CHAPTER I

GENESIS OF BANKING SECTOR IN INDIA

1.1 Introduction:

Indian banking is the lifeline of the nation and its people. Banking helped and developed vital sectors of economy and usher in a new drawn of progress on the Indian horizon. The sector has translated the hopes and aspirations of millions of people into reality. But to so, it has had covers miles and miles of difficult terrain, suffer the indignities of foreign rule and the pangs of partition. Today, Indian banks can confidently compete with modern banks of the world.

Banking existed in India even in Vedic period. Where giving and taking of credit in one form or the other was prevalent. Although the origin of banking in India was in money lending business, the transaction from money lending to formal banking took place before the second century.

Manu, the second century rishi and scholar has said in his works that sensible man should deposit his money with a person of good family, of good conduct and one who is well acquainted with law. Thus ancient times, when Indians left their homes for pilgrimages or business for long periods, they deposited their money and valuables for safekeeping with persons of repute. Overtime, a practice developed to lend part of such money deposited to needy persons to earn interests, or usury as it was called then. Thus the person with whom money was deposited for safe, enjoyed a good reputation, and was an indispensable pillar of ancient times.

The health of banking industry depends on its performance in the economy. Commercial banks serve as prime instruments just like arteries for the human body and they supply the required funds to the economy. In developing economies like India, were the propensity to consume is high and
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as a result the savings of the people are meager, banks would play a strategic role in attracting deposits from the people and in deploying these funds for lubricating various sectors of the economy. Over the years, there has been a phenomenal change, both quantitative and qualitative, in the banking industry’s contribution to the national economy. Although banks do not create new wealth, their lending, investing activities facilitates the economic processes of production, distribution and consumption. Without a sound and effective banking system in India, it cannot have a healthy economy. The banking system of India should not only be hassle free but it should be able to meet new challenges posed by the technology and any other external and internal factors. For the past three decades, India's banking system has several outstanding achievements to its credit. The most striking is its extensive reach. It is no longer confined to only metropolitans or cosmopolitans in India. In fact, Indian banking system has reached even to the remote corners of the country. This is one of the main reasons of India's growth process. The government's regular policy for Indian bank since 1969 has paid rich dividends with the nationalization of 14 major private banks of India.

Not long ago, an account holder had to wait for hours at the bank counters for getting a draft or for withdrawing his own money. Today, he has a choice. Gone are days when the most efficient bank transferred money from one branch to other in two days. Now it is simple as instant messaging or dials a pizza. Money has become the order of the day.

In planned economy like India, the part played by banks is that they supply credit for socially undesirable, unwanted and economically less beneficial purposes. Thus, commercial banks help the government in implementing the long-term plans and for utilizing the credit according to the planned priorities of the country.
1.1.1 What is bank?

Bank is a tank of money. A tank or reservoir for collecting and storage money from the public in the form of savings and deposits. The accumulated money is distributed by the way of loans and advances to the needy persons in various fields. Such as agriculture, industries and commerce etc. banks are the financial mediators playing very important role in economic development of all the nations of the world and form the core of money market. Therefore, banking is lifeblood of modern commerce. It truly be said that modern commerce is also depends upon banking that any cession of banking activity, even for a day or two would completely paralyze the economic life of nation. If banking business sneezes once, the entire nation catches cold. So today, banks are backbones of industry, commerce and economic society.

The service sector is growing at revolutionary pace, which in turn affects the way people work and live. New services are continually launched to satisfy the ever-increasing demands of the customers. The products of service sectors are diverse and numerous. It consists of industries that sell to customers, business customers and government agencies and non-profit organizations. At one end the products of service sector includes banking services the banking sector has experiencing rapid economic growth over the past few decades. So much services account for significance share of Gross Domestic Product (GDP) in nearly all developed and developing countries, as well as is being an increasingly important source of employment in these countries.

The term ‘Banker’ is being used since long time but there is no clear conception regarding its beginning. According one new point, the Italian money lenders were known as ‘Benchi’ or ‘Bencherri because these people kept a special type of table to transact their business.
According another viewpoint the word banker is derived from German word ‘banck’ that means heap or mound. Italian started using the name of banco, which means accumulation of either of money or stock.

Today, banks are part of our daily life. Banker meets the needs of requirements of farmers, businesspersons, entrepreneurs, governments, other segments of society. Bankers contribute to speedup the economic growth of country by mobilizing scarce financial resources for productive purpose. Hence, banking is the fundamental and industrial activities are well knitted with bankers. One cannot imagine the cessassion of banking activities even for a day. Now banks can offer access to even a common person and their activates extend to areas hither to untouched. A part from their traditional business oriented functions, they have now come out to fulfill national responsibilities. Banking is vital catalytic agent and basic infrastrucre for economic growth.

Today, banks are part of our daily life. Banker meets the needs and requirements society for speedy growth of a country mobilizing scarce financial resources for productive purposes. Hence, banking is the fundamental basis of economic, industrial and agriculture development of an economy. All commercial and industrial activities are well knitted with bankers.

Definition:

According to the banking companies regulations act 1949, “Banking business means accepting, for the purpose of lending or investment, of deposit of money from public, repayable on demand or otherwise and withdrawals by cheque, draft, order or otherwise.”

According section 5(c) of the banking regulation act, accepting, for the purpose of lending or investments, of deposits of money from the public, repayable on demand or otherwise, and withdrawal ,by cheque, draft, order or otherwise.
According to Macleod “the essential business of a banker to buy money and debts by creating other debts. a bankers is essentially a dealer in debts or credit”.

According to the Indian central banking enquiry committee “bank is financial institution for the custody of money, which it payout on customer order.”

Dr.L.Hart states that in this book ‘law of banking’ that banker is a one who in ordinary course of his business honors cheques drawn upon him by persons from and for whom he receives money current account.

