CHAPTER – 3

BANKING SYSTEM IN INDIA

3.1 Evolution of Banking

Banking is as old as the authentic history and the origins of modern commercial banking are traceable to ancient times. In ancient Greece around 2000 BC, the famous temples of Ephesus, Delphi and Olympia were used as depositories for people's surplus funds and these temples were the centers of money lending transactions.

The word "Bank" is said to be of Germanic origin, cognate with the French word "Banque" and the Italian word "Banca" both meaning "Bench". It is referred to a bench for keeping, lending and exchanging of money or coins in the market place by money lenders and money changers.

The Bank of Venice, founded in 1157 was the first public banking institutions. Following its establishment, were established the Bank of Barcelona in 1401 and Bank of Genoa in 1407 respectively. The Bank of Venice and the Bank of Genoa continued to operate successfully until the end of the 18th century. But the modern banking began with the English goldsmiths only after 1640. The Bank of England started its business in 1694 with a view to finance the government, to carry on its war with the neighbouring countries.

3.2 Definition

i) According to Sec.5(b) of the Banking Regulation Act, 1949, the term *"Banking means accepting for the purpose of lending or investment of deposits of money received from the public repayable on demand or otherwise and withdrawable by cheque, draft, order or otherwise"*[1].

ii) According to the Banking Regulation Act, 1949, a *"Banker" is the one who is engaged in the business of accepting deposits from the public and utilizing such deposits either for the purpose of lending or for the purpose of investment*[2].

iii) According to David Ricardo, *"Bank" is a dealer or transactor of money. They are the financial intermediaries collecting "deposits" and lending "loans"* [3].

3.3 Historical Context of Indian Banking Sector

Banking existed in India in one form or the other from times immemorial. The ancient Hindu scriptures refer the money lending activities in the Vedic period. During the Ramayana and Mahabharatha eras, banking need became a full-fledged business activity and during the Smriti period which followed the Vedic period and epic age the business of banking was carried on by the members of the Vaish community. Manu, the great law-giver of the time, speaks of the earning of interest as "the business of Vysyas".

The banker in the Smriti period performed most of those functions which banks perform in modern times, such as; accepting of deposits, granting secured and unsecured loans, acting as their customers baille, granting loan to kings in times of grave crisis, acting as the treasurer and banker to the state and issuing and managing the currency of the country.

During the Moghul period, 'metallic' money was issued and the indigenous bankers played a very important role in lending money and financing trade and commerce. Modern banking started in India only from the beginning of 19th century. The earliest commercial banks were started in India by the employees of the East India Company. These banks were known as 'Agency Houses'. They were mainly trading concerns which combined banking business with other activities, such as; trading & speculation.

The first joint stock bank to be setup in India was Bank of Hindustan in the year 1770. The others which followed were Bank of Bengal established in 1806, Bank of Bombay in 1840 and the Bank of Madras in 1843. These banks were established with the financial participation of the government. So, they were called 'the Presidency Banks'. They continued till 1921 when they were amalgamated and converted into the Imperial Bank of India.

The first purely Indian Joint Stock Bank to be established in the country was 'The Oudh Commercial Bank', established in the year 1889. Later it was followed by the establishment of Punjab National Bank in 1894 and People's Bank in 1901. The Indian banking system had to pass through a series of crisis and its growth was very slow during the first half of the 20th century. It is only after the independence, the Indian banking system has made rapid progress and today the Indian banking system is one of the well developed banking systems in the world.

3.4 Banking in Independent India

The Banking Regulations Act was passed in the year 1949, which provided a frame work for regulation and supervision of commercial banking activity. This regulation brought RBI, an Apex Bank under Government control. Under this act, RBI got wide ranging powers for supervision and control of banks. The act also vested licensing powers and the authority to conduct inspections.

The first step towards the nationalization of commercial banks was the result of a report in the year 1951 by the committee of direction of All India Rural Credit Survey, which recommended setting-up a strong integrated state owned commercial banking institution to stimulate banking development, in general and rural credit in particular. Thus, the Imperial Bank of India was taken over by the Government of India and renamed as State Bank of India (SBI) in the year 1955 with the RBI acquiring majority of the shares. A number of erstwhile banks owned by princely states were made subsidiaries of SBI in the year 1959. In the year 1960, RBI was empowered to force compulsory merger of weak banks with the strong ones and the total number of banks was thus reduced from 566 in 1951 to 85 in 1969.

3.5 Nationalization of Banks

The Indian banking system made a considerable progress in 1950's and 1960's, it established close links between commercial banks and industrial houses, resulting in cornering of bank credit to other sectors such as; agriculture and small scale industries. Functionally the banks catered only to the needs of organized industrial and trading sectors and neglected the primary sector such as; agriculture, forestry and fishing, which formed more than 50% of GDP and had to depend largely on own financing and on sources outside the commercial banks. It is against this backdrop that the process of financial development was given impetus with the adoption of the policy of social control over banks in 1967.

The GOI, in the year 1969, nationalized 14 banks having an aggregate deposit of Rs.50 crores or more and subsequently in the year 1980 the government took over 6 more scheduled commercial banks with deposits of Rs.200 crore and above. The sole objective was “to serve better the needs of development of the economy, in conformity with National Priorities and objectives”.

3.6 Structure of the Indian Banking System

The Indian banking structure comprises a heterogeneous mass covering a wide spectrum ranging from the unorganized indigenous bankers at the one end to the foreign banks at the other.

The Indian banking structure has at the apex the RBI entrusted with the responsibility for the formulation and implementation of the monitory policies of the country, regulating the banking sector, issuing and managing currency, purchasing and selling of government securities, and managing the foreign exchange position of the country.

The Reserve Bank derives its powers from the RBI Act of 1935 and the Banking Regulation Act, 1949. It performs the same functions as central banks do all over the world. But the RBI has taken developmental function also. Under this, it is responsible for institutionalizing of the vast savings of the country, through spread of banking habits and banking infrastructure. RBI is also supposed to help in a rapid industrialization through developmental organization set up for the purpose like the IDBI, IFCI, so on. It also overseas the agricultural development is not stifled for want of credit and has, for the purpose, set up National Agricultural Board for Rural Development (NABARD).

Having RBI at the apex, the banks in Indian Banking System are classified into two categories as shown in the fig.3.1.

Indian Banking Structure

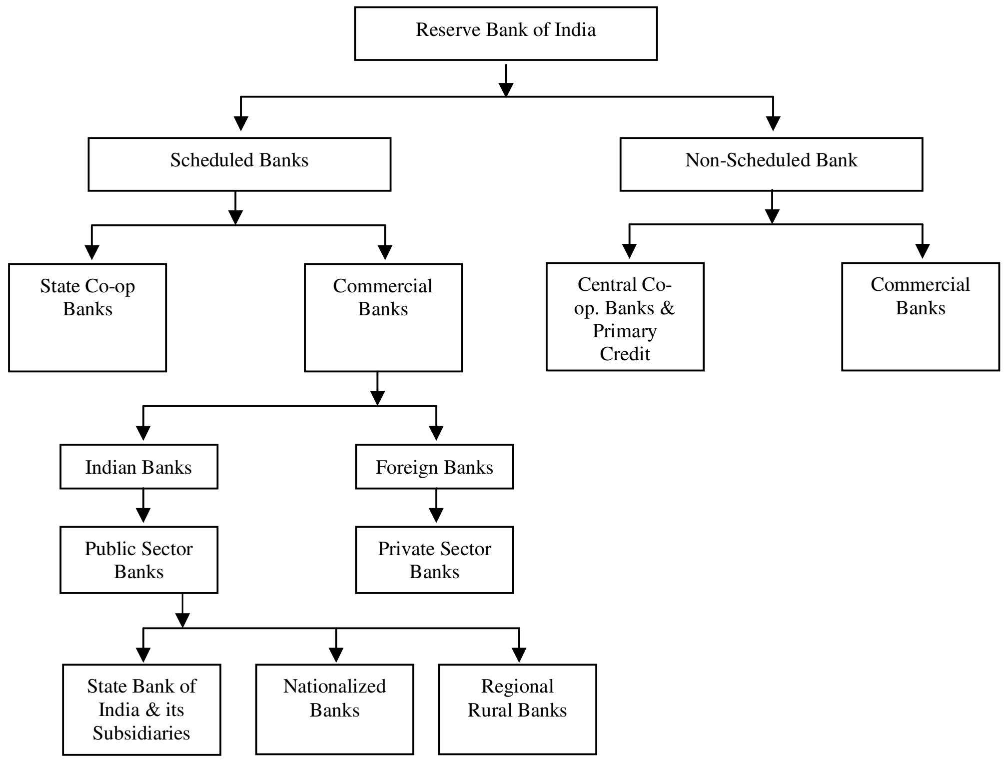

Fig. 3.1 Indian Banking Structure

Scheduled Banks

The Scheduled Banks are those which are included in the second schedule of RBI Act, 1935, others are non-scheduled banks. The state co-operative banks also come under the category of scheduled banks. To be included in the second schedule a bank (a) must have a paid up capital and reserves of not less than Rs.5 lakhs, (b) it must also satisfy the RBI that its affairs are not conducted in a manner detrimental to the interests of its depositors. Scheduled banks are required to maintain a certain amount of results with the RBI. They enjoy the facility of financial accommodation and remittance facilities at a concessional rates from the RBI.

