Chapter 4

Private sector banks

1) Concept of Private sector banks

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Chapter 4

Private sector banks:

4.1 Concept of Private sector banks:

The private-sector banks in India represent part of the Indian banking sector that is made up of both private and public sector banks. The "private-sector banks" are banks where greater parts of stake or equity are held by the private shareholders and not by government. Banking in India has been dominated by public sector banks since the 1969 when all major banks were nationalised by the Indian government. However since liberalisation in government banking policy in 1990s, old and new private sector banks have re-emerged. They have grown faster and bigger over the two decades since liberalisation using the latest technology, providing contemporary innovations and monetary tools and techniques. The private sector banks are split into two groups by financial regulators in India, old and new. The old private sector banks existed prior to the nationalisation in 1969 and kept their independence because they were either too small or specialist to be included in nationalisation. The new private sector banks are those that have gained their banking license since the liberalisation in the 1990s.

4.1(a) History And Evolution

Private-sector banks have been functioning in India since the very beginning of the banking system. Initially, during 1921, the private banks like bank of Bengal, bank of Bombay and bank of Madras were in service, which all together formed Imperial Bank of India.

Reserve Bank of India (RBI) came in picture in 1935 and became the centre of every other bank taking away all the responsibilities and functions of Imperial bank. Between 1969 and 1980 there was rapid increase in the number of branches of the private banks. In April 1980, they accounted for nearly 17.5 percent of bank branches in India. In 1980, after 6 more banks were nationalised, about 10 percent of the bank branches were those of private-sector banks. The share of the private bank branches stayed nearly same between 1980 and 2000.

Then from the early 1990s, RBI's liberalisation policy came in picture and with this the government gave licences to a few private banks, which came to be known as new private-sector banks.

There are two categories of the private-sector banks: "old" and "new".
The old private-sector banks have been operating since a long time and may be referred to those banks, which are in operation from before 1991 and all those banks that have commenced their business after 1991 are called as new private-sector banks.

Housing Development Finance Corporation Limited was the first private bank in India to receive license from RBI as a part of the RBI's liberalization policy of the banking sector, to set up a bank in the private-sector banks in India.

Historically, the private sector banks played a crucial role in the growth of joint stock banking in India. The first half of the 20th century witnessed phenomenal growth of private sector banks. As a result in 1951, there were 566 private banks of which 474 were non-scheduled and 92 scheduled classified on the basis of their capital size. The role of private sector banking started declining when the Government of India entered banking business with the establishment of State Bank of India in 1955 and subsequently two rounds of bank nationalization one in July 1969 (14 major banks), another in April 1980 (takeover of 6 banks). Consequently, the presence of public sector banks has increased.

At present, there are 32 private banks comprising of 24 old banks, which existed prior to 1993-94 and eight new private banks, which were established during 1993-94 and onwards after the RBI announced guidelines in January 1993 for establishment of new banks in private sector following the recommendations of Narasimham Committee-I (1991). Compared to New private sector banks, the old banks are smaller in size. For example, at end March 2000, the average net worth of the 24 Old Private Banks (OPBs) was Rs.179.67 Crore per OPB compared to that of the New Private Bank (NPB) at Rs. 479.88 Crore per NPB. The OPBs are essentially regional in character although some of them have scattered presence in areas other than in and around the areas of their origin. The number of branches of the NPBs was 999 at end March 2003, while those of OPBs 3491. The NPBs are extremely cautious in expanding their branch network and business because their managers, mostly drawn from the public sector banks know very well the ills of unbridled expansion of branches by public sector banks in the post-nationalization era.

The Narasimham Committee-I, that advocated competition in the banking industry, made unequivocal recommendation to allow private and foreign banks into the industry. Acting on the recommendations of the committee, the RBI laid down guidelines for the establishment of the private sector banks on January 1993. The guidelines prescribed that the private banks should be established as public limited companies under the Indian Companies Act: 1956. The paid-up capital shall not be
less than Rs. 100 Crore. The new guidelines issued in 2001 raised the minimum paid-up capital to Rs. 200 Crore, which shall be enhanced to Rs. 300 Crore within three years after the commencement of business. The promoters' share shall not be less than 40 per cent and the voting right of a shareholder shall not exceed 10 per cent. The new banks should avoid shortcomings such as unfair concentration of credit, cross-holding of industrial groups, etc. Those banks which intent to establish main office in a centre where no banking is having such office is to be preferred. These banks are required to observe priority sector lending targets as applicable to other domestic banks. The guidelines aim at ensuring that the new entrants are ab initio financially viable and technologically up-to-date While granting approvals for OPBs, one of the considerations before the RBI was that the new banks would start functioning in a professional manner giving clear signals to the effect that would improve the image of commercial banking system and give confidence to the depositing public.