A banker collects the money who have it to spare or who save it out their income and lends to those who have to require it. Broadly speaking banking implies receiving, consuming and using funds of the community. It accepting deposits from the public and gives loan to them. For centuries, the banking industry has dealt with businesses but not with consumers. Historically the primary purpose of a bank was to provide loans to trading concerns. Banks provided funds to allow businesses to purchase inventory, and collected those funds to allow businesses to purchase the inventory, collected those funds back with interest when goods were sold. In course of time banking services have expanded to include services directed at individuals, and risk in these much smaller transactions is pooled. Many other financial activities were added overtime. For example banks have important players in financial markets and offer financial services. In developing country like India the banking industry has played a multidimensional and multi directional role in the in overall developments.

Functioning of a bank is among the more complicated of corporate operations. Since banking involves dealing directly with money, governments in the most countries regulate this sector rather stringently. In India, the regulation traditionally has been very strict in the opinion of certain quarters, responsible for the present conditions of banks, where NPA are of a very high
order. The process of financial reforms started in 1991, has cleared the cobwebs somewhat but lot remains to be done. The multiplicity of policy and regulations that a bank has to work with makes it operations even more complicated, sometimes bordering on illogical. this section which is also intended for banking professional, attempts to give an overview of the functions in as simple manner as possible.

1.1.2 Types of banks

1. Saving Banks

Saving banks are established to create saving habit among the people. These banks are helpful for salaried people and low income groups. The deposits collected from customers are invested in bonds, securities, etc. At present most of the commercial banks carry the functions of savings banks. Postal department also performs the functions of saving bank.

2. Commercial Banks

Commercial banks are established with an objective to help businessmen. These banks collect money from public and give short-term loans to businesspersons by way of cash credits, overdrafts, etc. Commercial banks provide various services like collecting cheques, bill of exchange, and remittance money from one place to another place. In India, commercial banks are established under Companies Act, 1956. In 1969, 14 commercial banks were nationalised by Government of India. The policies regarding deposits, loans, rate of interest, etc. of these banks are controlled by the Central Bank.

3. Industrial Banks / Development Banks

Industrial / Development banks collect cash by issuing shares & debentures and providing long-term loans to industries. The main objective of these banks is to provide long-term loans for expansion and modernisation of industries. In India, such banks are established on a large scale after
independence. They are Industrial Finance Corporation of India (IFCI), Industrial Credit and Investment Corporation of India (ICICI) and Industrial Development Bank of India (IDBI).

4. Land Mortgage / Land Development Banks

Land Mortgage or Land Development banks are also known as Agricultural Banks because these are formed to finance agricultural sector. They also help in land development. In India, Government has come forward to assist these banks. The Government has guaranteed the debentures issued by such banks. There is a great risk involved in the financing of agriculture and generally commercial banks do not take much interest in financing agricultural sector.

5. Indigenous Banks

Indigenous banks means Money Lenders and Sahukars. They collect deposits from general public and grant loans to the needy persons out of their own funds as well as from deposits. These indigenous banks are popular in villages and small towns. They perform combined functions of trading and banking activities. Certain well-known Indian communities like Marwaries and Multani even today run specialised indigenous banks.

6. Central / Federal / National Bank

Every country of the world has a central bank. In India, Reserve Bank of India, in U.S.A, Federal Reserve and in U.K, Bank of England. These central banks are the bankers of the other banks. They provide specialised functions i.e. issue of paper currency, working as bankers of government, supervising and controlling foreign exchange.

A central bank is a non-profit making institution. It does not deal with the public but it deals with other banks. The principal responsibility of Central Bank is thorough control on currency of a country.
7. Co-operative Banks

In India, Co-operative banks are registered under the Co-operative Societies Act, 1912. They generally give credit facilities to small farmers, salaried employees, small-scale industries, etc. Co-operative Banks are available in rural as well as in urban areas. The functions of these banks are just similar to commercial banks.

8. Exchange Banks

Hong Kong Bank, Bank of Tokyo, Bank of America are the examples of Foreign Banks working in India. These banks are mainly concerned with financing foreign trade.

Following are the various functions of Exchange Banks:

1. Remitting money from one country to another country,
2. Discounting of foreign bills,
3. Buying and Selling Gold and Silver, and

9. Consumers Banks

Consumers bank is a new addition to the existing type of banks. Such banks are usually found only in advanced countries like U.S.A. and Germany. The main objective of this bank is to give loans to consumers for purchase of the durables like Motorcar, television set, washing machine, furniture, etc. The consumers have to repay the loans in easy installments.
1.2 AN OVERVIEW OF EVOLUTION OF BANK

The Evolution of banking system in the world can be traced back to 1157, when the first bank called ‘Bank of Venice’ was established in Italy to finance the monarch in war period, in England, the ‘bank of England’ was established in 1694 on Italian lines to support the government with finance. The first bank in India was started in 1770 by the Alexander and co. and English agency as the ‘Bank of Hindustan’ but the bank was failed in 1782 due to closure of the agency house in India. The first bank in the modern sense was established in the Bengal presidency as bank of Bengal, in 1806. After several days, Indian merchants in Calcutta established the union bank in 1839, but it failed as consequence of economic crisis of 1848-49.

The Allahabad bank was established in 1865 and still functioning today, is the oldest joint stock bank in India. The Indian governments realized the need for a national bank to run the accounts efficiently, it is amalgamated three presidency banks namely the bank of Bengal, the bank of Madras and the bank of Bombay to establish imperial bank. The imperial bank of India managed the accounts of the governments, public debt and the clearing house until the establishment of RBI in 1935 with aim to manage the currency and credit of the country by acting as banker of Government and commercial banks. The RBI also supervised and controlled the overall banking system of country.

The government took some serious steps to achieve the optimum utilization of available resources these are,

1. RBI was nationalized in 1948

2. Banking companies act 1949 was enacted for amending and consolidating the laws relating to banking companies

3. State bank of India was formed in 1955 by taking over imperial bank of India and this was followed by seven subordinates of SBI- in 1959.
For channelizing financial resources of banking industry towards more desirable sectors of the economy in national interest, the government of India has nationalized 14 major commercial banks on July 19, 1969, subsequently 6 more banks were nationalized in 1980. To bring about competitiveness and make the banks financially sound, financial sector reforms were introduced in 1991, this financial reforms brought more competition, deregulation in interest rates, mergers and acquisitions, technological changes and introduction of international norms of accounting in terms of capital adequacy, income reorganization, asset classification and provisioning etc., more specially the new branches by nationalized banks is being purely on commercial considerations, for gain competitive edge various mergers taken place, times bank with ICICI, Bank of Punjab and centurion bank amalgamated as centurion bank of Punjab.