Non Scheduled Banks

The Non-Scheduled banks are those joint stock banks that are not listed in the second schedule to the RBI Act, in 1939, i.e., when the RBI Act had been around for four years, there were about 1500 joint stock banks in the country of which as many as about 1400 were unscheduled. However, now the number has come down and the volume of their business is negligible small. The other unscheduled banks have since either closed down or merged with other scheduled banks, or converted themselves into non-banking companies.

Public Sector Banks

The Public Sector Banks (PSB) comprises of;

1) The State Bank Group
2) Nationalized Banks and
3) Regional Rural Banks.

The State Bank Group

The State Bank Group comprises of State Bank of India and its seven associates, viz.;

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

The State Bank of India is unique among the public sector banks on two accounts;

1) The bank was mandated by the governing act to extend banking facilities on a large scale and more particularly to rural and semi-urban areas.
2) The bank has traditionally conducted the treasury operations on behalf of the central and state governments and has, therefore, had a close relationship with the government departments and undertakings.

The Nationalized Banks Group originally comprised 20 banks of which 14 were nationalized in 1969 and 6 in 1980 and one of them – the New Bank of India, was later merged with Punjab National Bank. Thus 27 banks constitute public sector in Indian Commercial Banking. With these two rounds of nationalization and State Bank of India, being already in the ownership of the RBI to the extent of its equity, the organized banking sector has come in the government control. The nationalization of banks was done with a view to serving better the developmental needs of all sectors of the economy in consonance with the national policies and priorities. The broad aim got translated into spreading of banking areas, increased mobilization of savings, removal of regional disparities and channelizing credit into the weaker sections of the society.

Regional Rural Banks

Regional Rural Banks are an institution unique to our country. They came into existence on 2nd October, 1976. The need for these banks was felt because despite the existence of co-operative banks over last several decades and the progress recorded by the commercial banks since their nationalization, there still exists, a vast gap in supply of credit to the rural areas. RRBs were established to operate exclusively in rural areas to provide credit to small farmers, agricultural labourers, artisans, and small entrepreneurs. These banks are governed by the RRB Act, 1976. Each of them was formed with an authorized capital of Rs.1 Crore and an initial paid up capital of Rs.25 Lakhs contributed by the sponsor bank of each RRB, the state government, and the central government. These rural banks are supposed to have one or two districts as their area of operation and are expected to have branches upto a number of 100 although many RRBs have long since cross that number by a wide margin.

Private Sector Commercial Banks

The Private Sector Commercial Banks comprise the unscheduled joint stock banks as well as some of the schedule banks. However, with two rounds of nationalization and several rounds of mergers and closures there number has come down significantly. Even in terms of importance by way of spread of network and magnitude of business, this group has since been marginalized.

After the nationalization of banks, new banks in the private sector could not be setup in India, though there was no legal bar to that effect. The Narasimham Committee on financial sector recommended the establishment of such banks in India. The RBI therefore issued guidelines for setting-up of new private sector banks in India in January, 1993. These guidelines aimed at ensuring that the new banks are financially viable and technologically upto date from the start. They are expected to start functioning in a professional manner so as to improve the image of commercial banking system and to win the confidence of the depositing public.

The new banks shall be governed by the provisions of RBI Act, Banking Regulation Act, and other relevant statutes and shall follow all the directions, instructions, guidelines and advises given by the Reserve Bank. The private sector banks that have been established so far are; IDBI, ICICI, Axis Bank, to name a few.

Local Area Banks

In 1996, government decided to allow new local area banks with the twin objectives of; a) providing an institutional mechanism for promoting rural and semi-urban savings and b) for providing credit for viable economic activities in the local areas.

These banks will be established as public limited companies in the private sector and will be promoted by the individuals, companies, trusts, and societies. The minimum paid up capital of such banks to be Rs.5 crores with promoters contribution of atleast Rs.2 crore. They are expected to be setup in district towns and the area of their operation would be a maximum of three geographically contiguous districts where they can open their branches. A few local area banks have already been allowed to be setup.

Co-operative Banks

The Co-operative credit structure in India for short and medium term loans is a three tier federal structure. At the apex in each state is a State Co-operative Bank (SCB), at the district levels are the District Central Co-Operative Banks (DCC), and at the base are the primary credit societies, agricultural credit societies in village and urban co-operative banks and credit societies of the structure only the state co-operative banks figure in the second schedule of the RBI Act and hence have the status of scheduled banks. The co-operative banks at the state level and at the district level perform the usual banking functions although the credit societies are only what their nomenclature suggests.

Foreign Banks

The Foreign Banks include the branches in India of those banks which are incorporated abroad. Opening of branches in India of these foreign banks is largely by lateral matter with that country although the RBI remains the licensing authority.

These foreign banks operate in India mainly from the Metropolitan cities and maintain a strong profile in banking business related to foreign trade. Of late, however, many of these foreign banks have also started making forays into the retail personal banking segment in the country.

Development Banks

The Development Banks do not perform the banking business as per the legal definition of the word, but as far as the meeting of credit requirements of the large and medium industrial sector in the country is concerned, they have a pivotal role. Some of the more important development banks in the country are; Industrial Development Bank of India (IDBI), Industrial Finance Corporation of India (IFCI), Industrial Credit and Investment Corporation of India (ICICI), the various State Financial Corporation (SFCs), the Industrial Investment Bank of India (IIBI), and so on. Of this, only the ICICI is in the private sector. All these development banks are expected to meet the long and medium term credit needs for fixed capital of the large and medium sector industries. However, IDBI also supports the small scale sectors indirectly by way of its refinance and bills rediscounting schemes, and acts as an apex development bank.

3.7 Reformation of Indian Banking System

The banking sector plays a crucial role in the economic development of a nation. A sound, efficient, effective, vibrant and innovative banking system stimulates economic growth by mobilizing savings on a massive scale and efficiently allocating resources for productive as well as consumption purposes.

Indian banking witnessed a remarkable transformation consequent to the implementation of banking sector reforms since early 90s. The banking sector reforms included progressive reduction of statutory liquidity ratio (SLR) and cash reserve ratio (CRR); prescription of uniform accounting norms with regard to classification of assets, enactment of a statute providing for setting-up of tribunals for expeditious adjudication and recovery of bank loans; establishment of separate board for financial supervision of banks; permission for the entry of new private banks to inject competition; rationalization and deregulation of interest rates; implementation of capital adequacy norms; recapitalization of banks; permission to banks to access capital market for mobilizing additional equity; liberalized new branch licensing and new bank licensing policy.

Worldwide financial systems have undergone structural changes. The global factors driving these changes have been advancements in technology and computing, external financial liberalization and organizational changes in corporate world. Banking and finance in emerging economies has been no exception. But the structural shifts in these economies have been motivated by their country's specific factors also including macro economic pressures, disintermediation pressures and banking crisis of 1990's. These developments have been instrumental in formation of a 'Global Village' making the dividing line between financial products, type of financial institutions and their geographical location as irrelevant.

Globalization of banking operations and expansion of financial activities as a result of technology advancements, in an increasingly market driven environment have redefined the business models and changed the way the banks use to do the banking business. The banking industry has virtually seen a shift from brick and mortar banking to banking virtually across time zones, geographical reach and alternatively delivery channels.

3.8 Classification of Reforms

The banking sector reforms can be classified into 6 categories; viz., a) measures meant for promotion of competition, b) measures meant for strengthening the role of the market, c) prudential measures, d) legal measures, e) measures meant for strengthening supervision or supervisory controls and f) measures relating to technology. Some of these measures meant for strengthening competition included grant of limited operational autonomy to public sector banks (PSB); dilution of government stake in the equity of PSBs permitting them to mobilize capital from the open market; adoption of transparent licensing policy enabling the entry of private sector, foreign and joint venture banks; permitting foreign direct investment (FDI) in the financial sector as well as permitting portfolio investment; issue of guidelines on ownership and governance in private sector banks. Measures initiated to strengthen the role of market forces included progressive reduction in SLR and CRR, market determined pricing of government securities, deregulation of interest rates. Prudential measures which have been implemented covered fulfillment of capital adequacy norms; and new accounting, income recognition, provision and exposure norms. Measures initiated to strengthen risk management included assignment of risk weights to different categories of assets, norms on connected lending, credit concentration norms, application of marked – to – market principle for investment portfolio and fixation of limits for deployment of funds in sensitive factors and activities.

In addition, know your customer (KYC) guidelines, anti-money laundering (AML) standards, introduction of capital charge for market risk, high graded provisioning for non-performing assets (NPA), were adopted for implementation. Institutional and legal measures introduced for improving banks performance in the area of recovery and for asset quality up gradation included setting-up Lok Adalats, Debt Recovery Tribunals (DRT), Asset Reconstruction Companies (ARC), Settlement Advisory Committees (SAC), Corporate Debt Restructuring Mechanism. Enactment of securitization and reconstruction of financial assets and enforcement of security interest act (Sarfaesi Act) was another important mile stone in reforms. Setting-up Credit Information Bureau (India) Ltd., (CIBL) for sharing credit information and establishment of the Clearing Corporation of India Ltd, (CCIL) to act as central counter party for facilitating payments and settlement systems relating to fixed income securities and money market instruments extended support to banks.

Certain supervisory measures such as establishment of a separate board for financial supervision in RBI, recasting the role of statutory auditors and increased internal control through strengthening of internal audit, strengthening of corporate governance may also initiated. The technology related measures included setting-up of INdian FInancial NET work (INFINET) as the communication backbone for the financial sector, introduction of negotiated delink system for screen based trading in the government securities and implementation of real time gross settlement (RTGS) system.