Accordingly, nine banks were set-up in private sector including some by development financial institutions. Prominent among them are ICICI Bank, GTB, HDFC and IDBI bank. Another interesting development was merger of some banks. Barely Corporation Ltd merged with Bank of Baroda in 1999, Times Bank merged with HDFC Bank in 1996, Bank of Madura Ltd merged with ICICI bank in 2001 and Nedungadi Bank Ltd merged with Punjab National Bank in 2003. With regard to branch expansion, banks attaining capital adequacy norms and prudential accounting standards can set up new branches without the prior approval of RBI. Banks have the freedom to rationalize their existing branch network by relocating branches, opening of specialized branches, spinning off business, setting up of controlling offices, etc.

In terms of size, there are Goliaths and Davies among the banks. On one extreme, there is the omnipresent big bank like the SBI (Public Sector Bank) with 9017 branches. On other extreme, there is the small private sector bank; the Ganesh Bank of Kurundwad Ltd. located in an obscure town in Maharashtra operating with only 30 branches. The youngest bank is the United Bank of India established in 1950. It has been struggling to improve its market share. The Benares State Bank Ltd. is the oldest Bank established in 1871 in the holy city of Varanasi. It remained smaller in size compared to the youngest NPBs. The Bharat Overseas Bank Ltd, which came into being in 1973’s is the only private bank having a branch abroad. Between the two extremes, there are 21 banks, which are regional in character and operate with different levels of efficiency.

The New Private Sector Banks started publishing balance sheets since
1995-96. In that year the share of OPBs in total assets was 6.2 per cent while that of NPBs was 1.4 per cent. The NPBs had improved their market share to 5.3 per cent by 1999-2000 at the cost of PSBs. The share of private sector banks in the total number of branches in 1992-93 was only 8.33 percent. In 2002-03, the share of private sector banks in total bank branches is 8.75 percent.

4.1(ii) FOREIGN INVESTMENTS

The Government has been pursuing an open door policy and opened the flood gates for the inflow of foreign capital in the form of FOI, investments by foreign institutional investors and NRI's in the banking sector too. Foreign investments in private banks from all sources (FOI, FII, NRI), which was limited to 49 per cent of the capital but now raised to 74 percent facilitating setting up of subsidiaries of foreign banks and attracting investment in private sector banks. The new private sector banks are allowed to raise capital contribution from foreign institutional investors up to 20 per cent and from NRIs up to 40 percent of their share capital. Promoter’s stake in Indian banks is currently limited to 49 per cent. While issuing licenses the RBI has instructed those promoters of private banks who held a higher holding than the prescribed limit to divest their stake and bring it down to 49 per cent. Indian promoters argue that such discrimination may make Indian private banks vulnerable to take-over by foreign banks. It is hoped that the limit to Indian promoters holding will be raised to 74 per cent as is done for FOI. The guidelines issued by RBI in this regard are:

(a.) At all times a minimum of 26 per cent of the paid up capital of private banks has to be held by residents,

(b.) Holdings of a single entity or a group of related entities is cashed at 10 percent,

(c) FIIs are at present permitted to invest up to 10% each in a bank with a cap of 24 per cent for all FIIs put together. This can however be raised to 49 per cent with the approval of the board general body concerned.

The increase in foreign investments limit in private banks will have serious repercussions to Indian interests. It will enable foreign partners to increase their stake and acquire management control over Indian banks. Of course presently there is a cap on voting rights of any person to 10 per cent in private sector, irrespective of his shareholdings. It means that even if an entity holds more than 10 per cent
stake in a bank, its voting rights are capped to just 10 per cent in private sector. But there is a proposal to amend the Banking Regulation Act to remove this cap. With direct foreign investment up to 74 per cent, the so-called Indian private sector banks may opt collaboration or joint venture which will become Joint sector institutions between Indian investor and foreign investors. If the cap on voting right is removed, the foreign investors will surely obtain management control over Indian banks.