In a developing country like India, banking sector has played a multi dimensional and multi directional role in overall development. The nature of this role has however changed significantly over the period of independence. The period can be broadly classified into three phases first before nationalization i.e. from 1947 to 1969; second under nationalization and before liberalization i.e., the period between 1969 and 1991 and finally, after liberalization i.e., since 1991 to till now.

1.2.1 Banking in India at different stages:

A historical glance on the development of Indian banking reveals that it has passed through various phases of growth. The Indian banking industry over the past few decades especially in the post nationalization period is indeed remarkable. In the process commercial banks have evolved various modes and instruments of financing moving away from commercial banking to social banking and from class banking to mass banking by responding to socio-economic needs of the public. In order to appreciate the achievements made by the banking industry, it is appreciable to review its progress over the past
half-a-century which was characterized by many landmark developments. A review of this kind will not only help us in understanding the present status of industry but also present the future scenario of Indian banking.

1.2.1.1 First phase: Pre nationalization Era (1947-1969)

Two important steps taken by the government in 1949- the nationalization of RBI and enactment of banking regulation act, which gave extensive regulatory power to RBI over the commercial banks, characterized the first period. These two steps allowed the government to carry out several structural reforms in the banking sector. With the change in policy, regulation there was massive increase in the mobilization of savings by the commercial banking. The perception of the people towards banks changed significantly, and this was reflected in higher growth in time deposits as compared to demand deposits, and the rise in personal accounts relative to business account during this phase. For the first time the common man began to see banks as secure investment option and safe place to keep money. Another important step was established of state bank of India in 1955 and its associates in 1960, with the obligation to open new branches in rural areas and semi urban areas. This opened up the under developed interiors of country to a first time banking experience. However, as most commercial banking were under the control of big business houses, the expansion of branches in rural and semi urban areas was limited despite some efforts by the SBI and its associates, and the common man effectively remained outside the ambit of banking. In June 1969 only 22.2% bank offices were located in rural areas moreover the rural sectors had less than 10 % and agriculture sector only about 2% share in the total net bank credit. The focus of banking sector till 1969 was restricted to the industrial sector. The rural sector, and in particular the agricultural sector was largely neglected.
1.2.1.2 Second phase: Nationalization to liberalization

Fourteen major commercial banks nationalized in 1969 in order to focus on the primary sector which was underdeveloped. Six more banks were nationalized in 1980. With nationalization of banks, both expansion pattern and role of commercial banks have changed significantly. Bank offices in rural areas rose to more than 58% of total bank offices in 1990. There was massive expansion of branches of commercial banks after nationalization under the lead bank scheme. The branches expanded at about 2400 per year till mid 1980s and there after at a rate of around 850 per year. More than 45% of the expansion was in rural areas. The period between June 1969 and March 1990 was characterized by rapid expansion of the banking sector as a whole. The number of commercial banks increased from 89 to 274 during this period. Number of bank offices increased from 8262 in June 1969 to 59756 in March 1990. Of these bank offices the percentage of rural offices increased from merely 22.2% to 58.2%. For the same period, population per office comes down from 64 thousand to 14 thousand. Deposit as a percentage of nominal GNP rose significantly from 15.5% in June 1969 to as high as 48.6% in March 1990. Similarly, credit as percentage of nominal GDP increased from 12% to 29.5% during the same period. The most of important aspect of the changing role of banking sectors as a whole was the initiation of directed credit system under lead scheme. On the recommendations of the working groups on rural banks under chairmanship of M.Narasimham, regional rural were set up under an act of 1976. The regional banks are required to meet the credit requirements of weaker sections, small and marginal farmers, laborers, artisans and small entrepreneurs.
TABLE 1.1 GROWTH OF INDIAN BANKING SECTOR BEFORE AND AFTER NATIONALISATION

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<tbody>
<tr>
<td>1.</td>
<td>Number of branches</td>
<td>8,262</td>
<td>59,815</td>
<td>98,145</td>
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<tr>
<td>2.</td>
<td>Aggregate deposits (Rs. in Million)</td>
<td>46.5</td>
<td>1763.5</td>
<td>3468.3</td>
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<tr>
<td>3.</td>
<td>Advances (Rs. In Billions)</td>
<td>36</td>
<td>1032</td>
<td>5034</td>
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<tr>
<td>4.</td>
<td>No. of deposits (Rs. in Millions)</td>
<td>18</td>
<td>247</td>
<td>552</td>
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<tr>
<td>5.</td>
<td>No. of advances (Rs. in Millions)</td>
<td>1.1</td>
<td>25.6</td>
<td>44</td>
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1.2.1.3 Third phase: post liberalization era (after 1991)

In the post of liberalization era the role of banking sector changed significantly. The system of directed credit had led to the decline in profit of the banking sector as whole, its role in promotion of agriculture and small scale industries notwithstanding. The liberalization measures have had positive effect on the efficiency of the banking sector. Total non-performing assets as percentage of the total loan portfolio, which were as high as 24.8% in 1994, came down to 2.7% in 1994 as at end of March 2007. In recent years, the gross non – performing assets of scheduled banks as proportion of total assets declined to 1.3% during 2007-08 compared to 1.5% during 2006-07. After adopting the standard of the Basel norms, the quality of assets of the banks improved significantly. Among the other positive effects. Profit per employee rose from Rs. 10,000 in 1995-96 to 1, 30,000 in 2004-05 at constant prices. Similarly, business per employee rose from 6 million in 1995 to 242 millions in 2004-05. Profitability measured by net returns on assets of public sector banks as whole rose from -0.4 % in 1992 to 1.12% in 2003-04 which has been one of the highest in the world.

However, in the process of making the banking sector an efficient industry, some aspects which had gained priority in the pre liberalization period have
been undermined in the post reform era. The share of agriculture has come down from a high of 18% in 1990 to 13% in the late 1990’s. The evolution of banking sector in India and its role towards the growth and development of the country has been distinct and definitive. It has been responsive to the needs of the time and catered to the demands of the economy as whole.