The Indian economy has recently been exhibiting signs of staying ahead of global activity. Some signs cyclical recovery are currently evident, further, rapid globalization an increased competitiveness have forced a significant impact on banking innovations and their functioning in a diversified ways.

3.9 Innovation in Banking

Innovation means the introduction or application of something new – either new goods and services or new ways of reducing them. Innovation differs from invention in essential respect. An invention is the discovery of something new, whereas an innovation is the actual introduction or application of something new. Entrepreneurs and producers must innovate and adopt new methods and ideas to increase their productive capacity and improve working conditions, thereby raising productions and consequently the national income. Innovation is, therefore, an important factor responsible for a countries economic development.

Innovations in banking have become the order of the day and the concept of the bank a mere manager of liquidity belongs to the past. New services, both credit and non-credit one's have been introduced and existing services developed by banks throughout the world as they meet increasing competition for business from within the banking industry and from without, fill-up in their range of services to steal a march over their competitors by endeavoring to satisfy the needs of their present and potential customers demanding more flexible, advantageously priced and comprehensive facilities. Apart from selective introduction of modern technology to speed up, banking operations require an increasing degree of sophistication, there will be changes in the composition of banking business reflecting the changes is occurring in trade and industry. The banks, the world over, are becoming financial supermarkets in which a wide variety of services can be purchased and often conduct business that do not always resemble banking.

Many significant changes are taking place in our country in response to changes in national and international economic environment. These changes have also affected the financial sector and are forcing it to move towards a deregulated and more competitive environment. A marked future of the financial system in the decade of 1980's has been changes which have occurred in the institutional frame work and financial instruments. When viewed in historical context, such has been the pace of change which has occurred in the financial systems of developed countries and more particularly in the United Kingdom (UK)and United States of America (USA) in the last two decades and particularly in the recent years that it frequently referred to as constituting a "Revolution of Financial Services". Whether this description is an appropriate one is a matter on which opinions differ, but nevertheless, observers of the financial system have identified a number of major interlocking trends which have changed and are changing the institutions characteristics of the financial system.

Simultaneously, the trends towards the diversification by banks abroad, particularly by those banks which have branches in India and are trying to introduce innovations in their business activities in India so as to enable them to have a higher market share, in evitable had its impact on Indian banks. The demand for diversified financial services and banking innovations was also created by the structural changes that have taken place in the Indian economic over the last decade as shown below;

1. The share of primary and secondary vectors in national income declined and the share of service sector increased;
2. The salaried middle class has risen fast and they are in need of financial assets with higher income growth potential than usual commercial bank deposits;
3. The strategy of accelerating the pace of development has been undertaken by giving an impetus to increased consumption of industrial products through tax concessions and other means; and
4. The industrial growth appears to be largely anchored to the consumption needs of urban middle class, which has emerged with much potential demand for variety of financial services.

The process of disintermediation is part of the process of meeting the financial asset needs of the customers coming from the urban middle class. Many of the financial services offered by banks are oriented towards this class of customers. Diversification in this direction will be largely successful because here banks with their urban orientation in their home ground. Moreover, following the example of international banks, many Indian banks have tried to shift from traditional business to fee producing business as a step towards their efforts to innovate, adopt new market strategies and diversify.

3.10 Innovative Financial Services

The eighties have been years of exciting and progressive change in the banking business. Emerging from disintermediation process that has set in and consequential diversification being resorted to by banks in India in a big way.

Pursuant to this, certain new non-conventional and sophisticated services, based on customer conveniences and preferences, have been added to the banking arena. Significant among those are housing finance, hire purchase, leasing, factoring, merchant banking, mutual funds, consumer loans and venture capital finance, being provided by banks on their own or through subsidiaries setup exclusively to look after and manage these new areas of business. Some of these activities were there earlier to, but they have got a major fillip with more entrants into the business due to increased opportunities perceived or with certain liberalization measures in these lines of activities.

Apart from the above, the banking institutions are experiencing computer revolution and many other important innovations such as introduction of new financial instruments like certificates of deposits, commercial paper, participation certificates and cheques and credit cards, to cope with the emergent competitive environment. Besides, investment management including investment counseling and tax services are also evolving innovative packages to meet consumer demands.

Further, in view of the growing equity culture in the economy, banks have become active in distributing stocks and shares, debentures and bonds even with their own depositories. The corporate sector companies are branching out, as finance companies have undertaken a vast array of financial services. Several banks have expanded their overseas operation and they have undertaken financing the import – export business of their clients in a professional manner, many times competing with large international banks.

The international banking scene has undergone drastic changes, with the introduction of computer and telecommunication technology, which have lead to geographical and financial integration of international financial market in recent years. International banks have diversified their business into capital market operations since new profit opportunities have been noticed in this field. Responding to these changes in the international environments, the banking institutions in India have also been trying to diversify in such areas as consumer credit, credit cards and travelers cheques. It is however felt that institutions should not aim at something which is not their competence and that overseas bank offices should be used more as centers for information for exports.

The reforms made significant impact on banks and their functioning. The major areas of transformation in Indian banking are as follows;

Retail Loans

Retail loans are comparatively high yielding and safer, as risk is diversified among a large number of separate individuals, located across the geographic dimensions as wide as the network of bank branches. Besides this, retail loan offer handsome miscellaneous income by way of up-front fees against corporate loans. Retailing also offers further opportunities to cross-sell various other retail products like credit cards, insurance products, mutual funds and demat facilities to the depositors.

In the recent past, the banks, irrespective of their size, have been increasingly focusing on retail segment for both, resource mobilization and lending. The retail market or banking, which was the strong hold of non-banking financial institutions has now attracted to the attention of banks, including nationalized banks. Now, realizing the importance and also the necessity, banks in India are busy evolving strategies to tap the emerging retail banking market.

Concept of Retail Banking

Retail Banking is about providing banking services to individuals and joint individuals as opposed to whole sale banking, which focuses on industry and institutional clients. The concept of retail banking is not new to the banks. Retail banking is now being viewed as an attractive market segment, which offers opportunities for growth with profits. It is only in the recent times, that it has attracted special attention of the banks as a solution to some of their immediate concerns. The essence of retail banking lies in individual customers, while retail banking and retail lending are often used synonymously, but as a matter of fact, the latter is just one side of the retail banking. In retail banking, all the banking needs of the individual customers are taken care of in an integrated manner. Though retail banking encompasses all types of individual customers, often banks tend to focus on high net worth individuals. Retail banking portfolio encompasses deposits and asset-linked products as well as other financial services offered to individuals for personal consumptions.

3.11 Retail Banking Products & Services

Though a wide ranging of retail banking products and services are being offered by banks which cover both the deposits and the advances, major products offered under retail lending to suit various segments of customers like salaried persons, businessmen, traders, professionals, technocrats, pensioners, labourers are; housing loans, personal loans, educational loans, vehicle loans, loan for consumer goods, credit and debit cards, global & international cards, loans for holidays, insurance products, gold loans, and event loans.

Retail banking products for depositories in various segments, like children, house-wives, salaried class, professionals, technologists, pensioners, include; Flexi Deposit Accounts, Savings Bank Accounts, Recurring Deposits Account, Other Short Term deposits.

Thus, the banks are offering all the life-cycle products under their ‘Cradle to Grave” strategy to take care of all the credit needs of individuals.

Banks are coming out with more and more features to add value to retail banking products and services. Few value added services being offered by banks are;

a) Free collection of specified number of outstation instruments per month.
b) Instant credit of outstation cheques.
c) Concession in commission or exchange for issuance of pay orders of demand drafts.
d) Issuance of free cheque books.
e) Issuance of free ATM cards.
f) Waiver of credit care issuance fees.
g) Issuance of free-add on cards to members of the card holders family.
h) Execution of a standing instructions of customers.
i) Free investment advisory services.

Other Retail Banking Services offered by Banks include,

j) Payment of utility bills like electricity, telephone & water bills on due dates.
k) Payment of monthly, quarterly, half yearly education fee of children.
l) Payment of insurance premium on due dates.
m) Demating of shares, debentures & bonds.

n) Selling of insurance products

o) Housing finance.

Micro Financing

Micro financing is being practiced world over to combat the menace of poverty. In India it has become well accepted. There are numerous variants of micro finance as prevalent in the country today. These may differ in modalities, but the basic premise on which they work to offer financial services to the poor who have been unorganized and neglected by the financial sector. One of the systems, that is been widely adopted is the linkage through Self Help Groups (SHGs). In fact, a large number of developing nations have tried this approach for poverty amelioration. Micro financing is a tool to empower the poorest, particularly village women, by improving their lot through micro finance. Its design is quite inspiring and recovery rate is almost cent-percent. Emboldened by the success of NABARDs experiment of linking SHGs and also that of various financial institutions in other developing countries the banking sector in India adopted SHG concept.

Credit – Debit Cards

Credit cards are an easy method To Buy Now and Pay Later. The credit card is a double aged tool which enables one to pay for purchases with the card instead of paying cash on the spot. Thus they are extremely convenient as they can do away with the necessity of carrying large sums of cash around. Further, the card becomes handy when a person on tour finds that he has run out of cash but has to pay a bill incurred which can be defrayed by using the credit card. Another feature of the usage of the card is that the risk of loss of money is totally absent and the card, even if lost, can be obtained again, provided it is intimated to the issuer immediately. If one is trapped for cash, he can withdraw money at specified branches of the bank upto a specified monthly limit. Thus, we find that credit card takes care of liquidity problem of individuals. It is a tool at hands of its holders to tide over a budget deficit for a short period of time.

