Chapter – 1

INTRODUCTION
1. Introduction

1.1. An Overview of the Banks & Services

1.1.1. Meaning of Banks

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

The term bank is either derived from old Italian word banca or from a French word banque both mean 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 a 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.

1.1.2. Definition of a Bank

Oxford Dictionary defines a bank as "an establishment for custody of money, which it pays out on customer's order."\(^1\)

In simple words, we can say that Bank is a financial institution that undertakes the banking activity i.e. it accepts deposits and then lends the same to earn certain profit.

Banking systems can be defined as a mechanism through which the money supply of the country is created and controlled.

Bank is an institution which makes to individual such advances of money as may be required and safety made to which individual entrust money when not required by them for use.\(^2\)

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\(^1\) Oxford Dictionary 2010, p635
\(^2\) Prof. Kinley
1.1.2.1. Characteristics and Features of a Bank

a. Dealing in Money
   Bank is a financial institution which deals with other people’s money i.e. money given by depositors.

b. Individual / Firm / Company
   A bank may be a person, firm or a company. A banking company means a company which is in the business of banking.

c. Acceptance of Deposit
   A bank accepts money from the people in the form of deposits which are usually repayable on demand or after the expiry of a fixed period. It gives safety to the deposits of its customers. It also acts as a custodian of funds of its customers.

d. Giving Advances
   A bank lends out money in the form of loans to those who require it for different purposes.

e. Payment and Withdrawal
   A bank provides easy payment and withdrawal facility to its customers in the form of cheques and drafts; it also brings bank money in circulation. This money is in the form of cheques, drafts, etc.

f. Agency and Utility Services
   A bank provides various banking facilities to its customers. They include general utility services and agency services.

g. Profit and Service Orientation
   A bank is a profit seeking institution having service oriented approach.

h. Ever increasing Functions
   Banking is an evolutionary concept. There is continuous expansion and diversification as regards the functions, services and activities of a bank.
i. Connecting Link

A bank acts as a connecting link between borrowers and lenders of money. Banks collect money from those who have surplus money and give the same to those who are in need of money.

10. Banking Business

A bank's main activity should be to do business of banking which should not be subsidiary to any other business.

11. Name Identity

A bank should always add the word "bank" to its name to enable people to know that it is a bank and that it is dealing in money.

In simple words, Banking can be defined as the business activity of accepting and safeguarding money owned by other individuals and entities, and then lending out this money in order to earn a profit. However, with the passage of time, the activities covered by banking business have widened and now various other services are also offered by banks. The banking services these days include issuance of debit and credit cards, providing safe custody of valuable items, lockers, ATM services and online transfer of funds across the country/world.

It is well said that banking plays a silent, yet crucial part in our day-to-day lives. The banks perform financial intermediation by pooling savings and channelizing them into investments through maturity and risk transformations, thereby keeping the economy’s growth engine revving.

Banking business has done wonders for the world economy. The simple looking method of accepting money deposits from savers and then lending the same money to borrowers, banking activity encourages the flow of money to productive use and investments. This in turn allows the economy to grow. In the absence of banking business, savings would sit idle in our homes, the entrepreneurs would not be in a position to raise the money, ordinary people dreaming for a new car or house would not be able to purchase cars or houses.

In 1839, some Indian merchants in Calcutta established India's first bank known as "Union Bank", but it could not survive for long and failed in 1848 due to economic
crisis of 1848-49. Similarly, in 1863, "Bank of Upper India" was formed but it failed in 1913.

In 1865, "Allahabad Bank" was established as a joint stock bank. This bank has survived till date and is now considered as the oldest surviving bank in India.

1.1.3. Factor makes bank as super power

Trust is the most important element for a bank to survive. People keep money in a bank only when they trust that it will be given back to them as and when they demand the same on at least on the date of maturity in case the same has been given in the shape of fixed deposits. Of course, there are other reasons also for which people prefer to keep money in a bank rather than keep at home in their own safe. They can earn some extra money when the money is kept in saving or fixed deposits. Moreover, they can make payment by issuance of cheques and need not carry money for their day to day needs.

You know people earn money to meet their day-to-day expenses on food, clothing, education of children, housing, etc. They also need money to meet future expenses on marriage, higher education of children, house building and other social functions. These are heavy expenses, which can be met if some money is saved out of the present income. Saving of money is also necessary for old age and ill health when it may not be possible for people to work and earn their living.

The necessity of saving money was felt by people even in olden days. They used to hoard money in their homes. With this practice, savings were available for use whenever needed, but it also involved the risk of loss by theft, robbery and other accidents. Thus, people were in need of a place where money could be saved safely and would be available when required. Banks are such places where people can deposit their savings with the assurance that they will be able to withdraw money from the deposits whenever required. People who wish to borrow money for business and other purposes can also get loans from the banks at reasonable rate of interest.

Bank is a lawful organization, which accepts deposits that can be withdrawn on demand. It also lends money to individuals and business houses that need it.
Banks also render many other useful services – like collection of bills, payment of foreign bills, safe-keeping of jewelers and other valuable items, certifying the creditworthiness of business, and so on.