1.3 IMPORTANCE OF BANKING IN THE INDIAN ECONOMY:

The banking system which constitutes the core of the financial sector plays critical role in transmitting monetary policy impulses to the entire economic system. Money and finance is an important and necessary factor for economic development. Its importance lies in the fact that it place at the command of those who have technical skills and entrepreneurial talent but lack in other means to acquire the capacity missing factors necessary development. The segment of capital and money market dealing with lending and borrowing of funds, essentially for short term purpose, is represented by commercial banks act as a financial intermediations are process by which flow of savings of the community is allocated to finance the investment in economy.

Importance of commercial banks in the process of economic development has been recognized by all. The commercial banks play an important role in all economies the role becomes more important in planned or developing economies like India.

Banking industry is the blood of vascular system of economy. It has a positive role-play in the economic development of the country as resipositories of people saving and purveyors of credit, especially as the success of economic development depends on the mobilization of resources and investments in appropriate manner. In the country like India. Constitutionally committed to socialistic pattern of society – banks have important objective of the economic planning. A very significant measure to reduction of regional disparities, which is an important objective of economic planning. A very significant measure to reduce the regional imbalance in the credit deposit ratios in the various states.
The quote Bhaba “Banking is kingpin of the chariot of economic progress .as such it is like India neither be under estimated nor overlooked. The success of plan depends among other things, on the smooth and satisfactory performance of role by banking industry in our country. Strengthening the financial sector and improving the functioning of financial markets have been the core objective of the financial sector reforms in India. The significant transformation of the financial system has accrued in the financial markets, institutions and products.

1.3.1 Functions of bank

The functions of banks are divided into two categories:

i) Primary functions, And

ii) Secondary functions including agency functions.

i) Primary functions:

The primary functions of a commercial bank include:

a) Accepting deposits; and

b) Granting loans and advances;

a) Accepting deposits

The most important activity of a commercial bank is to mobilize deposits from the public. People who have surplus income and savings find it convenient to deposit the amounts with banks. Depending upon the nature of deposits, funds deposited with bank also earn interest. Thus, deposits with the bank grow along with the interest earned. If the rate of interest is higher, public are motivated to deposit more funds with the bank. There is also Safety of funds deposited with the bank.
b) Grant of loans and advances

The second important function of a commercial bank is to grant loans and advances. Such loans and advances are given to members of the public and to the business community at a higher rate of interest than allowed by banks on various deposit accounts. The rate of interest charged on loans and advances vary depending upon the purpose, period and the mode of repayment. The difference between the rates of interest allowed on deposits and the rate charged on the Loans is the main source of a bank’s income.

c) Loans

A loan is granted for a specific time period. Generally, commercial banks grant short-term loans. But term loans, that is, loan for more than a year, may also be granted. The borrower may withdraw the entire amount in lump sum or in installments. However, interest is charged on the full amount of loan. Loans are generally granted against the security of certain assets. A loan may be repaid either in lump sum or in installments.

d) Advances

An advance is a credit facility provided by the bank to its customers. It differs from loan in the sense that loans may be granted for longer period, but advances are normally granted for a short period of time. Further the purpose of granting advances is to meet the day to day requirements of business. The rate of interest charged on advances varies from bank to bank. Interest is charged only on the amount withdrawn and not on the sanctioned amount.

Modes of short-term financial assistance

Banks grant short-term financial assistance by way of cash credit, overdraft and bill discounting.
a) **Cash Credit**

Cash credit is an arrangement whereby the bank allows the borrower to draw amounts up to a specified limit. The amount is credited to the account of the customer. The customer can withdraw this amount as and when he requires. Interest is charged on the amount actually withdrawn. Cash Credit is granted as per agreed terms and conditions with the customers.

b) **Overdraft**

Overdraft is also a credit facility granted by bank. A customer who has a current account with the bank is allowed to withdraw more than the amount of credit balance in his account. It is a temporary arrangement. Overdraft facility with a specified limit is allowed either on the security of assets, or on personal security, or both.

c) **Discounting of Bills**

Banks provide short-term finance by discounting bills that is, making payment of the amount before the due date of the bills after deducting a certain rate of discount. The party gets the funds without waiting for the date of maturity of the bills. In case any bill is dishonored on the due date, the bank can recover the amount from the customer.

ii) **Secondary functions**

Besides the primary functions of accepting deposits and lending money, banks perform a number of other functions which are called secondary Functions. These are as follows -

a) Issuing letters of credit, travellers’ cheques, circular notes etc.

b) Undertaking safe custody of valuables, important documents, and Securities by providing safe deposit vaults or lockers;

c) Providing customers with facilities of foreign exchange.

d) Transferring money from one place to another; and from one branch to Another branch of the bank.
e) Standing guarantee on behalf of its customers, for making Payments for purchase of goods, machinery, vehicles etc.

f) Collecting and supplying business information;

g) Issuing demand drafts and pay orders; and,

h) Providing reports on the credit worthiness of customers.

1.4 NEED FOR BANK SERIES- IN PRESENT SITUATIONS

The old world of banking has changed considerably. The forces of globalization and technology have resulted in increasing integration of economies of the world.

- Today, banks are no more competing locally, but in the market place. It is important for banks to adopt this environment. It is said that life is a change while growth is optional.

- Banking has seen rapid deregulation. Today’s customers have wider range of products to choose from. In order to service this ever increasing customer demand, banks, which are highly branch focused, are concentrating on multi channel delivery.

- Increasing pressure on spreads, the focus on fund based income has shifted to fee based income as banks try to optimize this important source of income.

- Interest rates have been deregulated. Now every bank is allowed quota its own interest for deposits and advances.

- There is provision for foreign currency clearing in the domestic environment.

- World’s first country, where liquidity and interest rates risk management is mandated by central bank. i.e.RBI

- The challenge is to integrated silos of information; of customer management, in order explore newer opportunities. Operations and processes, which are largely manual, need to be more customers centric.
Product management, made sluggish by inadequate technology support, should be driven by time market parameters.