Debit Cards, on the other hand do not allow credit. The account usually debited immediately or on the same day when the card has been used to draw money are make purchases. No credit period is allowed.

3.12 Technological Development

Technology has transformed the global world of banking and financial services beyond recognition. No other industry offers more complex challenges and more exciting opportunities. Technological initiative spans retail and wholesale banking, lending solutions, payment systems, mortgages, securities, fund management, straight-through-processing, risk management, compliance, as well as messaging systems, which will benefit the customer in the banking sector. Computerization of the business of banks has been receiving high importance. The banking institutions have already crossed 70% level of computerization of their business. The directive from the Central Vigilance Commission (CVC) to achieve 100% computerization has resulted in renewed vigour towards computerization of branches.

Networking has been receiving focused attention by banks. This activity is also being monitored by the reserve bank. Most banks have their own corporate networks to facilitate inter branch and branch controlling office communication in an electronic mode. Inter-Bank and Inter-City communication takes place through the Indian Financial Network (INFINET). As part of the INFINET, the terrestrial lines have been augmented to provide for increased data transfer capabilities. All these have resulted in the dependence of bank on network based computing which has benefitted the customer. INFINET also provides for safe and secure transmission of electronic messages with the use of Public Key Infrastructure (PKI) which has the legal backing of Information Technology Act, 2000. It also provides for messages to flow in a structured environment, using SFMS, which provides for inter operability of messages so that Straight Through Processing (STP) is achieved.

ATM

Automated Teller Machines are increasingly providing functionalities that take away the routine teller functions and are an effective personalized secure customer information and cross-sell channel. With the RBI working towards the implementation of the cheque truncation initiative, this deposit module will facilitate faster cheque processing as the scanned image of the cheque and directly be sent for clearing with the ATM being the point of deposit and truncation. This will facilitate faster access to funds for consumers as well as cost and operational efficiencies for the banks.

Mobility in Banking

Mobile phone banking takes one step ahead of internet and tele-banking. The customer can do a banking activity, without even making a phone call. The most obvious advantage of mobile phone banking over tele-banking and internet banking is that it is truly “Any Time Any Where Banking”.

There are broadly two types of services that a customer could avail through mobile phone.

a) Alert Services – Alert services helps a customer keep a track of the activity on his accounts and

b) Requests – Allows a customer call for information pertaining to his bank accounts and transactions.

The mobile banking works through a set of text messages. The use of mobile phones in the country has become a revolutionary, therefore it is no surprise, that banks are offering services over mobile phones, as part of their tech banking initiatives.

Bank on the Net

Internet banking has become a necessity in today’s busy life styles. Using this mode to transact, saves precious time and effort.

From across the seven seas, as long as the customer has an access to the internet, he can have an access to his bank. Internet banking allows a customer to conduct a plethora of banking activities using the net. The best part about internet banking is the convenience offered along with total confidentiality and safety. The virtual ease with which a customer can bank today is reassuring.

Fund Transfers

Internet banking or online banking allows a customer to transfer funds from one account to another, across branches and cities. Some banking institutions have gone one step ahead by offering the customers the facility to transfer money from his account to that off any person with an account at the same bank or any bank, any time and from anywhere. All that the customer has to do is submit a signed declaration stating that he wants to access this facility.

Fixed Deposits and Demand Drafts

As part of internet banking activities, a majority of banks allow the customers to create a new fixed deposit. The customer is simply required to fill in the details of the bank account from which he wishes to transfer funds, the amount and duration of the deposit. The bank will do the rest and transfer the interest and maturity amount back to the account from which the customer has deposited. A number of banks are willing to issue demand drafts from the customer's account, once he provides them with the details of the amount, location and beneficiary over the net.

Pay Utility Bills

The customers can now even pay telephone, mobile and electricity bills over the net. However, some banks limit the facilities like these and creation of new fixed deposits and demand drafts requests to regular banking hours. In case, the customer puts in the request after banking hours, the bank promptly executes it on the next working day. So it is definitely better than standing in queues at utility offices or banking premises on a working day.

3.13 Other Banking Activities

Banks are also innovating on the company and treasury operations fronts. Mumbai International Bank (MIBOR) linked and commercial paper linked interest on loans are common. MIBOR is a reference rate arrived at every day at 4.00 pm by Reuters. It is the weighted average rate of call money business transacted by 22 institutions, including banks, primary dealers and financial institutions.

Wealth Management

Banks have begun to recognize the potential of wealth management as a very profitable business. The banking institutions aim to help individuals to preserve and systematically grow their wealth.

Most banks offer basic investment advisory services under the umbrella of their priority banking services. Banks offer complementary financial planning services to help one to know exactly what to do with ones money, so that one realizes the financial objectives. Banks organize investor meets; circulate market information reports and more under their banking investment advisory services.

The salient features are;

a) banks offer niche wealth management programmes under their priority banking services to customers with pre-defined limits of portfolio sizes.

b) wealth management services include risk assessment and asset allocation advice tailor made to individual needs.

c) long term goals and objectives are discussed and a careful provision is made to help the customer preserve and grow his wealth.

d) banks either have in house expertise to guide customers or they have tie-up with specialized organization for investment advice.

The wealth management process includes the development of financial plan and asset allocation plan. Long term goals and objectives are discussed and a careful provision is made to help the customer preserve and grow his wealth. Wealth management services includes estate planning, tax and legal consultancy, custodial services and more.

Customer Relationship Management (CRM) Solution

CRM is the industry term for the set of methodologies and tools that help an enterprise manage customer relationship in an organized way. It is a process or methodology used to learn more about customers needs and behaviors in order to develop stronger relationships with them. There are many technological components to CRM. It is a process that will help bring together lots of pieces of information about customers, sales, marketing effectiveness, responsiveness and market trends. CRM helps businesses use technology and human resources to gain insight into the behaviour of customers and the value of those customers.

In simple terms, CRM is defined as finding, getting, and retaining customers. CRM is the core of any customer-focused business strategy and includes the people processes, and technology associated with the sales, marketing and service. For a successful CRM, technology provides the base on which the process is built for tracking customer behaviour in order to develop marketing and relationship building programmes that bond consumers to a brand. Therefore, using CRM, a business can;

a) provide better customer services

b) increase customer revenues

c) discover new customer

d) cross sell or up sell products more effectively

e) help sales staff close deals faster, and

f) make call centers more sufficient.

Risk Management

Banks in India have adopted comprehensive risk management systems for focused attention to various types of risks such as; interest rate risk, credit risk, liquidity risk, market risk and operational risk. These risk management systems spell out internationally accepted risk measurement methods for various types of risks to calculate capital charge required for meeting prescribed capital adequacy ratio. Banks have setup separate risk management departments to ensure compliance with regulatory measures.

Corporate Governance

Corporate Governance is of crucial importance for banks. The corporate governance philosophy of banks is based on the pursuit of sound business ethics and strong professionalism that aligns the interest of all stakeholders and the socity at large. It is therefore necessary to constantly strengthen corporate governance mechanism in all banks.

Disclosure of reliable information facilitates market discipline, strengthens confidence and reduces the chances for rumours and creation of atmosphere of suspicion and misleading information that may bring about market instability. There is a vast scope for improvement in the Indian accounting standards to bring them at par with the global practices.

Inclusive Growth and Financial Inclusion

"Inclusive Growth" means that the poor and the disadvantage population should come within the ambit of main stream growth process. "Financial inclusion" means the outreach of formal financial system to the vast sections of the rural and urban population who are in the grip of the unorganized forces and trapped in acute perpetual poverty. It is a process of ensuring access to timely and adequate credit and financial services to vulnerable groups at affordable costs.

Major components of the inclusion growth and financial inclusion are as below:

a) inclusive growth should include all the poor, deprived disadvantaged sections of the population both in rural and urban areas in economic development. However, the action should begin in the rural areas, which are relatively more deprived. In later stages, it is essential to extend benefits to pensioners, self-employed and labourers in the unorganized sectors as well.

b) Formal financial system, viz., commercial banks, cooperatives, RRBs and insurance companies participate in the inclusive growth process. Because, the aim is not only to provide loan but also to offer a whole bunch of services to the poor, such as; banking, insurance, advisory services and other hybrid products and services.

c) There must be effective coordination among the agencies that participate in the inclusive growth process, viz., banks, NGOs, micro finance institutions and the government. The government provides the basic infrastructure, banks provide the financial inputs and the NGOs lend their leadership and executive skills. In the entire process of implementing such a programme, the RBI plays a catalytic role in coordinating with the players and guide orderly in the execution of the scheme.

3.14 Conclusion

So it is clear that banks in India are operating in an increasingly competitive environment. Not only the banking market has seen a large number of players competing with one another, but also the new entrants have the advantage of starting with a strong capitalization, modern technology, lean network and, more importantly without any accumulated problem of the past. It is also fair to expect that the initial target of the new competitors will be the most profitable segment of the banking business, i.e., high value corporate customers, business relating to high networth individuals, foreign trade related business and so on. Customers now have a real choice. Banks have become more customer responsive. The future of Indian banking, therefore holds greater promise for those who are willing to accept the challenge.

