were merged in 1921 to form the Imperial Bank of India. The triad had been transformed
into a monolith and a giant among Indian commercial banks had emerged. The new bank took on the triple role of a commercial bank, a banker's bank and a banker to the government. But this creation was preceded by years of deliberations on the need for a 'State Bank of India'. What eventually emerged was a 'half-way house' combining the functions of a commercial bank and a quasi-central bank.

The establishment of the Reserve Bank of India as the central bank of the country in 1935 ended the quasi-central banking role of the Imperial Bank. The latter ceased to be bankers to the Government of India and instead became agent of the Reserve Bank for the transaction of government business at centers at which the central bank was not established. But it continued to maintain currency chests and small coin depots and operate the remittance facilities scheme for other banks and the public on terms stipulated by the Reserve Bank. It also acted as a bankers' bank by holding their surplus cash and granting them advances against authorized securities. The management of the bank clearing houses also continued with it at many places where the Reserve Bank did not have offices. The bank was also the biggest tendered at the Treasury bill auctions conducted by the Reserve Bank on behalf of the Government. The establishment of the Reserve Bank simultaneously saw important amendments being made to the constitution of the Imperial Bank converting it into a purely commercial bank. The earlier restrictions on its business were removed and the bank was permitted to undertake foreign exchange business and executor and trustee business for the first time.

**Imperial Bank**

The Imperial Bank during the three and a half decades of its existence recorded an impressive growth in terms of offices, reserves, deposits, investments and advances, the increases in some cases amounting to more than six-fold. The financial status and security inherited from its forerunners no doubt provided a firm and durable platform. The lofty traditions of banking which the Imperial Bank consistently maintained and the high standard of integrity it observed in its operations inspired confidence in its depositors that no other bank in India could perhaps then equal. All these enabled the Imperial Bank to acquire a pre-eminent position in the Indian banking industry and also secure a vital place in the country's economic life.
When India attained freedom, the Imperial Bank had a capital base (including reserves) of Rs.11.85 crores, deposits and advances of Rs.275.14 crores and Rs.72.94 crores respectively and a network of 172 branches and more than 200 sub offices extending all over the country.

1.10 COMPOSITION OF INDIAN BANKING SYSTEM

1. India had a fairly well developed commercial banking system in existence at the time of independents in 1947.

2. The Reserve Bank of India was established in 1935. While the RBI become a state owned institution from January 1, 1949.

3. The banking regulation act was enacted in 1949 providing a framework for regulation and supervision of commercial banking activity.

There was a feeling that thought the Indian Banking System had made considerable progress in the ‘50s and ‘60s, it established close link between commercial and industry houses, resulting in cornering of bank credit by these segments to the exclusion of agriculture and industries. To meet this concern, in 1967, the government introduced the concept of social control in the banking industry. The close link between big business houses and big bank was intended to be snapped or at least made ineffective by the reconstitution of the board of directors to the effect that 51 percent of the directors were have to special knowledge and practical experience. Appointment of whole-time chairmen with special knowledge and practical experience of working of commercial bank or financial or economic or business administration was intended to professionalize the top management.
Imposition of restrictions on loans to be granted to the director’s corners was another step towards avoiding undesirable flow of credit to the units in which the directors were interested.

**Political compulsion Development Financial Institution**

From the fifties a number of exclusively state-owned Development Financial Institution (DFIs) were also set up both at the national state level, with a loan exception of Industrial Credit and Investment Corporation (ICICI) which had a minority private shareholding. The mutual fund activity was also a virtual monopoly of government owned institution, viz., the Unit Trust of India (UTI). Reference institution in agriculture and industry sectors were also developed, similar in nature to the DFIs. Insurance, both life and general also became state monopolies.¹⁷

**CHART NO.1.1 BANKING STRUCTURE IN INDIA¹⁸**


¹⁸ [http://agritech.tanu.ac.in/baking/banking_structure.jpg](http://agritech.tanu.ac.in/baking/banking_structure.jpg)
1.11 COMMERCIAL ROLE OF BANKS