Banks accept deposits from the general public as well as from the business community. Anyone who saves money for future can deposit his savings in a bank. Businessmen have income from sales out of which they have to make payment for expenses. They can keep their earnings from sales safely deposited in banks to meet their expenses from time to time. Banks give two assurances to the depositors –

a. Safety of deposit, and

b. Withdrawal of deposit, whenever needed

On deposits, banks give interest, which adds to the original amount of deposit. It is a great incentive to the depositor. It promotes saving habits among the public. On the basis of deposits banks also grant loans and advances to farmers, traders and businessmen for productive purposes. Thereby banks contribute to the economic development of the country and well being of the people in general. Banks also charge interest on loans. The rate of interest is generally higher than the rate of interest allowed on deposits. Banks also charge fees for the various other services, which they render to the business community and public in general. Interest received on loans and fees charged for services which exceed the interest allowed on deposits are the main sources of income for banks from which they meet their administrative expenses.

The activities carried on by banks are called banking activity. ‘Banking’ as an activity involves acceptance of deposits and lending or investment of money. It facilitates business activities by providing money and certain services that help in exchange of goods and services. Therefore, banking is an important auxiliary to trade. It not only provides money for the production of goods and services but also facilitates their exchange between the buyer and seller.

You may be aware that there are laws which regulate the banking activities in our country. Depositing money in banks and borrowing from banks are legal transactions. Banks are also under the control of government. Hence they enjoy the trust and
confidence of people. Also banks depend a great deal on public confidence. Without public confidence banks cannot survive.

1.1.4. Role of Banking

Banks provide funds for business as well as personal needs of individuals. They play a significant role in the economy of a nation. Let us know about the role of banking.

1. It encourages savings habit amongst people and thereby makes funds available for productive use.
2. It acts as an intermediary between people having surplus money and those requiring money for various business activities.
3. It facilitates business transactions through receipts and payments by cheques instead of currency
4. It provides loans and advances to businessmen for short term and long-term purposes.
5. It also facilitates import export transactions.
6. It helps in national development by providing credit to farmers, small-scale industries and self-employed people as well as to large business houses which lead to balanced economic development in the country.
7. It helps in raising the standard of living of people in general by providing loans for purchase of consumer durable goods, houses, automobiles, etc.
1.1.5. Types of Banks

There are various types of banks which operate in our country to meet the financial requirements of different categories of people engaged in agriculture, business, profession, etc. On the basis of functions, the banking institutions in India may be divided into the following types:

![Types of Banks Diagram]

**Central Banks**
- RBI, in India

**Development Banks**

**Specialized Banks**
- (EXIM Bank, SIDBI, NABARD)

**Commercial Banks**
- 1. Public Sector Banks
- 2. Private Sector Banks
- 3. Foreign Banks

**Co-operative Banks**
- 1. Primary Credit Societies
- 2. Central Co-operative Banks
- 3. State Co-operative Banks

**Fig. 01: Types of Bank**

1.1.5.1. Central Bank

A bank which is entrusted with the functions of guiding and regulating the banking system of a country is known as its Central bank. Such a bank does not deal with the general public. It acts essentially as Government’s banker; maintain deposit accounts of all other banks and advances money to other banks, when needed. The Central Bank provides guidance to other banks whenever they face any problem. It is therefore known as the banker’s bank. The Reserve Bank of India is the central bank of our country.

The Central Bank maintains record of Government revenue and expenditure under various heads. It also advises the Government on monetary and credit policies and
decides on the interest rates for bank deposits and bank loans. In addition, foreign exchange rates are also determined by the central bank.

Another important function of the Central Bank is the issuance of currency notes, regulating their circulation in the country by different methods. No other bank than the Central Bank can issue currency.

1.1.5.2. Commercial Banks

Commercial Banks are banking institutions that accept deposits and grant short-term loans and advances to their customers. In addition to giving short-term loans, commercial banks also give medium-term and long-term loan to business enterprises. Now-a-days some of the commercial banks are also providing housing loan on a long-term basis to individuals. There are also many other functions of commercial banks, which are discussed later in this lesson.

1.1.5.2.1. Types of Commercial banks: Commercial banks are of three types i.e., Public sector banks, Private sector banks and foreign banks.

1.1.5.2.1.1. Public Sector Banks: These are banks where majority stake is held by the Government of India or Reserve Bank of India. Examples of public sector banks are: State Bank of India, Corporation Bank, Bank of Boroda and Dena Bank, etc.

1.1.5.2.1.2. Private Sectors Banks: In case of private sector banks majority of share capital of the bank is held by private individuals. These banks are registered as companies with limited liability. For example: The Jammu and Kashmir Bank Ltd., Bank of Rajasthan Ltd., Development Credit Bank Ltd, Lord Krishna Bank Ltd., Bharat Overseas Bank Ltd., Global Trust Bank, Vysya Bank, etc.