The Indian Banks with low capital adequacy ratio will have the option to raise capital from overseas investors. Presently, Indian banks, which can offer stake to foreign investors, are IndusInd Bank, Bank of Punjab. Banks like ING Vysya and Centurion Bank may further increase the stake of foreign investors.

**Performance Evaluation of Private Sector Banks**

The performance of 16 Old Private Banks (OPBs) and 8 New Private Banks (NPBs) is evaluated during the reform period. The 8 new private banks as has already been stated, came into existence after 1992-93 and the financial results of these banks are published from 1995-96. Hence, their performance analysis rebates to the period 1995-96 to 2002-03. Only 16 old private sector banks are considered for the analysis, leaving those banks, which are merged with others, Bank of Mathura Ltd. (2001), Bareily The Nedungadi Bank Ltd. (2003) and those banks whose total assets are less than Rs. 100 Crore. The New Private Banks which are included for evaluation are Bank of Punjab Ltd., Centurion Bank Ltd., Global Trust Bank Ltd., HOFC Bank Ltd., ICICI Bank Ltd., OBI Bank Ltd., Industrial Bank Ltd' and UTI Bank Ltd.(now AXIS Bank Ltd).

A. The parameters elected for evaluation of efficiency of PBs are:

1) Business per Branch,

2) Operating expenses per Branch,

3) Profit per Branch,

4) Business per Employee,

5) Establishment expenses per Employee, and

6) Profit per Employee
B. The parameter selected for profitability analysis are:

1) Return on Assets,

2) Return on Equity,

3) Net interest Margin as a percentage of working funds,

4) Non-Interest Income as a percentage of Total Income, and

5) Credit-Deposit Ratio.

4.1(iii) **Entry of New Private Banks in India**

The Union Finance Minister, in his budget speech for the year 2010-11 had announced that ‘The Indian banking system has emerged unscathed from the crisis. We need to ensure that the banking system grows in size and sophistication to meet the needs of a modern economy. Besides, there is a need to extend the geographic coverage of banks and improve access to banking services. In this context, I am happy to inform the Honourable Members that the RBI is considering giving some additional banking licences to private sector players. Non- Banking Financial Companies could also be considered, if they meet the RBI’s eligibility criteria.’

Subsequently, in line with the above announcement, the Governor, Reserve Bank of India indicated in the Annual Policy Statement for the year 2010-11 that the Reserve Bank will prepare a discussion paper marshalling the international practices, the Indian experience as well as the extant ownership and governance (O&G) guidelines and place it on the Reserve Bank’s website by end-July 2010 for wider comments and feedback. The Reserve Bank also noted that detailed discussions will be held with all stakeholders on the discussion paper and guidelines will be finalised based on the feedback. All applications received in this regard would be referred to an external expert group for examination and recommendations to the Reserve Bank for granting licenses.

**Why New Banks in India:**

It is generally accepted that greater financial system depth, stability and soundness contribute to economic growth. But beyond that, for growth to be truly inclusive requires broadening and deepening the reach of banking. A wider distribution and
access of financial services helps both consumers and producers raise their welfare and productivity. Such access is especially powerful for the poor as it provides them opportunities to build savings, make investments, avail credit, and more important, insure themselves against income shocks and emergencies.

As of March 31, 2009, the Indian banking system comprised 27 public sector banks, 7 new private sector banks, 15 old private sector banks, 31 foreign banks, 86 Regional Rural Banks (RRBs), 4 Local Area Banks (LABs), 1,721 urban co-operative banks, 31 state co-operative banks and 371 district central co-operative banks. The average population coverage by a commercial bank branch in urban areas improved from 12,300 as on June 30, 2005 to 9,400 as on June 30, 2010 and in rural and semi urban areas from 17,200 as on June 30, 2005 to 15,900 as on June 30, 2010. The all India weighted average during the same period improved from 15,500 to 13,400. Though the Indian financial system has made impressive strides in resource mobilization, geographical and functional reach, financial viability, profitability and competitiveness, vast segments of the population, especially the underprivileged sections of the society, have still no access to formal banking services.