However the commercial role of banks is wider than banking, and includes:

- Issue of banknotes and currency exchange
- Processing of payments by way of telegraphic transfer, internet banking or other means
- Accepting money on term deposit
- Issuing bank drafts and bank cheques
- Lending money by way of overdraft, installment loan or otherwise.
- Providing documentary and standby letters of credit, guarantees, performance bonds, securities underwriting commitments and other item of off balance sheet exposures
- Safekeeping of documents and other items safe deposit boxes
- Sale, distribution or brokerage, with or without advice, of insurance, unit, trusts and similar financial product as “financial supermarket”

1.12 TYPES OF BANK

1.12.1 NATIONALIZED BANKS IN INDIA

Nationalized banks dominate the banking system in India. The history of Nationalized Banks in India dates back to mid-20th century, when Imperial Bank of India (IBA) was nationalized (under the SBI Act of 1995) and re-christened as State Bank of India (SBI) in July 1995. Then on 19th July 1960, its seven subsidiaries were also nationalized with deposits over crores. These subsidiaries of SBI were State Bank of Bikaner and Jaipur (SBBJ), State Bank of Mysore (SBM), State Bank of Patiala (SBP), State Bank of Saurashtra (SBS), and State Bank of Travancore (SBT).

However, the major nationalization of banks happened in 1969 by the then Prime Minister Late Indira Gandhi. The major objective behind nationalization was to spread banking infrastructure in rural areas and make cheap finance available to Indian Farmers. The nationalized 14 major commercial banks were Allahabad Bank, Andhra Bank, Bank of Baroda, Bank of India, Bank of Maharashtra, Canara Bank, Central Bank of India, Corporation Bank, Dena Bank, Indian Bank, Indian Overseas Bank, Oriental Bank of Commercial, Punjab and Sind Bank, Punjab National Bank,
Syndicate Bank, UCO Bank, Union Bank of India, United Bank of India, and Vijaya Bank.

In the year 1980, the second phase of nationalization of Indian Banks took place, in which 7 more banks were nationalized with deposits over 200 crores. With this, the government of India held a control over 91% of the banking industry in India. After the nationalization of banks there was a huge jump in the deposits and advance with the banks. At present, the State Bank of India is the largest Commercial Bank of India and is ranked one of the top five banks worldwide. It serves 90 million customers through a network of 9000 branches.

1.12.2 PUBLIC SECTOR BANKS

Public sector in India banking emerged to its present position in three stages. First, the conversion of the then existing Imperial Bank of India into the State Bank of India in 1955, followed by the taking over of the seven State Associated Banks as its subsidiary banks; Second, the nationalization of 14 major Commercial Banks on July 19, 1969 and last, the nationalization of 6 more Commercial Banks on April 15, 1980. One of them New Bank of India was later on merged with Punjab National Bank. Thus 27 banks constitute the public sector in Indian Commercial Banking.19

1.12.3 SUBSIDIARIES OF THE PUBLIC SECTOR BANKS

Public sector banks have in recent years diversified their activities in the Capital Market Mutual Funds, Factoring etc., by establishing subsidiary companies. Some of them are wholly owned subsidiaries while in the remaining ones the majority of shares are held by the public sector banks, while other banks, SIDBI, Asain Development Bank or even its other subsidiaries also participate in the share capital. For example, State Bank of India has set up a wholly owned subsidiary-SBI Fund. Its majority holding subsidiaries are SBI capital markets ltd., SBI Factors and Commercial Services ltd., SBI Gilts ltd and SBI card and payment services ltd., similarly, the public sector banks have established subsidiaries, which are engaged in the business of housing finance also, apart from the above mentioned businesses.20

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19 Indian financial system'P.N.VARSHNEY& D.K.MITTAL” Page no.2.8&2.9
20 Indian financial system’P.N.VARSHNEY& D.K.MITTAL” Page no.2.9&2.10
1.12.4 LIST OF PUBLIC SECTOR BANKS IN INDIA IS AS FOLLOWS: 21