1.1.5.2.1.3. Foreign Banks: These banks are registered and have their headquarters in a foreign country but operate their branches in our country. Some of the foreign banks operating in our country are Hong Kong and Shanghai Banking Corporation (HSBC), Citibank, American Express Bank, Standard & Chartered Bank, Grindlay’s Bank, etc. The number of foreign banks operating in our country has increased since the financial sector reforms of 1991.
1.1.5.3. Development Banks

Business often requires medium and long-term capital for purchase of machinery and equipment, for using latest technology, or for expansion and modernization. Such financial assistance is provided by Development Banks. They also undertake other development measures like subscribing to the shares and debentures issued by companies, in case of under subscription of the issue by the public. Industrial Finance Corporation of India (IFCI) and State Financial Corporation’s (SFCs) are examples of development banks in India.

1.1.5.4. Co-operative Banks

People who come together to jointly serve their common interest often form a co-operative society under the Co-operative Societies Act. When a co-operative society engages itself in banking business it is called a Co-operative Bank. The society has to obtain a licence from the Reserve Bank of India before starting banking business. Any co-operative bank as a society is to function under the overall supervision of the Registrar, Co-operative Societies of the State. As regards banking business, the society must follow the guidelines set and issued by the Reserve Bank of India.

1.1.5.4.1. Types of Co-operative Banks

There are three types of co-operative banks operating in our country. They are primary credit societies, central co-operative banks and state co-operative banks. These banks are organized at three levels, village or town level, district level and state level.

1.1.5.4.1.1. Primary Credit Societies: These are formed at the village or town level with borrower and non-borrower members residing in one locality. The operations of each society are restricted to a small area so that the members know each other and are able to watch over the activities of all members to prevent frauds.

1.1.5.4.1.2. Central Co-operative Banks: These banks operate at the district level having some of the primary credit societies belonging to the same district as their
members. These banks provide loans to their members (i.e., primary credit societies) and function as a link between the primary credit societies and state co-operative banks.

1.1.5.4.1.3. **State Co-operative Banks:** These are the apex (highest level) co-operative banks in all the states of the country. They mobilize funds and help in its proper channelization among various sectors. The money reaches the individual borrowers from the state co-operative banks through the central co-operative banks and the primary credit societies.

1.1.5.4.1.4. **Specialized Banks**

There are some banks, which cater to the requirements and provide overall support for setting up business in specific areas of activity. EXIM Bank, SIDBI and NABARD are examples of such banks. They engage themselves in some specific area or activity and thus, are called specialized banks.

Note: Public Sector Banks comprise 19 nationalized banks and State Bank of India and its 7 associate banks.

1.1.6. **Functions of Commercial Banks**

The functions of commercial banks are of two types. These are: Primary functions; and Secondary functions.

1.1.6.1. **Primary functions**

The primary functions of a commercial bank include:

1.1.6.1.1. **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.
1.1.6.1.2. 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 varies according to the purpose and period of loan and also the mode of repayment.

1.1.6.1.2.1. Loans

A loan is granted for a specific time period. Generally commercial banks provide short-term loans. But term loans, i.e., loans for more than a year may also be granted. The borrower may be given the entire amount in lump sum or in installments. Loans are generally granted against the security of certain assets. A loan is normally repaid in installments. However, it may also be repaid in lump sum.

1.1.6.1.2.2. 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.

1.1.6.1.2.2.1. Types of Advances

Banks grant short-term financial assistance by way of cash credit, overdraft and bill discounting. Let us learn about these.

i. Cash Credit

Cash credit is an arrangement whereby the bank allows the borrower to draw amount upto 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 terms and conditions agreed with the customers.
ii. **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 may be allowed either on the security of assets, or on personal security, or both.

iii. **Discounting of Bills**
Banks provide short-term finance by discounting bills, which 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.

1.1.6.2. **Secondary functions**
In addition to 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

i. Issuing letters of credit, traveler’s cheque, etc.

ii. Undertaking safe custody of valuables, important document and securities by providing safe deposit vaults or lockers.

iii. Providing customers with facilities of foreign exchange dealings.

iv. Transferring money from one account to another; and from one branch to another branch of the bank through cheque, pay order, demand draft.

v. Standing guarantee on behalf of its customers, for making payment for purchase of goods, machinery, vehicles etc.

vi. Collecting and supplying business information.

vii. Providing reports on the credit worthiness of customers.

viii. Providing consumer finance for individuals by way of loans on easy terms for purchase of consumer durables like televisions, refrigerators, etc.

ix. Educational loans to students at reasonable rate of interest for higher studies, especially for professional courses.
1.1.6.2.1. **E-banking (Electronic Banking)**

With advancement in information and communication technology, banking services are also made available through computer. Now, in most of the branches you see computers being used to record banking transactions. Information about the balance in your deposit account can be known through computers. In most banks nowadays human or manual teller counter is being replaced by the Automated Teller Machine (ATM). Banking activity carried on through computers and other electronic means of communication is called ‘electronic banking’ or ‘e-banking’. Let us now discuss about some of these modern trends in banking in India.

1.1.6.2.2. **Automated Teller Machine**

Banks have now installed their own Automated Teller Machine (ATM) throughout the country at convenient locations. By using this, customers can deposit or withdraw money from their own account any time.