- **Employees need to be trained and redeployed** as business requirements. In present environment, a paradigm change in the Indian banking industry is inevitable. Technology can be key business enabler in four critical areas, operational efficiency/customer management/product management and distribution management.

- Banks need to be **maintaining high levels of operational efficiency** in order to competitive. For this, the key is make optimal utilization of resources at their disposal.

- Organizations typical focus on achieving short-term efficiency. However, we need to devise the strategies for achieving **long term operational efficiency**. This requires banks to adopt new better ways of managing their operations cross-functional efficiencies have long-term impact on your business.

- Customer management is crucial today than ever before. Globalization and the information revolution have **raised customer expectations**; they expect custom services at ever-greater speed.

- Technology enables banks to increase productivity and rapid by respond to changing expectations of customers. For instance, account statements, (which were previously sent by snail to mail) can now instantly email. Further account opening which required visit to branch can done online.

- Subsequent to interest rates deregulations, banks have lot of **flexibility in product pricing**. In fact banks have to change their banks have to change their product pricing to derive advantages.

- We have to consider the organizational redesign, change management and business plan to back it up. Organizational redesign is not a one time activity at the start of project; it is an on going process.

- We need to focus on managing cost efficiencies and on increasing profits. This means that irrespective of the size of the project, every new initiative
must have a business plan backing it. There should be clear and acceptable case for Return on Investments. *(ROI)*

- The customer -facing team should be sensitive to customer expectations at multiple touch points of the banks. This will help deliver a unified and consistent experience across all these touch points. Banks need to impart continuous training to staff, call center agents, direct sales agents and other customer facing employees.

- Customer preferences with in the electronic delivery channels increased. ATMs and customer call centers are preferred. However some customers still prefer to visit branch office even at cost of longer transaction time. Further customer segmentations can help in pricing various transactions.

1.5 INDIAN BANKING – A GLOBAL PROSPECTIVE

Banks plays an important role in the economic development of developing countries. Economic development involves investment in various sectors of the economy. The banks collect savings for investment in various projects. In normal banking the banks perform agency services for their customers and helps economic development of the country. The purchase and sales securities, shares, make payments, receive subscription funds and collect utility bills for the Government department. There for banks save time and energy of busy people. Bank arranges foreign exchange for the business transactions with other countries. Banking sector are not simply collecting funds but also serve as a guide to the customer about the investment of their money.

The use of IT till the 1960’s was minimal. But the development of new networking paradigms that culminated into the World Wide Web, branches are networked, and that turn of the millennium, India witnessed the launch of internet banking. Banking transactions become cross- border and truly global for the first time. The new mantra for Indian banks is to go for global in search
of new markets, customers and profits. Indian banks have also made their presence overseas. For the purpose, Indian banking sector has already implemented internationally followed prudential accounting norms for classification of assets, income recognition and loan loss provisioning. The scope of disclosure and transparency has also been raised accordance to with international practices. India has complained with almost all core principles of effective banking supervision of Basel committee. Some of Indian banks are also presenting their accounts as per the U S GAAP. The road map for adoption of Basel II is also under formulation. Supporting institutional and regulatory framework at home is vital for domestic banks aspiring for global operations. RBI has suitably changed the country’s regulatory framework from time to time to support Indian financial institutions to withstand the competitive pressures placed on them by increasing withstand the competitive pressures placed on them by increasing globalization. All these factors give Indian banks much needed confidence for overseas operations.

The future of Indian banking represents a unique mixture of unlimited opportunities amidst instrument able challenges. On the one hand, we see the scenario represented by rapid process of globalization presently taking shape bringing the community of nations in the world together, transcending geographical boundaries, in the sphere of trade and commerce, and even employment opportunities of individuals. All these indicate newly emerging opportunities for Indian banking. National banks are over – staffed. The recruitment, training, placement and promotion of policies of the banks leave much desired. Another trend in banking is a shift of focus of banks from being product centric to customer centric. Access to internet has put wealth management decisions and demand side technologies and they can dictate the types of services they require. While the internet has enabled banks to deliver desired products/ services more quickly and inexpensively, the challenge for them is to enhance customer touch using e- channels, which is very important for client retention.
The banks today are facing intense competition and to maintain their market share, banks have to become more customer-centric. They have to offer all financial services to the customer’s one-stop point. Banks are poised to become large sized malls offering the gamut of financial services, be it banking, or credit cards, mutual funds or insurance. In short, the need of the hour is to be a provider of total financial solutions. Faced with global competition, the banks have to shore up the efficiency of their operations, which will be possible through the use of high-ended technology and process reengineering to increase the speed and efficiency and reduce transactions costs. An inevitable trend of future is consolidation through mergers and acquisitions. If Indian banks are to compete globally, they have not only to attain the critical mass and optimum size, but also they have to generate revenue synergies and fund their capital requirement.

1.6 BANKING SECTOR REFORMS:

Financial sector reforms were initiated as a part of overall reform in the country and wide ranging reforms covering in the industry, trade taxation, external factor, banking and financial markets have been carried out since mid 1991. Reforms were initiated in the middle of current account crisis occurred in 1991. The crisis was caused by poor macro economic performance.

Fifteen years (1991-2006) of economic and financial sector reforms have strengthened the fundamentals of the Indian banking economy and transformed the operating environment for banks and financial institutions in the country.

The most significant achievement of financial sector reforms have been the marked improvement in the financial health of commercial banks in the terms of capital adequacy, profitability and asset quality as also greater attention to risk management. Further deregulation has pended up new opportunities for banks to increase revenues by diversifying into investment banking, insurance, credit cards, depository services, mortgage finance securitization, etc. at the same time liberalization has brought greater
competition among banks, both domestic and foreign, as well as competition from mutual funds, non-banking financial companies (NBFC’s), post offices. Etc., during the post WTO regime competition will only be intensified as large global players emerge on the scene. Increasing competition is squeezing profitability and forcing banks to work efficiently on shrinking spreads. Positive fallout of competition is the greater availability to consumer and increased level of sophistication and technology in banks. As banks benchmarks themselves against global standards, there has been a marked increase in disclosures and transparency in bank balance sheets as also greater focus on corporate governance. Banking sector reforms essentially consisted of a two pronged approach. While nudging the Indian banking system to better health through the introduction of international best practices of in prudential regulation and supervision early in the reforms cycle, the idea was gradually induce the competition in the system. The implementation periods for such norms were however, chosen to suit Indian situation.