- Allahabad Bank
- Andhra Bank
- Bank of Baroda
- Bank of India
- Bank of Maharashtra
- Canara Bank
- Central Bank of India
- Corporation Bank
- Dena Bank
- Indian Bank
- Indian Overseas Bank
- Oriental Bank of Commerce
- Punjab and Sind Bank
- Punjab National Bank
- Syndicate Bank
- UCO Bank
- Union Bank of India
- Vijaya Bank
- IDBI Bank

SBI AND ASSOCIATE BANKS

- State Bank of India
- State Bank of Bikaner & Jaipur
- State Bank of Hyderabad
- State Bank of Mysore
- State Bank of Patiala
- State Bank of Travancore
- State Bank of Saurashtra (merged into SBI in 2008)
- State bank of Indore (merged into SBI in 2010)

1.12.5 PRIVATE SECTOR BANKS IN INDIA

The banks which have been set up in the 1990s under the guidelines of the Narasimham Committee are referred to as private sector banks.

1.12.6 OLD PRIVATE SECTOR BANKS

They are those private sector banks which were established before 1991, and have not been nationalized in the time of nationalization.

- Bank of Rajasthan Ltd.
- Bharat Overseas Bank Ltd.
- Catholic Syrian Bank Ltd.
- City Union Bank Ltd.
- Dhanlakshmi Bank Ltd.
- Fedral Bank Ltd
- ING Vysya Bank Ltd.
- Jammu & Kashmir Bank Ltd.
- Karnataka Bank Ltd
- Lord Krishna Bank Ltd.
- Nainital Bank Ltd.
- Ratnakar Bank Ltd.
- Sangli Bank Ltd.
- South Indian Bank Ltd.
- Tamilnadu Markentile Bank Ltd.
- SBI Commercial & International Bank Ltd.
- Karur Vysya Bank Ltd.
- Lakshme Vilas Bank Ltd.

1.12.7 NEW PRIVATE SECTOR BANKS

They are those private sector banks which came into existence after the recommendation of Narshimham committee I of 1991. The guidelines for licensing of new banks in the private sector were issued by the RBI on January 22, 1993, after
review of the functioning of the new banks in private sector in consultation with the government.

- Axis Bank (former UTI Bank)
- HDFC Bank Ltd
- Centurian Bank of Punjab Ltd
- Development Credit Bank Ltd
- Kotak Mahindra Bank Ltd
- ICICI Bank Ltd
- Indus land Bank Ltd
- Yes Bank Ltd

1.13 DEVELOPMENT OF BANKS

1.13.1 TRADITIONAL BANKING FUNCTIONS

In very general terms, the traditional functions of a commercial bank can be classified under following main heads:

1. **Receiving of Money on Deposit:**

   This is the most important function of banks, as it is largely by means of deposits that a bank prepares the basis for several other activities. The money power of a bank, by which it helps largely the business community and other customers, depends considerably upon the amounts it can borrow by way of deposits. The deposits of a bank can take the form of fixed, savings or current deposits.

2. **Lending of Money:**

   This function is not only very important but is the chief source of profit for banks. By lending money banks place funds at the disposal of the borrower, in exchange for a promise of payment at a future date, enabling the borrowers to carry on their business/productive activities and meet their other requirements. Banks thus, help their clients to meet their needs with the money lent to them and return the money with interest as per agreed terms. The advances of a bank can take the form of loans, cash, credits, bills purchase / discount facilities.
3. **Transferring Money From Place to Place:**

   This function is also one of the important functions of banks. Banks allow the faciliti
   ties of transfer of funds by issuing demand drafts, Telegraphic / Telephonic Transfers, Mail Transfer etc.

4. **Miscellaneous Functions:**

   Safe custody of valuables, issue of various forms of credits e.g. letters of credit, traveler’s cheques and furnishing guarantees on behalf of customers and providing fee based services are also important functions performed by banks.