Since the future will be dominated by the technology, investment in newer technology has to be made to modernize existing operations, to face competitive challenges and to meet customer expectations. But, the cost of technology emerge much before the generation of expected revenues. Operation risk also may increase or decrease as a result of major technological investments. Thus, a careful monitoring of the progress of technological projects is essential. Also, the management has to make sure that the IT strategy remains aligned with their business strategy so as to avoid being saddled with dead investment.

As the Indian banking industry moves into another world, consumers wait with bated breath to soak up the impact once it all starts working. One thing is for sure the situation in the banking sector will be lot better. Technology for one will make sure that consumers will dance all the way to the bank.

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CHAPTER – 3

BANKING SYSTEM IN INDIA

3.1 Evolution of Banking

Banking is as old as the authentic history and the origins of modern commercial banking are traceable to ancient times. In ancient Greece around 2000 BC, the famous temples of Ephesus, Delphi and Olympia were used as depositories for people's surplus funds and these temples were the centers of money lending transactions.

The word "Bank" is said to be of Germanic origin, cognate with the French word "Banque" and the Italian word "Banca" both meaning "Bench". It is referred to a bench for keeping, lending and exchanging of money or coins in the market place by money lenders and money changers.

The Bank of Venice, founded in 1157 was the first public banking institutions. Following its establishment, were established the Bank of Barcelona in 1401 and Bank of Genoa in 1407 respectively. The Bank of Venice and the Bank of Genoa continued to operate successfully until the end of the 18th century. But the modern banking began with the English goldsmiths only after 1640. The Bank of England started its business in 1694 with a view to finance the government, to carry on its war with the neighbouring countries.

3.2 Definition

i) According to Sec.5(b) of the Banking Regulation Act, 1949, the term *"Banking means accepting for the purpose of lending or investment of deposits of money received from the public repayable on demand or otherwise and withdrawable by cheque, draft, order or otherwise"*[1].

ii) According to the Banking Regulation Act, 1949, a *"Banker" is the one who is engaged in the business of accepting deposits from the public and utilizing such deposits either for the purpose of lending or for the purpose of investment*[2].

iii) According to David Ricardo, *"Bank" is a dealer or transactor of money. They are the financial intermediaries collecting "deposits" and lending "loans"* [3].

3.3 Historical Context of Indian Banking Sector

Banking existed in India in one form or the other from times immemorial. The ancient Hindu scriptures refer the money lending activities in the Vedic period. During the Ramayana and Mahabharatha eras, banking need became a full-fledged business activity and during the Smriti period which followed the Vedic period and epic age the business of banking was carried on by the members of the Vaish community. Manu, the great law-giver of the time, speaks of the earning of interest as "the business of Vysyas".

The banker in the Smriti period performed most of those functions which banks perform in modern times, such as; accepting of deposits, granting secured and unsecured loans, acting as their customers baille, granting loan to kings in times of grave crisis, acting as the treasurer and banker to the state and issuing and managing the currency of the country.

During the Moghul period, ‘metallic’ money was issued and the indigenous bankers played a very important role in lending money and financing trade and commerce. Modern banking started in India only from the beginning of 19^{th} century. The earliest commercial banks were started in India by the employees of the East India Company. These banks were known as ‘Agency Houses’. They were mainly trading concerns which combined banking business with other activities, such as; trading & speculation.

The first joint stock bank to be setup in India was Bank of Hindustan in the year 1770. The others which followed were Bank of Bengal established in 1806, Bank of Bombay in 1840 and the Bank of Madras in 1843. These banks were established with the financial participation of the government. So, they were called ‘the Presidency Banks’. They continued till 1921 when they were amalgamated and converted into the Imperial Bank of India.

The first purely Indian Joint Stock Bank to be established in the country was ‘The Oudh Commercial Bank’, established in the year 1889. Later it was followed by the establishment of Punjab National Bank in 1894 and People’s Bank in 1901. The Indian banking system had to pass through a series of crisis and its growth was very slow during the first half of the 20^{th} century. It is only after the independence, the Indian banking system has made rapid progress and today the Indian banking system is one of the well developed banking systems in the world.

3.4 Banking in Independent India

The Banking Regulations Act was passed in the year 1949, which provided a frame work for regulation and supervision of commercial banking activity. This regulation brought RBI, an Apex Bank under Government control. Under this act, RBI got wide ranging powers for supervision and control of banks. The act also vested licensing powers and the authority to conduct inspections.

The first step towards the nationalization of commercial banks was the result of a report in the year 1951 by the committee of direction of All India Rural Credit Survey, which recommended setting-up a strong integrated state owned commercial banking institution to stimulate banking development, in general and rural credit in particular. Thus, the Imperial Bank of India was taken over by the Government of India and renamed as State Bank of India (SBI) in the year 1955 with the RBI acquiring majority of the shares. A number of erstwhile banks owned by princely states were made subsidiaries of SBI in the year 1959. In the year 1960, RBI was empowered to force compulsory merger of weak banks with the strong ones and the total number of banks was thus reduced from 566 in 1951 to 85 in 1969.

3.5 Nationalization of Banks

The Indian banking system made a considerable progress in 1950's and 1960's, it established close links between commercial banks and industrial houses, resulting in cornering of bank credit to other sectors such as; agriculture and small scale industries. Functionally the banks catered only to the needs of organized industrial and trading sectors and neglected the primary sector such as; agriculture, forestry and fishing, which formed more than 50% of GDP and had to depend largely on own financing and on sources outside the commercial banks. It is against this backdrop that the process of financial development was given impetus with the adoption of the policy of social control over banks in 1967.

The GOI, in the year 1969, nationalized 14 banks having an aggregate deposit of Rs.50 crores or more and subsequently in the year 1980 the government took over 6 more scheduled commercial banks with deposits of Rs.200 crore and above. The sole objective was "to serve better the needs of development of the economy, in conformity with National Priorities and objectives".

3.6 Structure of the Indian Banking System

The Indian banking structure comprises a heterogeneous mass covering a wide spectrum ranging from the unorganized indigenous bankers at the one end to the foreign banks at the other.

The Indian banking structure has at the apex the RBI entrusted with the responsibility for the formulation and implementation of the monitory policies of the country, regulating the banking sector, issuing and managing currency, purchasing and selling of government securities, and managing the foreign exchange position of the country.

The Reserve Bank derives its powers from the RBI Act of 1935 and the Banking Regulation Act, 1949. It performs the same functions as central banks do all over the world. But the RBI has taken developmental function also. Under this, it is responsible for institutionalizing of the vast savings of the country, through spread of banking habits and banking infrastructure. RBI is also supposed to help in a rapid industrialization through developmental organization set up for the purpose like the IDBI, IFCI, so on. It also overseas the agricultural development is not stifled for want of credit and has, for the purpose, set up National Agricultural Board for Rural Development (NABARD).

Having RBI at the apex, the banks in Indian Banking System are classified into two categories as shown in the fig.3.1.

Indian Banking Structure

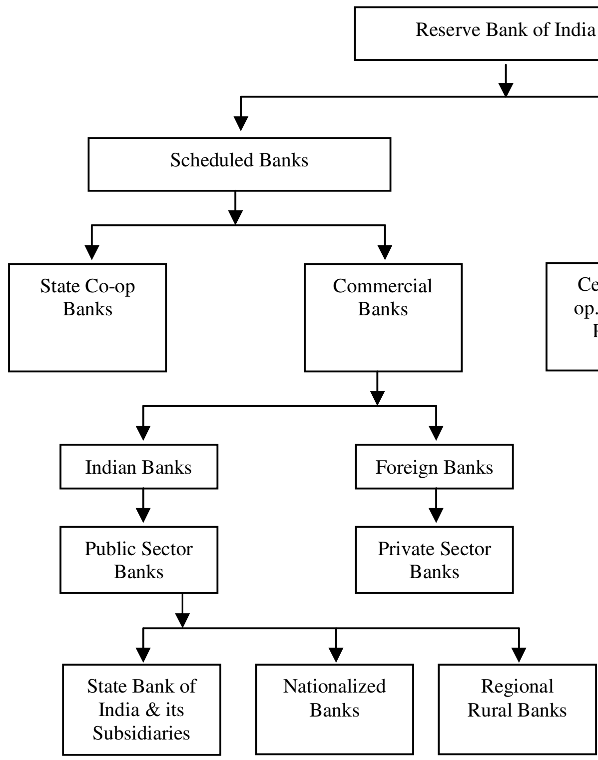

Fig. 3.1 Indian Banking Structure

Scheduled Banks

The Scheduled Banks are those which are included in the second schedule of RBI Act, 1935, others are non-scheduled banks. The state co-operative banks also come under the category of scheduled banks. To be included in the second schedule a bank (a) must have a paid up capital and reserves of not less than Rs.5 lakhs, (b) it must also satisfy the RBI that its affairs are not conducted in a manner detrimental to the interests of its depositors. Scheduled banks are required to maintain a certain amount of results with the RBI. They enjoy the facility of financial accommodation and remittance facilities at a concessional rates from the RBI.

Non Scheduled Banks

The Non-Scheduled banks are those joint stock banks that are not listed in the second schedule to the RBI Act, in 1939, i.e., when the RBI Act had been around for four years, there were about 1500 joint stock banks in the country of which as many as about 1400 were unscheduled. However, now the number has come down and the volume of their business is negligible small. The other unscheduled banks have since either closed down or merged with other scheduled banks, or converted themselves into non-banking companies.

Public Sector Banks

The Public Sector Banks (PSB) comprises of;

1) The State Bank Group
2) Nationalized Banks and
3) Regional Rural Banks.