Following note worthy policy initiative were exercised in Indian banking sector:

- Interest rates can be deregulated. Interest rates of deposits and lending have been deregulated with the banks enjoying greater freedom to determine their rates.
- Financial regulation through statutory pre-emption has been lowered, while setting up prudential regulation at the same time.
- Reduction in reserves requirements by lowering SLR to 25%, CRR TO 5%, Bank rate to 6% in the phased manner, thus releasing more lendable funds which bank can display profitability.
- Steps have been initiated to strengthen public sector banks (PSB’s) through increasing their autonomy, and re-capitalization. It was recognized that the restoration of health banking system required ‘stock’ solution improvement in future profitability.
- Measures have also been taken to broaden the ownership base of PSB’s; consequently, the private share holding in PSB’s has gone up, ranging from 23% to 43.70%.
- The banking system has witnessed greater levels of transparency and standards of disclosures.
- New instruments have been opened up for bank financing, insurance, credit cards infrastructure financing, leasing, gold banking, besides of investments banking, asset management, factoring, etc.
- New investments have been introduced with greater flexibility and better risk management, e.g., interest rates swaps, forward rate agreement, cross country forward contracts, etc.
- Limits for investments in overseas markets by banks, mutual funds and corporate have been liberalized. The overseas investments limit for corporate has been raised to 100% of net worth and ceiling of $100 million on prepayment of external borrowing has been removed.
- Universal banking has been introduced with banks introduced with banks permitted to diversify into long-term finance and development financial institutions (DFI’s) into working capital.
- Technology infrastructure for the payments and settlement system has strengthened with electronic fund transfer, centralized funds management system, structured financial messaging solution, negotiated dealing system and move towards real time gross settlement.
- Credit delivery mechanism has been reinforced to increase the flow of credit to priority sectors through focus on micro credit and self help group.
- RBI guidelines have been issued for putting in place risk management systems in banks. Risk management committees in banks address credit risk, market risk operational risk.
- The limit for FDI in private banks has been increased from 49% to 74%. In addition, the limit for FII in private banks is 49%
1.7 WTO AND BANKING ISSUES

India is signatory of WTO financial services agreement, 1977 there are broadly following major related banking issues:
1. Permission to foreign banks to enter India through the subsidiary route.
2. Restrictions on foreign share of banking assets.
3. Restriction on the number of branch licenses per year.
4. Cap on the investment limit of foreign banks in finance companies.
6. Trading in banking services through modes of supply other than commercial presence.

1.8 CHANGING DIMENSION OF INDIAN BANKING

The present banking scenario provides a lot of opportunities as well as facing lot of challenges also. In the past few years, we observed that there was lot of down and up trends in banking sector due to the global finance crisis. In India it has not major affected but in America still the economy is under the pressure of economic crisis. India is being fundamentally strong supported by concrete economic policies, decisions and implementations by the Indian Government i.e. Prime Minister Dr. Man Mohan Singh. Banking sector is not major affected but definitely, there was reflection on the share market.

To improve major areas of banking sector Govt. of India. RBI, Ministry of finance has made several notable efforts. Many of leading banks operating in market have made use of the changed rules and regulations such as CRR, Interest Rates Special offers to the customers such as to open account in zero balance. Now days almost all banks entered into all areas of banking services. As a result of innovation banking products are a reality now. Even saving accounts have become subject of innovation. Due to liberalization, Privatization and Globalization, Indian banks going global and many global banks are setting up shops in India. The Indian banking system is set to involve
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into a totally new level. It will help the banking system to grow in strength going into future. Due to liberalization banks are operating on reduced spread main focus is highlighted on consumerism and how to customers linked and remain attached with the bank. Therefore banks are entered these days in non banking products such insurance in which area there are tremendous opportunities. After the LPG, impact and deregulation dimensions of business of banks are changed. The following are the some important business changes, which took place, Freedom has been given to banks to structure their own rates of interest in respect of both lending and deposit operations, which form the core banking. With the view increasing the recycling of banking resources and active better recovery performance, a separate act called recovery of dues to banks and financial institutions Act, 1993 was enacted.

Deposits have been provided with number of innovative saving products to suit their diverse requirements and similarly, borrowers have been given freedom and opportunity to bring about disintermediation in saving-investment process as they can meet their financial requirement directly from the capital market not only from the domestic segment but also abroad.

Banks have been allowed to compete with financial institutions (FI’s) in the matter of extending long –term loans including project loans, similarly, the financial institutions have also freedom to extend short-term credit facilities to their borrowers. Some banks have entered in the insurance sector (ICICI bank and HDFC bank) and some of public sectors banks like SBI, PNB, and OBC are trying enter into the insurance sector but there are many issues to be sorted out before banks taken up insurance business.

1.9 ISSUES IN BANKING:

While the fact remains that growth of the Indian banking system and the pace of branch expansion during the last few years has been quite impressive by any standards, one cannot help admitting that banks have sacrificed certain qualitative aspects of this growth. In the ultimate reckoning, prudential
regulations have helped to ensure systematic stability in the face of several external and internal uncertainties during the last few years. However, it needs to be recognized that prescription of norms alone does not necessarily ensure the improvement in the functioning of banks, especially improvements in the systems of credit evaluation, risk assessment and management, technology, the quality of human resources, customer service as well as the quality of internal controls and corporate governance. The following points are:

1. Need To Revamp the Organization Structure:

   It is the urgent need of each bank to take a serious look into its organizational structure which has to be properly revamped to enable it to bear not only the stress and strain of the growth but also to face the challenges arising from the rapidly changing banking scenario. There will have to be judicious blending of the needs for the greater delegation of the power, decentralization of banks during the recent past. These necessitate modified organization structure, pragmatic operational policies, sophisticated control mechanism and skilled manpower for overall strength of the banking system in fulfilling the objectives.