**1.13.2 REFORMS IN THE BANKING SECTOR**

   Banking Sector reforms were initiated to upgrade the operating standard health and financial soundness of the banks.

   The Government of India setup the Narasimham Committee in 1991, to examine all aspects relating to structure, organization and functioning of the Indian banking system the recommendations of the committee aimed at creating a competitive and efficient banking system.

   Another committee which is Khan Committee was instituted by RBI in December, 1997 to examine the harmonization of the role and operations of development financial institutions and banks. It submitted its report in 1998. The major recommendations were a gradual more towards universal banking, exploring the possibility of gain full merger as between banks, banks and financial institutions.

   Then the Varma Committee was established this committee recommended the need for greater use of IT even in the weak public sector banks, restructuring of weak banks but not merging them with strong banks, VRS for at least 25% of the staff.

   The Banking Sector reforms aimed at improving the policy frame work, financial health and institutional infrastructure, there two phase of the banking reforms.
Phase I: Narasimham Committee I (1991)

- Deregulation of the interest rate structure.
- Progressive reduction in pre-emptive reserves.
- Liberalization of the branch expansion policy.
- Introduction of prudential norms.
- Decline the emphasis laid on directed credit and phasing out the confessional rate of interest to priority sector.
- Deregulation of the entry norms for private sector banks and foreign banks.
- Permitting public and private sector banks to access the capital market.
- Setting up to asset reconstruction fund.
- Constituting the special debt recovery tribunals.
- Freedom to appoint chief executive and officers of the banks.
- Changes in the institutions of the board.

Phase II: Narasimham Committee II (April 1998)

➤ **Capital Adequacy**

- Minimum capital to risk asset ratio be increased from the existing 8 percent to 10 percent by 2002.
- 100 percent of fixed income portfolio marked to market by 2001.
- 5 percent market risk weight for fixed income securities and open foreign exchange position limits.
- Commercial risk weight (100%) to government guaranteed.

➤ **Asset Quality**

- Banks should aim to reduce gross NPAs to 3% and net NPA to zero percent by 2002.
- Directed credit obligations to be decline from 40 percent to 10 percent.
- Government guaranteed irregular accounts to be classified as NPAs and provide for.
- 90 day overdue norms to be applied for cash based income recognition.
- **Systems and Methods.**
  - Banks to start recruitment from market.
  - Overstaffing to be dealt with by redeployment and right sizing via VRS.
  - Public sector banks to be given flexibility in remuneration structure.
  - Introduce a new technology.

- **Industry Structure**
  - Only two categories of financial sector players to emerge. Banks and non-bank finance companies.
  - Mergers to be driven by market and business considerations.
  - Feeble banks should be converted into narrow banks.
  - Entry of new private sector banks and foreign banks to continue.
  - Banks to be given greater functional autonomy & minimum government shareholding 33 percent for State Bank of India, 51 percent for other Public Sector Banks.

- **Regulation and Supervision**
  - Board for financial regulation and supervision to be constituted with statutory powers.
  - Greater emphasis on public disclosure as opposed to disclosure to regulators.
  - Banking regulation and supervision to be progressively delinked from monetary policy.

- **Legal Amendments**
  - Broad range of legal reforms to facilitate recovery of problem loans.
  - Introduction of laws governing electronic fund transfer.

Many of the important recommendations of Narasimham Committee II have been accepted and are under implementation the second generation banking reforms concentrate on strengthening the foundation of the banking system by structure technological up graduation and human resource development.
1.14 BANKING IN THE PRE-INDEPENDENCE PERIOD

The banking in India has its origin from Vedic times. Rina (debt) is often mentioned in Rigveda. According to the Central Banking Enquiry Committee (1931), money lending activity in India traced back to the Vedic Period, i.e., 2000 to 1400 BC. The existence of professional banking in India could be traced back to the 500 BC. Kautilya’s Arthasastra, dating back to 400 BC contained references of creditors, lender and lending rates.