The State Bank Group

The State Bank Group comprises of State Bank of India and its seven associates, viz.;

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

The State Bank of India is unique among the public sector banks on two accounts;

1) The bank was mandated by the governing act to extend banking facilities on a large scale and more particularly to rural and semi-urban areas.
2) The bank has traditionally conducted the treasury operations on behalf of the central and state governments and has, therefore, had a close relationship with the government departments and undertakings.

The Nationalized Banks Group originally comprised 20 banks of which 14 were nationalized in 1969 and 6 in 1980 and one of them – the New Bank of India, was later merged with Punjab National Bank. Thus 27 banks constitute public sector in Indian Commercial Banking. With these two rounds of nationalization and State Bank of India, being already in the ownership of the RBI to the extent of its equity, the organized banking sector has come in the government control. The nationalization of banks was done with a view to serving better the developmental needs of all sectors of the economy in consonance with the national policies and priorities. The broad aim got translated into spreading of banking areas, increased mobilization of savings, removal of regional disparities and channelizing credit into the weaker sections of the society.

Regional Rural Banks

Regional Rural Banks are an institution unique to our country. They came into existence on 2nd October, 1976. The need for these banks was felt because despite the existence of co-operative banks over last several decades and the progress recorded by the commercial banks since their nationalization, there still exists, a vast gap in supply of credit to the rural areas. RRBs were established to operate exclusively in rural areas to provide credit to small farmers, agricultural labourers, artisans, and small entrepreneurs. These banks are governed by the RRB Act, 1976. Each of them was formed with an authorized capital of Rs.1 Crore and an initial paid up capital of Rs.25 Lakhs contributed by the sponsor bank of each RRB, the state government, and the central government. These rural banks are supposed to have one or two districts as their area of operation and are expected to have branches upto a number of 100 although many RRBs have long since cross that number by a wide margin.

Private Sector Commercial Banks

The Private Sector Commercial Banks comprise the unscheduled joint stock banks as well as some of the schedule banks. However, with two rounds of nationalization and several rounds of mergers and closures there number has come down significantly. Even in terms of importance by way of spread of network and magnitude of business, this group has since been marginalized.

After the nationalization of banks, new banks in the private sector could not be setup in India, though there was no legal bar to that effect. The Narasimham Committee on financial sector recommended the establishment of such banks in India. The RBI therefore issued guidelines for setting-up of new private sector banks in India in January, 1993. These guidelines aimed at ensuring that the new banks are financially viable and technologically upto date from the start. They are expected to start functioning in a professional manner so as to improve the image of commercial banking system and to win the confidence of the depositing public.

The new banks shall be governed by the provisions of RBI Act, Banking Regulation Act, and other relevant statutes and shall follow all the directions, instructions, guidelines and advises given by the Reserve Bank. The private sector banks that have been established so far are; IDBI, ICICI, Axis Bank, to name a few.

Local Area Banks

In 1996, government decided to allow new local area banks with the twin objectives of; a) providing an institutional mechanism for promoting rural and semi-urban savings and b) for providing credit for viable economic activities in the local areas.

These banks will be established as public limited companies in the private sector and will be promoted by the individuals, companies, trusts, and societies. The minimum paid up capital of such banks to be Rs.5 crores with promoters contribution of atleast Rs.2 crore. They are expected to be setup in district towns and the area of their operation would be a maximum of three geographically contiguous districts where they can open their branches. A few local area banks have already been allowed to be setup.

Co-operative Banks

The Co-operative credit structure in India for short and medium term loans is a three tier federal structure. At the apex in each state is a State Co-operative Bank (SCB), at the district levels are the District Central Co-Operative Banks (DCC), and at the base are the primary credit societies, agricultural credit societies in village and urban co-operative banks and credit societies of the structure only the state co-operative banks figure in the second schedule of the RBI Act and hence have the status of scheduled banks. The co-operative banks at the state level and at the district level perform the usual banking functions although the credit societies are only what their nomenclature suggests.

Foreign Banks

The Foreign Banks include the branches in India of those banks which are incorporated abroad. Opening of branches in India of these foreign banks is largely by lateral matter with that country although the RBI remains the licensing authority.

These foreign banks operate in India mainly from the Metropolitan cities and maintain a strong profile in banking business related to foreign trade. Of late, however, many of these foreign banks have also started making forays into the retail personal banking segment in the country.

Development Banks

The Development Banks do not perform the banking business as per the legal definition of the word, but as far as the meeting of credit requirements of the large and medium industrial sector in the country is concerned, they have a pivotal role. Some of the more important development banks in the country are; Industrial Development Bank of India (IDBI), Industrial Finance Corporation of India (IFCI), Industrial Credit and Investment Corporation of India (ICICI), the various State Financial Corporation (SFCs), the Industrial Investment Bank of India (IIBI), and so on. Of this, only the ICICI is in the private sector. All these development banks are expected to meet the long and medium term credit needs for fixed capital of the large and medium sector industries. However, IDBI also supports the small scale sectors indirectly by way of its refinance and bills rediscounting schemes, and acts as an apex development bank.

3.7 Reformation of Indian Banking System

The banking sector plays a crucial role in the economic development of a nation. A sound, efficient, effective, vibrant and innovative banking system stimulates economic growth by mobilizing savings on a massive scale and efficiently allocating resources for productive as well as consumption purposes.

Indian banking witnessed a remarkable transformation consequent to the implementation of banking sector reforms since early 90s. The banking sector reforms included progressive reduction of statutory liquidity ratio (SLR) and cash reserve ratio (CRR); prescription of uniform accounting norms with regard to classification of assets, enactment of a statute providing for setting-up of tribunals for expeditious adjudication and recovery of bank loans; establishment of separate board for financial supervision of banks; permission for the entry of new private banks to inject competition; rationalization and deregulation of interest rates; implementation of capital adequacy norms; recapitalization of banks; permission to banks to access capital market for mobilizing additional equity; liberalized new branch licensing and new bank licensing policy.

Worldwide financial systems have undergone structural changes. The global factors driving these changes have been advancements in technology and computing, external financial liberalization and organizational changes in corporate world. Banking and finance in emerging economies has been no exception. But the structural shifts in these economies have been motivated by their country's specific factors also including macro economic pressures, disintermediation pressures and banking crisis of 1990's. These developments have been instrumental in formation of a 'Global Village' making the dividing line between financial products, type of financial institutions and their geographical location as irrelevant.

Globalization of banking operations and expansion of financial activities as a result of technology advancements, in an increasingly market driven environment have redefined the business models and changed the way the banks use to do the banking business. The banking industry has virtually seen a shift from brick and mortar banking to banking virtually across time zones, geographical reach and alternatively delivery channels.

3.8 Classification of Reforms

The banking sector reforms can be classified into 6 categories; viz., a) measures meant for promotion of competition, b) measures meant for strengthening the role of the market, c) prudential measures, d) legal measures, e) measures meant for strengthening supervision or supervisory controls and f) measures relating to technology. Some of these measures meant for strengthening competition included grant of limited operational autonomy to public sector banks (PSB); dilution of government stake in the equity of PSBs permitting them to mobilize capital from the open market; adoption of transparent licensing policy enabling the entry of private sector, foreign and joint venture banks; permitting foreign direct investment (FDI) in the financial sector as well as permitting portfolio investment; issue of guidelines on ownership and governance in private sector banks. Measures initiated to strengthen the role of market forces included progressive reduction in SLR and CRR, market determined pricing of government securities, deregulation of interest rates. Prudential measures which have been implemented covered fulfillment of capital adequacy norms; and new accounting, income recognition, provision and exposure norms. Measures initiated to strengthen risk management included assignment of risk weights to different categories of assets, norms on connected lending, credit concentration norms, application of marked – to – market principle for investment portfolio and fixation of limits for deployment of funds in sensitive factors and activities.

In addition, know your customer (KYC) guidelines, anti-money laundering (AML) standards, introduction of capital charge for market risk, high graded provisioning for non-performing assets (NPA), were adopted for implementation. Institutional and legal measures introduced for improving banks performance in the area of recovery and for asset quality up gradation included setting-up Lok Adalats, Debt Recovery Tribunals (DRT), Asset Reconstruction Companies (ARC), Settlement Advisory Committees (SAC), Corporate Debt Restructuring Mechanism. Enactment of securitization and reconstruction of financial assets and enforcement of security interest act (Sarfaesi Act) was another important mile stone in reforms. Setting-up Credit Information Bureau (India) Ltd., (CIBL) for sharing credit information and establishment of the Clearing Corporation of India Ltd, (CCIL) to act as central counter party for facilitating payments and settlement systems relating to fixed income securities and money market instruments extended support to banks.

Certain supervisory measures such as establishment of a separate board for financial supervision in RBI, recasting the role of statutory auditors and increased internal control through strengthening of internal audit, strengthening of corporate governance may also initiated. The technology related measures included setting-up of INdian FInancial NET work (INFINET) as the communication backbone for the financial sector, introduction of negotiated delink system for screen based trading in the government securities and implementation of real time gross settlement (RTGS) system.

The Indian economy has recently been exhibiting signs of staying ahead of global activity. Some signs cyclical recovery are currently evident, further, rapid globalization an increased competitiveness have forced a significant impact on banking innovations and their functioning in a diversified ways.