1.1.6.2.3. **Debit Card**

Banks are now providing Debit Cards to their customers having saving or current account in the banks. The customers can use this card for purchasing goods and services at different places in lieu of cash. The amount paid through debit card is automatically debited (deducted) from the customers’ account.

1.1.6.2.4. **Credit Card**

Credit cards are issued by the bank to persons who may or may not have an account in the bank. Just like debit cards, credit cards are used to make payments for purchase, so that the individual does not have to carry cash. Banks allow certain credit period to the credit cardholder to make payment of the credit amount. Interest is charged if a cardholder is not able to pay back the credit extended to him within a stipulated period. This interest rate is generally quite high.

1.1.6.2.5. **Net Banking**

With the extensive use of computer and Internet, banks have now started transactions over Internet. The customer having an account in the bank can log into the bank’s
website and access his bank account. He can make payments for bills, give instructions for money transfers, fixed deposits and collection of bill, etc.

1.1.6.2.6. Phone Banking

In case of phone banking, a customer of the bank having an account can get information of his account, make banking transactions like, fixed deposits, money transfers, demand draft, collection and payment of bills, etc. by using telephone. As more and more people are now using mobile phones, phone banking is possible through mobile phones. In mobile phone a customer can receive and send messages (SMS) from and to the bank in addition to all the functions possible through phone banking.

1.1.7. History of Banks

The banking history is interesting and reflects evolution in trade and commerce. It also throws light on living style, political and cultural aspects of civilized mankind. The strongest faith of people has always been religion and God. The seat of religion and place of worship were considered safe place for money and valuables. Ancient homes didn't have the benefit of a steel safe, therefore, most wealthy people held accounts at their temples. Numerous people, like priests or temple workers were both devout and honest, always occupied the temples, adding a sense of security. There are records from Greece, Rome, Egypt and Ancient Babylon that suggest temples loaned money out, in addition to keeping it safe. The fact that most temples were also the financial centers of their cities and this is the major reason that they were ransacked during wars. The practice of depositing personal valuables at these places which were also functioning as the treasuries in ancient Babylon against a receipt were perhaps the earliest form of “Banking”. Gradually as the personal possession got evaluated in term of money, in form of coins made of precious metal like gold and silver, these were being deposited in the temple treasuries. As these coins were commonly accepted form of wealth, ‘lending’ activity to those who needed it and were prepared to ‘borrow’ at an interest began. The person who conducted this ‘lending’ activity was known as the “Banker” because of the bench he usually set. It is also observed that the term ‘bankrupt’ got evolved then as the irate depositors broke the bench and table of the insolvent banker. With the expansion of trade the concept of banking gained
greater ground. The handling of “banking” transcended from individual to groups to companies. Issuing currency was one of the major functions of the banks. The earliest form of money – coins, were a certificate of value stamped on a metal, usually gold, silver, and bronze or any other metal, by an authority, usually the king. With the increasing belief and faith in such authority of their valuation and the necessities of wider trade a substitute to metal was found in paper. The vagaries of monarchial rule led to the issues of currency being vested with the banks since they enjoyed faith, controlled credit and trading.

In ancient India during the Maurya dynasty (321 to 185 BC), an instrument called adesha was in use, which was an order on a banker desiring him to pay the money of the note to a third person, which corresponds to the definition of a bill of exchange as we understand it today. During the Buddhist period, there was considerable use of these instruments. Merchants in large towns gave letters of credit to one another. Trade guilds acted as bankers, both receiving deposits and issuing loans. The larger temples served as bankers and in the south the village communities economically advanced loans to peasants. There were many professional bankers and moneylenders like the sethi, the word literally means “chief”. It has survived in the North India as seth. Small purchases were regularly paid for in cowry shells (varataka), which remained the chief currency of the poor in many parts of India. Indigenous banking grew up in the form of rural money lending with certain individuals using their private funds for this purpose. The people paid their tribute in copper instead of gold, and they bought all the necessaries and luxuries they desired in the same coin. However, the Sultan’s tokens were not accepted in counties in which his decree did not run. Soon the whole external trade of Hindustan came to a standstill.

The first banks were The General Bank of India, which started in 1786, and Bank of Hindustan, which started in 1790; both are now defunct. The oldest bank in existence in 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. 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.

Indian merchants in Calcutta established the Union Bank in 1839, but it failed in 1848 as a consequence of the economic crisis of 1848-49. The Allahabad Bank, established in 1865 and still functioning today, is the oldest Joint Stock bank in India. Foreign banks too started to arrive, particularly in Calcutta, in the 1860s. The Comptoir d'Escompte de Paris opened a branch in Calcutta in 1860, and another in Bombay in 1862; branches in Madras and Pondicherry, then a French colony, followed. HSBC established itself in Bengal in 1869. Calcutta was the most active trading port in India, mainly due to the trade of the British Empire, and so became a banking centre. The next was the Punjab National Bank, established in Lahore in 1895, which has survived to the present and is now one of the largest banks in India. The presidency banks dominated banking in India but there were also some exchange banks and a number of Indian joint stock banks. All these banks operated in different segments of the economy. The exchange banks, mostly owned by Europeans, concentrated on financing foreign trade. Indian joint stock banks were generally undercapitalized and lacked the experience and maturity to compete with the presidency and exchange banks.