Mr. W.E. Preston, member, Royal Commission on Indian Currency and Finance set up in 1926 observed “… it may be accepted that a system of banking that was eminently suited to India’s then requirements was in force in that country many centuries before the science of banking became an accomplished fact in England.”23 Aryans treated money lending as one of the four honest callings, the other three being “tillage, trading and harvesting. In Sutra period (Seventh to Second century of B.C), Jatakas (Buddhist writings) had a mention of money lending.

During 2\textsuperscript{nd} to 5\textsuperscript{th} centuries of A.D., the money lending was considered as most important for economic development. The Kings followed the Kautilya’s Arthasastra to regulate the interest rates and laid down rules for creditors and debtors. The laws of Manu were also conferred wide powers on the creditors for the recovery of debts. During this period, money lenders were well controlled and regulated.

During 6\textsuperscript{th} to 16\textsuperscript{th} centuries, no significant changes were taken place in the indigenous banking. During Moghul period, indigenous banking was very popular. These bankers were very much affected with the passage of political power to Britishers. The first joint stock bank was Bank of Bombay, established in 1720 in Bombay. Bank of Hindustan in Calcutta followed this in 1770.24

In 18\textsuperscript{th} Century, three Presidency banks, Bank of Bengal (1806), Bank of Bombay (1840) and Bank of Madras (1843) were established,25 as the existing banks were not sufficient to meet the needs of the country. These banks performed the functions of Central Bank till their amalgamation into Imperial Bank of India in

24 H.C. Agarwal, Banking Law and Practice, op. cit., pp. 3-4
25 Evolution of Banking in India, Chapter III. Report on Currency and Finance, op. cit., pp. 75-76}
The first entirely Indian joint stock bank was the Oudh Commercial Bank, established in 1881 in Faizabad. It was defunct in 1958. The first Indian bank was the Allahabad bank, set up in 1865 followed by Punjab National Bank in 1895 and Bank of India in 1906. Many more Indian Joint Stock banks were established in India due to Swadeshi Movement.

A new era was started in the history of banking with the establishment of Reserve Bank of India in 1935. The RBI is the central bank of the country and has given vested powers to regulate, control and develop the banking in the country.

1.15 BANKING SERVICES

In this changing scenario, the role of banks is very important for the growth and development of customers as well as economy. Banking Sector is offering traditional and other service as under:

- Regular Saving and current accounts
- Regular fixed deposits
- ATM services
- Credit cards
- Debit cards
- Student banking
- Special NRI Services
- Home loan, Vehicle loan
- Tele and internet banking
- Online trading
- Business multiplies A/Cs
- Insurance
- Relief bonds & mutual fund
- Loans against shares
- Retail banking
- Special deposit scheme
- Senior citizen – special deposit scheme
- Other facilities for customers

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26 The name of Imperial Bank of India was suggested by Lord John Maynard Keynes quoted in Report on Currency on Finance 2006-08 Vol.4 pp. 78
1.15.1 RETAIL BANKING SERVICES

- **CREDIT CARDS**

  A card issued by a financial company giving the holder an option to borrow funds, usually at point of sale. Credit cards charge interest and are primarily used for short-term financing. Interest usually begins one month after a purchase is made and borrowing limits are pre-set according to the individual's credit rating.

  Credit cards have higher interest rates (around 19% per year) than most consumer loans or lines of credit. Almost every store allows for payment of goods and services through credit cards. Because of their widespread acceptance, credit cards are one of the most popular forms of payment for consumer goods and services in the U.S.

- **DEBIT CARDS**

  It is a new product introduced in India by Citibank a few years ago in association with MasterCard. A debit card facilitates purchases or payments by the cardholder. It debit money from the account of the cardholder during a transaction. This implies that the cardholder can spend only if his account permits.28

- **NET BANKING**

  With Net Banking one can easily perform various functions:

  - Check Account Balance
  - Download Account Statement
  - Request for a stop payment of a cheque.
  - Request for a new cheque book.
  - Access demats account
  - Transfer funds.
  - Facilitate bill Payments.
  - Pay Credit Card dues instantly.