2. Need to Develop Excellence in Management:

   Banking sector needs to improve quality of management, which in turn depends inter alia on the decision support system, technology, adoption, management international system and modern management practices. There are critical requirements in the regard as stated by panel of independent observers are then list, they are

   ➢ An open culture and extensive vertical and horizontal communication.
   ➢ Strong share values.
   ➢ Profit performance as a value.
   ➢ Customer driven business orientation.
   ➢ Willingness to invest in new products.
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➢ Strong and consistent leadership and strong sense of direction.
➢ A commitment to recruit the best people.
➢ Invest in training and carrier development.
➢ A client or product information system promoting assessment clients.
➢ Product profitability.
➢ Strong credit risk management.

3. Need To Improve Corporate Governance Standards:

The corporate world in general is following a relentless march towards better corporate governance standards and adaption of uniform accounting standards and disclosures requirements. These twin requirements are particularly relevant to banking sector where depositors funds are many times higher than the equity of promoters.

4. Need to adopt appropriate technology:

A crucial element in this modernization process is the adoption of appropriate technology which involves extensive computerization. It may be emphasized that around the world, the present generation is witnessing the revolution in technology. They are increasingly transforming it from a support function a driving force. Further, liberalization and deregulation have heightened competition among banks which will only intensify with liberalization under the WTO regime and banks in India will have to benchmark themselves against world class banks.

5. Need to bring down the Non-performing Assets:

Apart from the magnitude of the current profits, an important indicator of performance of banks is provided through the level of non-performance Assets (NPA’s) since this reflects on the quality of loan portfolio. At the end march 2010 NPA of the commercial banks stood 70,904crores. Ratio of NPAs to net advances constituted 6.2 percent in 2011-12. With nearly 6 percent of local loans officially considered as non performing as at the end of March 11-12.
6. Need to Strengthen the Risk Management Strategies:

   It is worth remembering that risk is intrinsic to any business— all the more so to banking business. The growing sophistication is banking operations, derivative trading, securities underwriting, corporate advisory business, and improvements in information technology, on-line electronic bank diversity and complexity of risks being encountered by banks. The major risks confronting banks are credit risk, interest rate risk, operational risk, foreign exchange risk and liquidity risks.

7. Need to Improve Customer Service:

   The basic object of any service industry lies in customer satisfaction and this is all the more so in the banking sector. The efficiency of a bank judged by its customers in relation to the courtesy extended to and the speed and accuracy with which their transactions are completed. But by the number of complaints raised against the banks, it is high time that some introspection is done to analyze the causes for the dilution of quality customers services and take up some steps to remedy them.

8. Need to Transform the Banking System to the Global Level:

   Admittedly, the Indian banking system has made tremendous strides in extending its reach domestically; but unfortunately, it is conspicuous by its absence internationally. The branches of our banks in other parts of the world are few. Even these branches confined to India-related business. Banking is service-oriented business requiring the high levels of professional and personal skills and national boundaries are no longer relevant in mobilization and allocation of capital. Contemporary trends towards globalization demand that India should emerge as a major international banking center, just as it has an important centre in the field of information technology and software. Of course, this is not something which can be achieved in a relatively short span of time; but the time is now opportune to plan ahead and achieve the vision now early in the new millennium.
1.10 ROLE OF BANKING IN INDIA IN DEVELOPING ECONOMY:

Along with the regular functions of the commercial banks, they also play an effective role in their economic development. The role of commercial banks in developing economy is as under;

1. **mobilization of savings for capital formation**

   The commercial banks through a network of branch banking mobilize the savings. People of the developing countries have low incomes and the banks induce them to save by introducing variety of deposit schemes to suit the needs of individual customers. By mobilizing savings, the banks channelize them into various productive projects and investments. Thus they contribute in the capital formation of a developing economy.

2. **Financing industry**

   The commercial banks provide finance to the industrial sector in different ways. They provide short term, medium term and long-term loans to the industry. In India, the commercial banks provide short term, medium term financing to small scale industries and underwrite the shares and debentures of large-scale industries. They not only provide finance for the industry, but also assist in developing the capital markets.

3. **Financing trade**

   The commercial banks help in financing internal and external trade. The retailers to maintain stock of the goods in which they deal. They also assist in the movement of goods in which they deal. They also assist in the movement of goods from one place to another by providing types of facilities such as, issuing drafts, providing overdraft facilities. Discounting and accepting bills of exchange and so on. They also provide foreign exchange to importers and exporters.
4. Finance agriculture

The commercial banks help the large agriculture credit to agriculture sector in developing countries in different ways. They provide agriculture credit to agriculturalists in rural; areas for marketing their produce, providing irrigation facilities, developing land, modernization and mechanization of their farms, etc. They also provide financial assistance for dairy forming, animal husbandry, poultry forming, sheep breeding, horticulture, and so on. Thus, the commercial banks meet the credit requirements of all types of rural people.

5. Financing employment generating activities

The commercial banks provide financial assistance for education, young entrepreneurs, medical and engineering graduates and other technically trained persons to establish their own business. Thus the banks contribute not only in capital formation but also for entrepreneurial activities in developed countries. Thus the banks contribute not only in capital formation but also for entrepreneurial activities in developing countries.

6. Financing consumer activities

The commercial banks advance loans to consumers for the purchase of vehicles, housing, washing machines, refrigerators, computers, etc. In this way they help in raising the standards of living of people in developing countries, since they have levels and do not possess sufficient financial resources to buy durable consumer goods.

7. Monetary policy

The commercial banks help the economic growth and development of a country by the faithfully following the monetary policy of the bank. The central bank depends upon the commercial banks for the success of its policy of monetary management in keeping with requirements of developing economy.
1.11 PROSPECTS OF AN INDIAN BANKING

1. Competition

There is an intensification of competitive pressures from international banks and financial institutions. This scenario posits a clear need for banks to put in place more vibrant and efficient structures, strategies and delivery processes within given time span so that they can face challenge successfully.

2. Innovations

Innovation is the key to the future sustained growth of the banking industry. However, innovation cannot be limited to products and brands alone. Successful financial services players required to embed innovation in every aspect of their functioning. Ranging from the products and process to even people, systems and business partners.

3. Customer data base:

There is large data base of knowledge about exiting customers that is available. But is seldom effectively used by banks and other financial institutions. For example, apart from demographic profile, personal and family income details and a host of other background information.