Swadeshi Movement The period between 1906 and 1911, saw the establishment of banks inspired by the Swadeshi movement. The Swadeshi movement inspired local businessmen and political leaders to found banks for the Indian community. A number of banks established then have survived to the present such as Bank of India, Corporation Bank, Indian Bank, Bank of Baroda, Canara Bank and Central Bank of India. Ammembal Subbarao Pai founded “Canara Bank Hindu Permanent Fund” in 1906. Central Bank of India was established in 1911 by Sir Sorabji Pochkhanawala and was the first commercial Indian bank completely owned and managed by Indians. In 1923, it acquired the Tata Industrial Bank. The fervour of Swadeshi movement lead to establishing of many private banks in Dakshina Kannada and Udupi district which were unified earlier and known by the name South Canara (South Kanara) district. Four nationalized banks started in this district and also a leading private sector bank. Hence, undivided Dakshina Kannada district is known as “Cradle of Indian Banking”. Development after Freedom The second milestone in history of Indian banking was India becoming a sovereign republic. The Government of India initiated measures to play an active role in the economic life of the nation,
and the Industrial Policy Resolution adopted by the government in 1948 envisaged a mixed economy. This resulted into greater involvement of the state in different segments of the economy including banking and finance.

**State Bank of India**

Pursuant to the provisions of the State Bank of India Act (1955), the Reserve Bank of India, which is India's central bank, acquired a controlling interest in the Imperial Bank of India. On 30th April 1955, the Imperial Bank of India became the State Bank of India. The government of India recently acquired the Reserve Bank of India's stake in SBI so as to remove any conflict of interest because the RBI is the country's banking regulatory authority.

The roots of the State Bank of India Act rest in the first decade of 19th century in 1959, the government passed the State Bank of India (Subsidiary Banks) Act, enabling the State Bank of India to take over eight former state-associated banks as its subsidiaries.

1. State Bank of India
2. State Bank of Bikaner and Jaipur
3. State Bank of Hyderabad
4. State Bank of Indore*
5. State Bank of Mysore
6. State Bank of Patiala
7. State Bank of Saurashtra
8. State Bank of Travancore

On 13th September 2008, the State Bank of Saurashtra, one of its associate banks, merged with the State Bank of India. *On 26th August, 2010, the State Bank of Indore was merged with the State Bank of India. After 1947, before nationalization of Indian banking in the year 1969, all the major banks were taken under central government control and Indian government became the major share holder thus was given a new terminology called public sector banks.

Three types of banks are available in India:

1. Government / public sector banks
2. Nationalized banks
3. Private and foreign banks

In the early 1990s, the then Narasimha Rao government embarked on a policy of liberalization, licensing a small number of private banks. These came to be known as Global Trust Bank, which later amalgamated with Oriental Bank of Commerce, Axis Bank (earlier known as UTI Bank), ICICI Bank and HDFC Bank. Banking sector in India, which has seen rapid growth with strong contribution from all the three sectors of banks, namely: Government banks, Private banks and Foreign banks.

HDFC Bank

Housing Development Finance Corporation Limited, more popularly known as HDFC Bank Ltd, was established in the year 1994, as a part of the liberalization of the Indian Banking Industry by Reserve Bank of India (RBI).

HDFC Bank is the first private commercial bank of India, incorporated in August 1994, after the Reserve Bank of India allowed establishing private sector banks. This Bank has 1412 branches and over 3295 ATMs, in 528 cities in India, and all branches of the bank are linked on an online real-time basis.

It was one of the first banks to receive an ‘in principle’ approval from RBI, for setting up a bank in the private sector. The bank was incorporated with the name ‘HDFC Bank Limited’, with its registered office in Mumbai. The following year, it started its operations as a Scheduled Commercial Bank.

A Bank’s main source of income is interest. A bank pays out at a lower interest rate on deposits and receives a higher interest rate on loans. It generally gives many types of loan as home loan, education loan, business loan, agriculture loan, mortgage loan, personal loan etc.

A personal loan is a kind of unsecured loan which can be used for any purpose that the borrower deems necessary. There are two kinds of personal-loans secured and
unsecured. An unsecured loan is generally offered to people that the lender considers a low credit risk.

The loan amount can be used for any purpose such as home renovation, marriage expenses, medical expenses, holidays, consumer durables, higher education etc. Personal loans are repayable in equal monthly installments (EMIs) and the loan tenure varies.

The maximum amount of personal loan for which you are eligible depends upon your take-home salary. The exact loan amount depends on your eligibility and takes into account many other things as well, like your credit rating, job security, residential location and the ability to repay the loan amount in time.

Government banks especially State bank of India charges loan interest rate on daily reducing balances while HDFC bank charges fixed approximate 12.36% interest rate. State Bank of India gives loan repayment period that is up to 48 months but HDFC Bank has flexible repayment options ranging from 12-60 months. Other than interest rate State bank of India charges 1%-2% of loan amount as processing fees where as HDFC Bank charges comparatively high processing charges that is 2%-3% of loan amount and sometimes penalties also. HDFC Bank provides speedy loan at doorstep also and it gives concession on interest rate for a privileged account holder but State Bank of India doesn’t provide this facility.