The Reserve Bank is therefore considering providing licences to a limited number of new banks. A larger number of banks would foster greater competition, and thereby reduce costs, and improve the quality of service. More importantly, it would promote financial inclusion, and ultimately support inclusive economic growth, which is a key focus of public policy.

This discussion paper outlines past approaches, international experience, and considers the various costs and benefits of increasing the number of new banks as well as the pros and cons of various policy parameters in licensing new banks.

4.1(iv) Past Approach to New Banks:

Reserve Bank’s approach

When financial sector reforms were initiated in India in the early nineties, guidelines for licensing of new banks in the private sector were issued in January
1993 and subsequently revised in January 2001; the objective was to install greater competition in the banking system to increase productivity and efficiency.

The revised 2001 guidelines by and large were still cautious in nature. Large industrial houses were not permitted to promote new banks. However, individual companies, directly or indirectly connected with large industrial houses were permitted to own 10 percent of the equity of a bank, but without any controlling interest.

An NBFC with good track records was considered eligible to convert into a bank, provided it was not promoted by a large industrial house and satisfied the prescribed minimum capital requirements, a triple A (AAA) or its equivalent, credit rating in the previous year, capital adequacy of not less than 12 percent and net Non-Performing Assets (NPA) ratio of not more than 5 percent. The initial minimum paid up capital was prescribed at Rs. 200 crore to be raised to Rs.300 crore within three years of commencement of business.

Promoters were required to contribute a minimum of 40 percent of the paid up capital of the bank at any point of time, with a lock-in period of five years. However, if the promoter's contribution to the initial capital was more than the minimum 40 percent, they were required to dilute their excess stake after one year of the bank's operations.

Non Resident Indians (NRIs) were permitted to participate in the primary equity of a new bank to the maximum extent of 40 percent. However, the equity participation was restricted to 20 percent within the above ceiling of 40 percent, in the case of a foreign banking company or finance company (including multilateral institutions) acting as a technical collaborator or a co-promoter.

Banks were required to maintain an arm’s length relationship with business entities in the promoter group and individual company/ies investing upto 10 percent of the equity. They could not extend any credit facilities to the promoters and company / ies investing up to 10 percent of the equity. The relationship between business entities in a promoter group and the bank had to be of a similar nature as between two independent and unconnected entities.

The shares of the bank had to be listed on a stock exchange. Capital adequacy ratio
of the bank had to be 10 percent on a continuous basis from the commencement of operations.

Banks were obliged to maintain upto 40 percent of their net bank credit as loans to the priority sector. Banks were obliged to open at least 25 percent of their total number of branches in rural and semi urban centres.

**Reserve Bank’s experience**

10 new banks were set up in the private sector after the 1993 guidelines and 2 new banks after the 2001 revised guidelines. Out of these, four were promoted by financial institutions, one each by conversion of co-operative bank and NBFC into commercial banks, and the remaining six by individual banking professionals and an established media house.

Out of the four banks promoted by individuals in 1993, only one has survived with muted growth. One bank has been compulsorily merged with a nationalized bank due to erosion of net worth on account of large capital market exposure. The other two banks have voluntarily amalgamated with other private sector banks over a period of 10 to 13 years due to the decisions of the majority shareholders arising out of poor governance and lack of financial strength.

Out of the remaining six banks that were licensed in 1993, one bank promoted by a media group has voluntarily amalgamated itself with another private sector bank within five years of operations and four banks promoted by financial institutions have either merged with the parent or rebranded and achieved growth over a period of time. The bank that was converted from a Cooperative bank has taken some time in aligning itself to the commercial banking and is endeavoring to stabilize itself.

The two banks licensed in the second phase have been functioning for less than 10 years and their transition from the settling stage has been fairly smooth. The experience of the Reserve Bank over these 17 years has been that banks promoted by individuals, though banking professionals, either failed or merged with other banks or had muted growth. Only those banks that had adequate experience in broad financial sector, financial resources, trustworthy people, strong and
competent managerial support could withstand the rigorous demands of promoting and managing a bank.

The experience with small banks has not been encouraging. Out of the six Local Area Banks licensed, only four remain. The license of one has been cancelled due to serious misrepresentation concealment of facts at the time of granting of licence and another has been merged with a bank on account of bad governance and unfit management. Of the remaining four, two though continuing to maintain minimum capital, liquidity and profitability, have not progressed much. The remaining two are functioning satisfactorily but their growth has been restrained due to inadequacies of the small bank model.