4. Technology:

Many large banks have confined the CBS (Core Banking Solution) facility to only 20% to 30% of their branches. With justification that it will cover 70% to 80% business in bank. This is deprived the fruits of modern technology to the mass customers of rural and small branches.

5. Quality of services:

Despite the implementation of CBS solution, the other side is that quality of service at different branches varies widely. Without single window or teller systems, customers have to spread considerable time at the branch counters to complete their transactions. This may be ultimately dissatisfying them.
6. **Impact on customers**

The shift from branch counter to e-channels has indeed enhanced customer services and convince. However, customer’s experiences in resolving their problems through their interactive voice response systems/call centers have not been satisfactory in most cases. The warmth and human touch is missing in these mechanical media, leaving many customers to contemplate the benefits of talking to the good old bankers. Also in the absence of channel integration, the customers are unable to get identical the crucial role of bank economists in transforming the banking system in India. Economists have to be more ‘mainstreamed’ within the operational structure of commercial banks. Apart from the traditional functioning of macro-scanning, the inter-linkages between treasuries, dealing rooms and trading rooms of banks need to be viewed not only with the day-to-day needs of operational necessity, but also with analytical content and policy foresight.

Today, operational aspects of the functioning of banks are attracting intensive research by professional economists. In particular, measuring and modeling different kinds of risks faced by banks, the behavior of risk-return relationships associated with different portfolio mixes and the impact of fluctuations in financial markets on the financial performance of banks are areas, which lend themselves to analytical and empirical appraisal by economists and econometricians. They, in turn, are discovering the degrees of freedom and room for analytical maneuver in high frequency information generated by the day-to-day functioning of banks. It is vital that we develop an environment where these synergies are nurtured to serve the longer-term strategic interests of banks. Even in real time trading and portfolio decisions, the fundamental analysis of economists provides an independent assessment of market behavior, reinforcing technical analysis. A serious limitation of the applicability of standard economic analysis to banking relates to the inadequacies of the database. Absence of long time series data storage in the banking industry often poses serious problems to the quest for the formal
analytical relationships between variables. Even if such data exist, the presence of structural breaks may blur meaningful analysis based on traditional formulation. Economists need to think innovatively to overcome this problem. Use of panel regression, non-parametric methods and multivariate analyses could go a long way in understanding and validating behavioral relationships in banking.

Another important challenge for the economics profession is to develop proper models for measurement of various risks in Indian conditions. This is a necessity in view of the move towards risk-based supervision. Quantification of operational risks and calibration of Value at Risk (VaR) models pose major computational challenge to bankers and policy makers alike, particularly in India. A major difficulty lies in identifying the right statistical model that determines the underlying distribution suited to the particular category of operational loss, and building the necessary database for deriving operationally meaningful conclusions.

In order to make a meaningful contribution to banking, economists must have the experience of working in operational areas of banks. For this purpose, economists need to ‘soil their hands’ in dealing rooms, treasuries and investment units, credit authorization and loan recovery, strategic management groups and management information systems of the banks to understand the ground realities. There are also ‘economies’ to be gained from field-level credit appraisal, asset recovery, debt restructuring, market and consumer behaviors in which banks are involved. Thus, the profession needs to amalgamate the objectivity and theoretical soundness of economics with the functional dimensions of banking and finance. It is this combination of specialist training with operational experience, which is going to make the economics profession relevant to the changing face of banking in India.
1.12 INDIAN BANKING : GLOBAL BENCH MARKS

On the global scenario, let’s first take a look at the ranking of Indian banks amongst the global banks. Twenty Indian banks are in the list of top 1000 world banks according to (financial times, London) in July, 2004. India’s entry in the top 25 Asian banks (excluding Japan) is State Bank of India (SBI) at No 10. An encouraging finding of “The Banker’s” analysis that the twenty Indian Banks in the list of 1000, continue to provide the highest average return on capital amongst the Asian banks, going up to 34.2 percent compared to an already high 27.1 Per cent in the year 2003.

The theme “Indian banking –global Bench marks” states that a great change, i.e. from Indian banking to global banking – which clearly reflects today’s reality: the increasing globalization of Indian economy.

Over the past decade, India has emerged as one of the fastest- growing economies in globe. The rest of the world has been impressed to see that the reforms initiated in the early 1990’s fruit. a decade of economic sector reforms has strengthened the fundamentals of the Indian economy and transformed the operating environment for banks and financial institutions in the country. The sustained and gradual pace of reforms has helped avoid any crisis and actually fuelled growth.

**Today, our financial system rapidly changing. Some of features change is:**

1. Increasing sophistication of capital markets
2. Emergence of global investments
3. Industrial considerations
4. Heightened focus on customer relations
5. Proliferation of new players entering the markets.
1.13 INDIAN BANKS: CHANGING PARADIGMS

Banking as the major part of the financial sector, is life blood for the whole industry, necessary to survive. It plays a decisive role in accelerating the rate of economic growth in each economy. In the wake of contemporary changes in the world economy and other domestic crisis like adverse balance of payment problem, increasing fiscal deficits etc. our country too embarked upon economic reforms. As banking sectors represents financial sector reforms they are necessary for faster economic growth to meet the emerging challenges. To improve the adverse situation in banking, banking sector reforms were introduced in 1991 and 1998 by committee constituted under the chairmanship of Mr. M. Narasimham. In banking sector reforms were introduced to remove the deficiencies in the banking sector. Following were the problems of Indian banking sector was facing prior to the reforms.

- Highly regulated by the RBI
- Eroded productivity and efficiency of public sector
- Continuous losses suffered by the public sector banks year after year
- Increasing NPA’s
- Deteriorating portfolio quality
- Poor customer services
- Obsolete work technology
- Inability to face the competitive environment

Hence, need of the hour was to introduce some policies to remove the above said deficiencies. Therefore, in the light of above dissertations, Narasimham Committee we appointed in 1991 and it submitted its reports by Nov 1991, with detailed measures to improve the adverse situation of banking industry. The main motive of reforms was improving the operational efficiency of the banks to further enhance their productivity and profitability.