There are some limitations of both State Bank of India and HDFC Bank. They require customers minimum age-21 year, monthly income, maximum age of applicant at loan maturity is 58 years, minimum employment period is required, minimum income is required and the customer should be an Indian resident.

The banking sector also witnessed the benefits; Government took major steps in this Indian Banking Sector Reform after independence.

i. First major step in this direction was nationalization of Reserve Bank in 1949.

ii. Enactment of Banking Regulation Act in 1949

iii. Reserve Bank of India Scheduled Banks' Regulations, 1951.
iv. Nationalization of Imperial Bank of India in 1955, with extensive banking facilities on a large scale especially in rural and semi-urban areas.


These were aimed to provide banking coverage to all section of the society and every sector of the economy. The Industrial Credit and Investment Corporation of India Limited (ICICI) was incorporated at the initiative of World Bank, the Government of India and representatives of Indian industry, with the objective of creating a development financial institution for providing medium-term and long-term project financing to Indian businesses. Nationalization Process Nationalization of banks in India was an important phenomenon. Despite the provisions, control and regulations of Reserve Bank of India, banks in India except the State Bank of India or SBI, continued to be owned and operated by private persons. By the 1960s, the Indian banking industry had become an important tool to facilitate the development of the Indian economy. At the same time, it had emerged as a large employer, and a debate had ensued about the nationalization of the banking industry. Indira Gandhi, then Prime Minister of India, expressed the intention of the Government of India in the annual conference of the All India Congress Meeting in a paper entitled "Stray thoughts on Bank Nationalization." The meeting received the paper with enthusiasm. Thereafter, her move was swift and sudden. The Government of India issued an ordinance and nationalized the 14 largest commercial banks with effect from the midnight of July 19, 1969. Within two weeks of the issue of the ordinance, the Parliament passed the Banking Companies (Acquisition and Transfer of Undertaking) Bill, and it received the presidential approval on 9 August 1969. A second dose of nationalization of 6 more commercial banks followed in 1980. The stated reason for the nationalization was to give the government more control of credit delivery. With the second dose of nationalization, the Government of India controlled around 91% of the banking business of India. Later on, in the year 1993, the government merged New Bank of India with Punjab National Bank. It was the only merger between nationalized banks and resulted in the reduction of the number of nationalized banks from 20 to 19. Currently there are 27 nationalized commercial banks. Economic Liberalization The second major turning point in this phase was Economic
Liberalization in India. After Independence in 1947, India adhered to socialist policies.

In the early 1990s, the then government embarked on a policy of liberalization, licensing a small number of private banks. These came to be known as New Generation tech-savvy banks, and included Global Trust Bank (the first of such new generation banks to be set up), which later amalgamated with Oriental Bank of Commerce, Axis Bank (earlier as UTI Bank), ICICI Bank and HDFC Bank. This move, along with the rapid growth in the economy of India, revitalized the banking sector in India, which has seen rapid growth with strong contribution from all the three sectors of banks, namely, government banks, private banks and foreign banks. Currently (2007), banking in India is generally fairly mature in terms of supply, product range and reach—even though reach in rural India still remains a challenge for the private sector and foreign banks. In terms of quality of assets and capital adequacy, Indian banks are considered to have clean, strong and transparent balance sheets relative to other banks in comparable economies in its region. The Reserve Bank of India is an autonomous body, with minimal pressure from the government. The stated policy of the Bank on the Indian Rupee is to manage volatility but without any fixed exchange rate—and this has mostly been true. With the growth in the Indian economy expected to be strong for quite some time especially in its services sector— the demand for banking services, especially retail banking, mortgages and investment services are expected to be strong.

1.1.8. Personal Loan Schemes

Personal loan can be taken for any personal requirement ranging from marriage to holidaying or maybe to buy a lifestyle product or medical emergencies. The end Personal loans are unsecured loans provided by the banks and non-banking financial companies without taking any collateral security, though some banks may insist on a guarantor purpose is not important to the bank as long as it is not for speculative trading. Normally personal loan will be very helpful to the end users for their personal use and now they can easily get loan from bankers and private finance based on their eligibility like salary and business income.
Personal loan is a simple hassle free process of acquiring personal finance with minimal documentation and within quick time. The bank will require the borrower’s documents regarding the proof of identity, residence along with income proof / ITR of last 2 years to initiate the process for loan sanction. After verifying the documents and checking the borrower’s credit score with Credit Information Bureau (India) Limited commonly known as CIBIL, the bank may decide whether to approve or reject the personal loan. Normally bankers will consider whose CIBIL score is equal or more than 700.

A loan that establishes consumer credit that is granted for personal use usually unsecured and based on the borrower’s integrity and ability to pay.