28Http://www.hdfcbank.com/debit cards-lending.htm, 22, July. 2010, 10:00 PM
• **MOBILE BANKING**

With Mobile Banking one can easily perform various functions:

- Check Balance
- Check last three transactions.
- Request for a statement
- Request for a cheque book.
- Enquire on a cheque status.
- Instruct stock cheque payment.
- View FD details.
- Transfer funds.
- Pay Utility Bills.

• **PHONE BANKING**

With Phone Banking one can easily perform various functions:

- Check Balance
- Check last three transactions.
- Request for a cheque book.
- Transfer funds.
- Enquire on a cheque status, and much more.

• **ANYWHERE BANKING**

One can deposit or withdraw cash from any branch of a particular bank all over the country up to a prescribed limit. One can also transfer funds.

• **AUTOMATED TELLER MACHINES (ATM)**

With Automated Teller Machines one can easily perform various functions:

- Cash Withdrawal
- Cash Deposit
- Balance Enquiry
- Cheque Book Request
- Transaction at various merchant establishments
SMART CARD
Plastic card with embedded microprocessor chip, electronic memory and a battery used for information storage and management and authentication, it looks like works like, and is of the same size as a bank or credit card but may not have a magnetic strip on its back. Of the several types of smart cards, some are contact-less (do not require to be swiped through a magnetic strip reader) whereas others require contact with the reader.

1.16 SOME INNOVATIVE SERVICES

✓ ICICI Bank set up the first ATM in a corporate main quarter (Infosys) to tap the company’s salary accounts. This was the first instance of a bank leveraging its corporate relationship for retail banking.

✓ State Bank of India chief A.K. Purwar introduced a product said “Teacher Plus”, where the teaching community was gave a many products like home loans, car loans, and personal loans and so on at a concessional rate.

✓ Another innovation comes from IDBI Bank managing director Gunit Chadha. This is “ATM Next” – possibly the first service of its kind in the world. The bank is giving information from the internet and making it available to customers at the ATMs. This includes live cricket scores, news headlines, local movie listings and emergency contact numbers clearly a service beyond banking.

✓ Both IDBI Bank and HDFC Bank are offering instant mobile refill facilities through ATMs and SMS banking. This service has only just been launched in Europe and India is among the few countries in Asia to have it.

✓ Home loans seem to be one area where most of the innovations are taking place. At least three financial intermediaries – HDFC, ICICI Bank and HSBC claim to have been the first to start home loans with floating rate interest. Today over 75 per cent of incremental home loans are disbursed at floating rates.
✓ ABN Amro uses mobile phones to give information its customers on their credit card transaction. “Cart Alerts”, which come in the form of an SMS, are not necessarily a customer demand.

✓ Standard Charted Bank went one step ahead and linked its customer’s home loan account with current account, where the main amount of the loan gets reduced on a daily basis as the excess cash in the current account automatically flows in towards repaying the home loan.

1.17 CHALLENGES IN BANKING SECTOR

There has been considerable widening and deepening of the Indian financial system in the recent years. The enhanced role of the Banking sector in the Indian Economy, the increasing levels of deregulation and the increasing levels of competition have placed numerous demands on our Banks. The adverse consequences of malfunction of the Banking system could be more severe than in the past. Hence, focus of RBI, the regulator & supervisor of Indian Banking system is at ensuring greater financial stability. While operating in this highly demanding environment, the banking system is exposed to various risks & challenges few of them are discussed as under:

Improving Risk Management System:

RBI had issued guidelines on Asset Liability Management and Risk Management Systems in Banks in 1999 and Guidance Notes on Credit Risk Management and Market Risk Management in October 2002 and the Guidance note on Operational Risk Management in 2005. Though Basel II focuses significantly on risks it implementation cannot be seen as an end in itself. The current business environment demands an integrated approach to risk management. It is no longer sufficient to manage each Risk Independently. Banks in India are moving from the individual segment system to an enterprise wide Risk Management System. This is placing greater demands on the Risk Management skills in Banks and has brought to the forefront, the need for capacity building, while the first priority would be risk integrating across the entire Bank, the desirability of Risk aggregation across the Group will also need attention. Banks would be required to allocate significant resources towards this objective over the next few years.
✓ Rural Coverage:

Indian local banks specially state bank groups having a good coverage and many branches in rural areas. But that is quite lacking technical enhancement. The services available at cities are specifically not available to rural branches, which are necessary if banks want to compete now a day.

✓ Technological Problems:

That is true that Indian banks were already started computerized workings and so many other technological upgradation done but is this sufficient? In metro cities Indian local banks are having good comparable technology but that cannot be supported and comparable by the whole network of other cities and village branches.

✓ Corporate Governance:

Banks not only accept and deploy large amount of uncollateralized public funds in fiduciary capacity, but they also leverage such funds through credit creation. Banks are also important for smooth functioning of the payment system. Profit motive cannot be the sole criterion for business decisions. It is a significant challenge to banks where the priorities and incentives might not be well balanced by the operation of sound principles of Corporate Governance. If the internal imbalances are not re-balanced immediately, the correction may evolve through external forces and may be painful and costly to all stakeholders. The focus, therefore, should be on enhancing and fortifying operation of the principles of sound Corporate Governance.

✓ Customer Service:

There are concerns in regard to the Banking practices that tend to exclude vast sections of population, in particular pensioners, self-employed and those employed in unorganized sector. Banks are expected to oblige to provide Banking services to all segments of the population, on equitable basis. Further, the consumers interests are at times not accorded full protection and their grievances are not properly attended to by Banks. Banks are expected to encourage greater degree of financial inclusion in the country setting up of a mechanism for ensuring fair treatment of consumers; and effective redressed of customer grievances.
Branch Banking:

Traditionally Banks have been looking to expansion of their Branch Network to increase their Business. The new private sector banks as well as the foreign banks have been able to achieve business expansion through other means. Banks are examining the potential benefits that may accrue by tapping the agency arrangement route and the outsourcing route. While proceeding in this direction banks ought not to lose sight of the new risks that they might be assuming in outsourcing. Hence they have to put in place appropriate strategies and systems for managing these new risks.

Competition:

With the ever increasing pace and extent of globalization of the Indian economy and the systematic opening up of the Indian Banking System to global competition, banks need to equip themselves to operate in the increasingly competitive Environment. This will make it imperative for Banks to enhance their systems and procedures to international standards and also simultaneously fortify their financial positions.

Transparency and Disclosures:

In order to bring about meaningful disclosure of the true financial position of banks to enable the users of financial statements to study and have a meaningful comparison of their positions, a series of measures were initiated by RBI. It covered a No. of aspects such as capital adequacy, asset quality, profitability, country risk exposure, risk exposures in derivatives, segment reporting and related party disclosures etc.

With a view to moving closer towards international best practices and International Accounting Standards and the disclosure need under pillar 3 of Basel II, RBI has proposed enhanced disclosures of certain qualitative aspects. Banks are required to formulate a formal disclosure policy that addresses the banks’ approach for determining what disclosures it will make and the internal controls over the disclosure process.
✓ **Know Your Customer (KYC) Guidelines:**

The guidelines were revisited in the context of the recommendations made by the financial action task force on Anti Money Laundering Standards and on Combating Financing of Terrorism. Compliance with these standards both by the banks/financial institutions and the country has become necessary for international financial relationships. Compliance with this requirement is a significant challenge to the entire banking industry to fortify itself against misuse by anti-social persons / entities and thus project a picture of solidarity and financial integrity of the Indian Banking system to the international community.
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