3.9 Innovation in Banking

Innovation means the introduction or application of something new – either new goods and services or new ways of reducing them. Innovation differs from invention in essential respect. An invention is the discovery of something new, whereas an innovation is the actual introduction or application of something new. Entrepreneurs and producers must innovate and adopt new methods and ideas to increase their productive capacity and improve working conditions, thereby raising productions and consequently the national income. Innovation is, therefore, an important factor responsible for a countries economic development.

Innovations in banking have become the order of the day and the concept of the bank a mere manager of liquidity belongs to the past. New services, both credit and non-credit one's have been introduced and existing services developed by banks throughout the world as they meet increasing competition for business from within the banking industry and from without, fill-up in their range of services to steal a march over their competitors by endeavoring to satisfy the needs of their present and potential customers demanding more flexible, advantageously priced and comprehensive facilities. Apart from selective introduction of modern technology to speed up, banking operations require an increasing degree of sophistication, there will be changes in the composition of banking business reflecting the changes is occurring in trade and industry. The banks, the world over, are becoming financial supermarkets in which a wide variety of services can be purchased and often conduct business that do not always resemble banking.

Many significant changes are taking place in our country in response to changes in national and international economic environment. These changes have also affected the financial sector and are forcing it to move towards a deregulated and more competitive environment. A marked future of the financial system in the decade of 1980's has been changes which have occurred in the institutional frame work and financial instruments. When viewed in historical context, such has been the pace of change which has occurred in the financial systems of developed countries and more particularly in the United Kingdom (UK)and United States of America (USA) in the last two decades and particularly in the recent years that it frequently referred to as constituting a "Revolution of Financial Services". Whether this description is an appropriate one is a matter on which opinions differ, but nevertheless, observers of the financial system have identified a number of major interlocking trends which have changed and are changing the institutions characteristics of the financial system.

Simultaneously, the trends towards the diversification by banks abroad, particularly by those banks which have branches in India and are trying to introduce innovations in their business activities in India so as to enable them to have a higher market share, in evitable had its impact on Indian banks. The demand for diversified financial services and banking innovations was also created by the structural changes that have taken place in the Indian economic over the last decade as shown below;

1. The share of primary and secondary vectors in national income declined and the share of service sector increased;
2. The salaried middle class has risen fast and they are in need of financial assets with higher income growth potential than usual commercial bank deposits;
3. The strategy of accelerating the pace of development has been undertaken by giving an impetus to increased consumption of industrial products through tax concessions and other means; and
4. The industrial growth appears to be largely anchored to the consumption needs of urban middle class, which has emerged with much potential demand for variety of financial services.

The process of disintermediation is part of the process of meeting the financial asset needs of the customers coming from the urban middle class. Many of the financial services offered by banks are oriented towards this class of customers. Diversification in this direction will be largely successful because here banks with their urban orientation in their home ground. Moreover, following the example of international banks, many Indian banks have tried to shift from traditional business to fee producing business as a step towards their efforts to innovate, adopt new market strategies and diversify.

3.10 Innovative Financial Services

The eighties have been years of exciting and progressive change in the banking business. Emerging from disintermediation process that has set in and consequential diversification being resorted to by banks in India in a big way.

Pursuant to this, certain new non-conventional and sophisticated services, based on customer conveniences and preferences, have been added to the banking arena. Significant among those are housing finance, hire purchase, leasing, factoring, merchant banking, mutual funds, consumer loans and venture capital finance, being provided by banks on their own or through subsidiaries setup exclusively to look after and manage these new areas of business. Some of these activities were there earlier to, but they have got a major fillip with more entrants into the business due to increased opportunities perceived or with certain liberalization measures in these lines of activities.

Apart from the above, the banking institutions are experiencing computer revolution and many other important innovations such as introduction of new financial instruments like certificates of deposits, commercial paper, participation certificates and cheques and credit cards, to cope with the emergent competitive environment. Besides, investment management including investment counseling and tax services are also evolving innovative packages to meet consumer demands.

Further, in view of the growing equity culture in the economy, banks have become active in distributing stocks and shares, debentures and bonds even with their own depositories. The corporate sector companies are branching out, as finance companies have undertaken a vast array of financial services. Several banks have expanded their overseas operation and they have undertaken financing the import – export business of their clients in a professional manner, many times competing with large international banks.

The international banking scene has undergone drastic changes, with the introduction of computer and telecommunication technology, which have lead to geographical and financial integration of international financial market in recent years. International banks have diversified their business into capital market operations since new profit opportunities have been noticed in this field. Responding to these changes in the international environments, the banking institutions in India have also been trying to diversify in such areas as consumer credit, credit cards and travelers cheques. It is however felt that institutions should not aim at something which is not their competence and that overseas bank offices should be used more as centers for information for exports.

The reforms made significant impact on banks and their functioning. The major areas of transformation in Indian banking are as follows;

Retail Loans

Retail loans are comparatively high yielding and safer, as risk is diversified among a large number of separate individuals, located across the geographic dimensions as wide as the network of bank branches. Besides this, retail loan offer handsome miscellaneous income by way of up-front fees against corporate loans. Retailing also offers further opportunities to cross-sell various other retail products like credit cards, insurance products, mutual funds and demat facilities to the depositors.

In the recent past, the banks, irrespective of their size, have been increasingly focusing on retail segment for both, resource mobilization and lending. The retail market or banking, which was the strong hold of non-banking financial institutions has now attracted to the attention of banks, including nationalized banks. Now, realizing the importance and also the necessity, banks in India are busy evolving strategies to tap the emerging retail banking market.

Concept of Retail Banking

Retail Banking is about providing banking services to individuals and joint individuals as opposed to whole sale banking, which focuses on industry and institutional clients. The concept of retail banking is not new to the banks. Retail banking is now being viewed as an attractive market segment, which offers opportunities for growth with profits. It is only in the recent times, that it has attracted special attention of the banks as a solution to some of their immediate concerns. The essence of retail banking lies in individual customers, while retail banking and retail lending are often used synonymously, but as a matter of fact, the latter is just one side of the retail banking. In retail banking, all the banking needs of the individual customers are taken care of in an integrated manner. Though retail banking encompasses all types of individual customers, often banks tend to focus on high net worth individuals. Retail banking portfolio encompasses deposits and asset-linked products as well as other financial services offered to individuals for personal consumptions.

3.11 Retail Banking Products & Services

Though a wide ranging of retail banking products and services are being offered by banks which cover both the deposits and the advances, major products offered under retail lending to suit various segments of customers like salaried persons, businessmen, traders, professionals, technocrats, pensioners, labourers are; housing loans, personal loans, educational loans, vehicle loans, loan for consumer goods, credit and debit cards, global & international cards, loans for holidays, insurance products, gold loans, and event loans.

Retail banking products for depositories in various segments, like children, house-wives, salaried class, professionals, technologists, pensioners, include; Flexi Deposit Accounts, Savings Bank Accounts, Recurring Deposits Account, Other Short Term deposits.

Thus, the banks are offering all the life-cycle products under their 'Cradle to Grave" strategy to take care of all the credit needs of individuals.

Banks are coming out with more and more features to add value to retail banking products and services. Few value added services being offered by banks are;

a) Free collection of specified number of outstation instruments per month.
b) Instant credit of outstation cheques.
c) Concession in commission or exchange for issuance of pay orders of demand drafts.
d) Issuance of free cheque books.
e) Issuance of free ATM cards.
f) Waiver of credit care issuance fees.
g) Issuance of free-add on cards to members of the card holders family.
h) Execution of a standing instructions of customers.
i) Free investment advisory services.

Other Retail Banking Services offered by Banks include,

j) Payment of utility bills like electricity, telephone & water bills on due dates.
k) Payment of monthly, quarterly, half yearly education fee of children.
l) Payment of insurance premium on due dates.
m) Demating of shares, debentures & bonds.

n) Selling of insurance products

o) Housing finance.

Micro Financing

Micro financing is being practiced world over to combat the menace of poverty. In India it has become well accepted. There are numerous variants of micro finance as prevalent in the country today. These may differ in modalities, but the basic premise on which they work to offer financial services to the poor who have been unorganized and neglected by the financial sector. One of the systems, that is been widely adopted is the linkage through Self Help Groups (SHGs). In fact, a large number of developing nations have tried this approach for poverty amelioration. Micro financing is a tool to empower the poorest, particularly village women, by improving their lot through micro finance. Its design is quite inspiring and recovery rate is almost cent-percent. Emboldened by the success of NABARDs experiment of linking SHGs and also that of various financial institutions in other developing countries the banking sector in India adopted SHG concept.

Credit – Debit Cards

Credit cards are an easy method To Buy Now and Pay Later. The credit card is a double aged tool which enables one to pay for purchases with the card instead of paying cash on the spot. Thus they are extremely convenient as they can do away with the necessity of carrying large sums of cash around. Further, the card becomes handy when a person on tour finds that he has run out of cash but has to pay a bill incurred which can be defrayed by using the credit card. Another feature of the usage of the card is that the risk of loss of money is totally absent and the card, even if lost, can be obtained again, provided it is intimated to the issuer immediately. If one is trapped for cash, he can withdraw money at specified branches of the bank upto a specified monthly limit. Thus, we find that credit card takes care of liquidity problem of individuals. It is a tool at hands of its holders to tide over a budget deficit for a short period of time.

Debit Cards, on the other hand do not allow credit. The account usually debited immediately or on the same day when the card has been used to draw money are make purchases. No credit period is allowed.