Process of personal loan once the borrower is qualified for the personal loan it takes close to about three days or so to get the loan amount disburse. The personal loan repayment is in equated monthly installments and tenure can vary from 1- 5 years. It is advisable for a borrower to get in touch with as many banks as possible and get them to make loan offers to him. Then he can then try to negotiate with them and select the most cost effective option for him. The borrower will also have to take into consideration the processing fee and prepayment charges while finalizing the lender. Always remember that personal loan should be taken in dire emergency as far as possible. Being classified as unsecured loans, these loans are usually more expensive in terms of interest rate compare to any other loan taken against collateral security like gold jewelry, high surrender value insurance policies, etc.

Eligibility Personal loans are provided by various banks and non banking financial companies (NBFCs). There are various factors which affect personal loan eligibility. Below mentioned are some of the few factors which the bank or the NBFC will consider while they decide on personal loan eligibility.

Financial Background this is the most important parameter that determines if we are eligible for a personal loan and also the quantum of personal loan we are eligible for. It will help the bank understand how well we can pay back our loan. Every bank will have a minimum level of income to be eligible for a personal loan.

Credit History this will help the bank ascertain our track record for payment of EMI of any loan or the payment of the credit card bills. In case we have paid all your
previous EMIs and credit card bills on time, chances are there getting the loan is higher.

Company in which we are employed Personal loan eligibility may depend upon the company we are working for. In case our company is a public ltd or among the A class companies, which the banks call them as, the chances are there to get a loan becomes very easy. If we are working for a B class company, then getting a personal loan may be difficult for we or it may be costlier also compared to a person who is working in an A class company. Which means that if we are working for a company which belongs to the A class according to the bank, and then the personal loan rate would be comparatively lower to a person who belongs to a B class company.

Any other loans we may be holding In case we are having any other loan at the given point of time, then our eligibility for personal loan may go down as we are already paying towards EMI of the previous loan and the income in our hand would be lower compared to a case where we are not paying any EMI.

Personal loan providers in India Applying for a personal loan are quite simple these days. The personal loan market is filled with competitors, such as HDFC bank, ICICI bank, AXIS bank, SBI Personal Loan and all Public and private sector banks. Among the NBFCs Bajaj Finance Limited is playing key role. Other financiers are Fullerton India Credit Company Ltd and Shriram City Union Finance Ltd.

1.1.8.1. Types of Personal Loan: The personal loan is divided into two types; Personal Loan for Salaries class, Personal Loan for Self Employed class and Personal loan cross sell.

1.1.8.1.1. Salaried class Personal Loan: Some of the general important criteria are:

i. The applicant should get a healthy and stable income with a ration of 1:4 , i.e., if a salary of an individual is Rs.20000/- the EMI should not cross Rs.5000/-.

ii. The applicant should be not less than 21 years and 60 years of age.

iii. Few of the financial institution lend to their own exiting customer, who are having good track record with them.

iv. The residing stability is also an important factor. For rented class, 6 months to 1 year residence stability is sufficient.
v. Apart from this all the KYC documents, such as ID proof, address proof, bank statement etc., should satisfy the financier.

1.1.8.1.2. Self employed class Personal Loan: Some of the general important criteria are:

i. The applicant should not less than 21 years and should not cross 65 years of age at the time of completing the loan.

ii. The banking transaction should be healthy and indeed should have no returns.

iii. To understand the stability of the business the business RC is also mandate.

iv. Few of the financial institution also ask for the latest income tax return copy, the Profit & Loss and Balance Sheet, to understand the cash flow of the applicant.

1.1.8.1.3. Personal Loan Cross Sell: Some of the general important criteria are: Bajaj Finance Limited is playing major role in this segment in all over India. Who are existing customers in bajaj could be offered for this loan as pre approved loan. Customer is required to submit only KYC documents like address proof, ID proof and photograph. They need not to submit any other papers.

1.2. Conceptual Framework of Study

1.2.1. Loan Schemes of Banks

Customers can avoid high rate of interest and compare with other banks and financiers rate during loan availing time.

Prevention is better than cure. So customers need to honor their EMI cheques on time. Otherwise they can face some difficult situation with bankers and finance. In future they can not avail any loan with bankers and finance if they do not repay the amount on time.

End users can think about their repaying capacity. They can calculate their personal loan EMI at 1:4 calculations and this will be very useful to them for prompt repayment.
Bankers and finance can provide prompt repayment rebate to the customers and this will be a good encouragement to the customers for their repayment.

CIBIL is an important tool to the bankers for determining about their loan sanctioning. So customer need to maintain their credit record with all the bankers and financiers as good one.

1.2.1.1. Service Quality

Increased competition, highly educated consumers, and increase in standard of living are forcing many businesses to review their customer service more efforts to retain existing customer rather than to acquire new ones since the cost of acquiring new customer is greater than cost of retaining existing customer.

There is enough evidence that demonstrates the strategies benefits of quality in contributing to market share and return on investment. Customer is vital for the development of trade, industry and service sector particularly in financial services. Therefore, the significant of customer service in the banking sector came to force to compete in a market driven environment. Measuring service quality in the service sector particularly in the banking sector is more difficult than measuring the quality of manufactured goods.