3.12 Technological Development

Technology has transformed the global world of banking and financial services beyond recognition. No other industry offers more complex challenges and more exciting opportunities. Technological initiative spans retail and wholesale banking, lending solutions, payment systems, mortgages, securities, fund management, straight-through-processing, risk management, compliance, as well as messaging systems, which will benefit the customer in the banking sector. Computerization of the business of banks has been receiving high importance. The banking institutions have already crossed 70% level of computerization of their business. The directive from the Central Vigilance Commission (CVC) to achieve 100% computerization has resulted in renewed vigour towards computerization of branches.

Networking has been receiving focused attention by banks. This activity is also being monitored by the reserve bank. Most banks have their own corporate networks to facilitate inter branch and branch controlling office communication in an electronic mode. Inter-Bank and Inter-City communication takes place through the Indian Financial Network (INFINET). As part of the INFINET, the terrestrial lines have been augmented to provide for increased data transfer capabilities. All these have resulted in the dependence of bank on network based computing which has benefitted the customer. INFINET also provides for safe and secure transmission of electronic messages with the use of Public Key Infrastructure (PKI) which has the legal backing of Information Technology Act, 2000. It also provides for messages to flow in a structured environment, using SFMS, which provides for inter operability of messages so that Straight Through Processing (STP) is achieved.

ATM

Automated Teller Machines are increasingly providing functionalities that take away the routine teller functions and are an effective personalized secure customer information and cross-sell channel. With the RBI working towards the implementation of the cheque truncation initiative, this deposit module will facilitate faster cheque processing as the scanned image of the cheque and directly be sent for clearing with the ATM being the point of deposit and truncation. This will facilitate faster access to funds for consumers as well as cost and operational efficiencies for the banks.

Mobility in Banking

Mobile phone banking takes one step ahead of internet and tele-banking. The customer can do a banking activity, without even making a phone call. The most obvious advantage of mobile phone banking over tele-banking and internet banking is that it is truly "Any Time Any Where Banking".

There are broadly two types of services that a customer could avail through mobile phone.

a) Alert Services – Alert services helps a customer keep a track of the activity on his accounts and

b) Requests – Allows a customer call for information pertaining to his bank accounts and transactions.

The mobile banking works through a set of text messages. The use of mobile phones in the country has become a revolutionary, therefore it is no surprise, that banks are offering services over mobile phones, as part of their tech banking initiatives.

Bank on the Net

Internet banking has become a necessity in today's busy life styles. Using this mode to transact, saves precious time and effort.

From across the seven seas, as long as the customer has an access to the internet, he can have an access to his bank. Internet banking allows a customer to conduct a plethora of banking activities using the net. The best part about internet banking is the convenience offered along with total confidentiality and safety. The virtual ease with which a customer can bank today is reassuring.

Fund Transfers

Internet banking or online banking allows a customer to transfer funds from one account to another, across branches and cities. Some banking institutions have gone one step ahead by offering the customers the facility to transfer money from his account to that off any person with an account at the same bank or any bank, any time and from anywhere. All that the customer has to do is submit a signed declaration stating that he wants to access this facility.

Fixed Deposits and Demand Drafts

As part of internet banking activities, a majority of banks allow the customers to create a new fixed deposit. The customer is simply required to fill in the details of the bank account from which he wishes to transfer funds, the amount and duration of the deposit. The bank will do the rest and transfer the interest and maturity amount back to the account from which the customer has deposited. A number of banks are willing to issue demand drafts from the customer's account, once he provides them with the details of the amount, location and beneficiary over the net.

Pay Utility Bills

The customers can now even pay telephone, mobile and electricity bills over the net. However, some banks limit the facilities like these and creation of new fixed deposits and demand drafts requests to regular banking hours. In case, the customer puts in the request after banking hours, the bank promptly executes it on the next working day. So it is definitely better than standing in queues at utility offices or banking premises on a working day.

3.13 Other Banking Activities

Banks are also innovating on the company and treasury operations fronts. Mumbai International Bank (MIBOR) linked and commercial paper linked interest on loans are common. MIBOR is a reference rate arrived at every day at 4.00 pm by Reuters. It is the weighted average rate of call money business transacted by 22 institutions, including banks, primary dealers and financial institutions.

Wealth Management

Banks have begun to recognize the potential of wealth management as a very profitable business. The banking institutions aim to help individuals to preserve and systematically grow their wealth.

Most banks offer basic investment advisory services under the umbrella of their priority banking services. Banks offer complementary financial planning services to help one to know exactly what to do with ones money, so that one realizes the financial objectives. Banks organize investor meets; circulate market information reports and more under their banking investment advisory services.

The salient features are;

a) banks offer niche wealth management programmes under their priority banking services to customers with pre-defined limits of portfolio sizes.

b) wealth management services include risk assessment and asset allocation advice tailor made to individual needs.

c) long term goals and objectives are discussed and a careful provision is made to help the customer preserve and grow his wealth.

d) banks either have in house expertise to guide customers or they have tie-up with specialized organization for investment advice.

The wealth management process includes the development of financial plan and asset allocation plan. Long term goals and objectives are discussed and a careful provision is made to help the customer preserve and grow his wealth. Wealth management services includes estate planning, tax and legal consultancy, custodial services and more.

Customer Relationship Management (CRM) Solution

CRM is the industry term for the set of methodologies and tools that help an enterprise manage customer relationship in an organized way. It is a process or methodology used to learn more about customers needs and behaviors in order to develop stronger relationships with them. There are many technological components to CRM. It is a process that will help bring together lots of pieces of information about customers, sales, marketing effectiveness, responsiveness and market trends. CRM helps businesses use technology and human resources to gain insight into the behaviour of customers and the value of those customers.

In simple terms, CRM is defined as finding, getting, and retaining customers. CRM is the core of any customer-focused business strategy and includes the people processes, and technology associated with the sales, marketing and service. For a successful CRM, technology provides the base on which the process is built for tracking customer behaviour in order to develop marketing and relationship building programmes that bond consumers to a brand. Therefore, using CRM, a business can;

a) provide better customer services

b) increase customer revenues

c) discover new customer

d) cross sell or up sell products more effectively

e) help sales staff close deals faster, and

f) make call centers more sufficient.

Risk Management

Banks in India have adopted comprehensive risk management systems for focused attention to various types of risks such as; interest rate risk, credit risk, liquidity risk, market risk and operational risk. These risk management systems spell out internationally accepted risk measurement methods for various types of risks to calculate capital charge required for meeting prescribed capital adequacy ratio. Banks have setup separate risk management departments to ensure compliance with regulatory measures.

Corporate Governance

Corporate Governance is of crucial importance for banks. The corporate governance philosophy of banks is based on the pursuit of sound business ethics and strong professionalism that aligns the interest of all stakeholders and the socity at large. It is therefore necessary to constantly strengthen corporate governance mechanism in all banks.

Disclosure of reliable information facilitates market discipline, strengthens confidence and reduces the chances for rumours and creation of atmosphere of suspicion and misleading information that may bring about market instability. There is a vast scope for improvement in the Indian accounting standards to bring them at par with the global practices.

Inclusive Growth and Financial Inclusion

"Inclusive Growth" means that the poor and the disadvantage population should come within the ambit of main stream growth process. "Financial inclusion" means the outreach of formal financial system to the vast sections of the rural and urban population who are in the grip of the unorganized forces and trapped in acute perpetual poverty. It is a process of ensuring access to timely and adequate credit and financial services to vulnerable groups at affordable costs.

Major components of the inclusion growth and financial inclusion are as below:

a) inclusive growth should include all the poor, deprived disadvantaged sections of the population both in rural and urban areas in economic development. However, the action should begin in the rural areas, which are relatively more deprived. In later stages, it is essential to extend benefits to pensioners, self-employed and labourers in the unorganized sectors as well.

b) Formal financial system, viz., commercial banks, cooperatives, RRBs and insurance companies participate in the inclusive growth process. Because, the aim is not only to provide loan but also to offer a whole bunch of services to the poor, such as; banking, insurance, advisory services and other hybrid products and services.

c) There must be effective coordination among the agencies that participate in the inclusive growth process, viz., banks, NGOs, micro finance institutions and the government. The government provides the basic infrastructure, banks provide the financial inputs and the NGOs lend their leadership and executive skills. In the entire process of implementing such a programme, the RBI plays a catalytic role in coordinating with the players and guide orderly in the execution of the scheme.

3.14 Conclusion

So it is clear that banks in India are operating in an increasingly competitive environment. Not only the banking market has seen a large number of players competing with one another, but also the new entrants have the advantage of starting with a strong capitalization, modern technology, lean network and, more importantly without any accumulated problem of the past. It is also fair to expect that the initial target of the new competitors will be the most profitable segment of the banking business, i.e., high value corporate customers, business relating to high networth individuals, foreign trade related business and so on. Customers now have a real choice. Banks have become more customer responsive. The future of Indian banking, therefore holds greater promise for those who are willing to accept the challenge.

Since the future will be dominated by the technology, investment in newer technology has to be made to modernize existing operations, to face competitive challenges and to meet customer expectations. But, the cost of technology emerge much before the generation of expected revenues. Operation risk also may increase or decrease as a result of major technological investments. Thus, a careful monitoring of the progress of technological projects is essential. Also, the management has to make sure that the IT strategy remains aligned with their business strategy so as to avoid being saddled with dead investment.

As the Indian banking industry moves into another world, consumers wait with bated breath to soak up the impact once it all starts working. One thing is for sure the situation in the banking sector will be lot better. Technology for one will make sure that consumers will dance all the way to the bank.

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