1.2.1.2. Customer Service

Customer service has great significance in the banking industry. The banking system in India today has perhaps the largest outreach for delivery of financial services and is also serving as an important conduit for delivery of financial services. While the coverage has been expanding day by day, the quality and content of dispensation of customer service has come under tremendous pressure mainly owing to the failure to handle the soaring demands and expectations of the customers

1.2.1.3. Satisfaction

Banks and credit unions both received high marks for their customer service at branches and for online banking. However, customers gave a failing grade to the competitiveness of bank interest rates, while credit union customers find the lack of convenient ATMs and branches to be the most troublesome aspect of the experience.
1.2.1.4. Products

Banks and credit unions can provide a safe and convenient way to accumulate savings—and some banks offer services that can help you manage your money. Deposits at banks and credit unions are federally insured up to a limit set by Congress.

1.2.1.4. Loan-associated factors General

1.2.1.4.1. Installments

The amount to be paid on loan final due date which includes: the principle and interest of the last installment and the difference amount the shortfalls of the previous monthly principles. The last installment is normally higher than the monthly installment

1.2.1.4.2. Insurance/Guarantees

Bank guarantees function as a form of insurance for a third party who has a contractual relationship with one of the bank's customers. This is best demonstrated with an example. Suppose a private contractor is negotiating a job with a municipal government to construct a project. The government has never dealt with this particular contractor before and is leery of assuming the risk of working with a new entity.

The government might only accept the contractor's bid on the condition that the contractor receives a guarantee from his bank. The guarantee states that, in the event of default on the contract by the contractor, the bank will agree to pay a sum of money to the government. In this case, the government is the beneficiary of the guarantee.

1.2.1.4.3. Interest Rates

It is defined as the proportion of an amount loaned which a lender charges as interest to the borrower, normally expressed as an annual percentage. It is the rate a bank or other lender charges to borrow its money, or the rate a bank pays its savers for keeping money in an account.

1.3. Statement of Problems

Despite the rapid growth and broadening of microfinance and the financial sector at large, in the past few years, it is estimated that over three billion people globally still
lack access to a broad range of financial products and services on a sustainable basis. The situation is particularly dire in sub-Saharan Africa, where over 90% of the population are excluded from access to financial services from the formal financial system (United Nations, 2007). Agent banking is a new concept for commercial banks in Kenya and hence the study of innovation adoption. Although agent banking is gaining a lot of interest from the banking industry, it has not received a lot of attention from scholars. There are limited studies that have been done to highlight the factors that influence agent banking adoption among commercial banks. For instance, Mitchell (1995) established that extensive use of emergent banking delivery channels have made banking services convenient to bank customers. Kumar et al. (2006) explored expansion of the bank outreach through correspondent banking in Brazil. Similarly, Hernandez-Coss (2009), explored the impact of introducing banking agents in Mexico. Despite these studies having been conducted in developing countries, the findings may not be applicable in Kenya owing to certain environmental differences. A good number of studies have been done on various aspects in the banking sector in Kenya. Examples of these studies include Ali (2008), Otunya (2006), Kisia (2006), Kisingu (2007), and Kinuthia (2008). Ali (2008), determined the strategic issue management practiced by commercial banks in Kenya, whereas Otunya (2006), surveyed consumer adoption of mobile phone banking in Kenya, and Kisia (2006) determined factors affecting provision of services by commercial banks in Kenya to international business. Given the novelty of agent banking in Kenya, there has been no research study in this topic, yet as at December 2010, Central Bank of Kenya had approved over eight thousand (8,000) applications for retail agents by various commercial banks (Central Bank of Kenya, 2010).

One way to tackle the loan repayment problem is to investigate the factors which affect the loan repayment of MFIs., (Onyeagocha et al., 2012) although loan repayment is determined by willingness, ability and other characteristics of the borrowers; businesses characteristics and characteristics of the lending institutions including product designs and suitability of their products to borrowers. Regarding the characteristics of borrowers, repayment of loans depends on the willingness and ability of the borrowers to repay. Therefore, individual borrowers can either repay their loans or choose to default. It is also true that the factors influencing loan repayment capacity among borrowers are not only likely to differ by programs but
also differ from country to country depending on the domestic business and economic environment (Tundui and Tundui, 2013).

Sidama Micro financing institution (SMFI) is one of major micro financing institutions of Ethiopia working to provide credit and saving services to urban and rural poor who do not have access to financial services from formal banks in Sidama Zone. However, to outreach large number of poor and lift themselves out from poverty, the numbers of defaulters have been challenging the institution’s social as well as financial objectives by retaining large amount of loan, as a result this hinder it not to combat to ward poverty reduction strategy and its realization of sustainability by diminishing loan repayment rate. Therefore, to alleviate aforementioned problems the researcher intended to study major socio- economic factors and loan related factors that determines loan repayment performance of borrowers in SMFI

1.4. Significance of the Study

Firstly, the study will assist commercial banks in Kenya identify and monitor the factors influencing agent banking adoption. Those factors relating to institution’s ability to provide the conditions conducive to the introduction and acceptance of innovations could be used to map out an institutional framework for adoption. The research findings will help in monitoring development and growth of agent banking. Secondly, the research will help suggest possible solutions and strategies to the problems in agent banking. Thirdly, the study will contribute to the body of knowledge and to adding information on the banking industry.