The Local Area Bank model has inherent weakness such as unviable and uncompetitive cost structures which are a result of its small size and concentration risk. Local Area banks are required to confine their operations to a small area of three districts. This concentration exposes the banks to the risk of adverse selection. Further, the size of operations and also the locational disadvantage of these banks act as a constraint to attracting and retaining professional staff as well as competent management. Corporate governance standards in these banks are also found wanting partly because of their concentrated ownership.

The experience with other small banks i.e. urban co-operative banks and small deposit taking NBFCs is similar. Low capital base lack of professional management, poor credit management, and diversion of funds have led to multi-faceted problems.

As such, in the interest of the depositors and the financial system as a whole, and also due to the thrust on the financial inclusion, banks should be required to start with sufficient initial capital. Further, strong capital base would also ensure that the banks withstand any adverse conditions in the financial sector as well as the economy.

**Recommendations of Expert Committee And Lessons From The Global Crisis**

High Level Investment Commission

The February 2006 report of The High Level Investment Commission, constituted by the Government of India in December 2004 with the objective of enhancing
both foreign and domestic investment levels in India, has, among other things, recommended permitting ownership in Indian banks of up to 15 percent by Indian corporates, and also to increase limits of holdings by any one foreign bank up to 15 percent in private banks.

High Level Committee on Fuller Capital Account Convertibility

The July 2006 report of The High Level Committee on Fuller Capital Account Convertibility, constituted by the Reserve Bank of India in March 2006 under the chairmanship of Shri S. S. Tarapore, has recommended that RBI should evolve policies to allow, on a case by case basis, industrial houses to have a stake in Indian banks or promote new banks. The policy may also encourage non-banking finance companies to convert into banks. It has also recommended that after exploring these avenues until 2009, foreign banks may be allowed to enhance their presence in the banking system.

Committee on Financial Sector Reforms

The September 2008 report of The High Level Committee on Financial Sector Reforms, constituted by the Government of India in August 2007 under the chairmanship of Dr. Raghuram G. Rajan, has recommended allowing more entry to private well-governed deposit-taking small finance banks with stipulation of higher capital adequacy norms, a strict prohibition on related party transactions, and lower allowable concentration norms (loans as a share of capital that can be made to one party). Such measures would also increase financial inclusion by reaching out to poorer households and local small and medium enterprises.

Lessons from the recent global financial crisis

A constellation of regulatory practices, accounting rules and incentives magnified the credit boom ahead of the recent global financial crisis. The same factors accelerated the downturn in markets and intensified the crisis. Macroeconomic stability and financial stability were generally treated as separate and unrelated constructs with the former focusing on preserving low and stable inflation, while the latter dealing with the firm-level supervision of the formal banking sector. In this process, not only was the growing shadow financial sector ignored, but also factors such as the interconnectedness within the complex financial system,
especially between banks and the financial institutions, the systemic risk arising out of too-big-to-fail entities and system-wide liquidity needs.

Though the epicentre of the crisis lay in the sub-prime mortgage market in the US, it was transmitted rapidly throughout the globe, destabilizing financial markets and banking systems. The crisis eventually impacted the broader macro-economy, affecting economic growth and employment throughout the world.

The magnitude of this crisis has clearly signaled the need for major overhaul of the global financial regulatory architecture, the importance and need for improving quality and level of capital, risk management and governance standards, having strong domestic (indigenous) banks, avoiding large and complex banking structures as well as strengthening banks’ transparency and disclosures.

Issues For Consideration

Various opinion makers have expressed views about the desirability of permitting new banks (including local area banks), allowing conversion of NBFCs into banks and whether large industrial and business houses should be allowed to set up banks.

A number of issues, however, bear consideration. These include:
⇒ Minimum capital requirements for new banks and promoters contribution

⇒ Minimum and maximum caps on promoter shareholding and other shareholders

⇒ Foreign shareholding in the new banks

⇒ Eligible Promoters

(A) Whether industrial and business houses could be allowed to promote banks.

(B) Should Non-Banking Financial Companies be allowed conversion into banks or to promote a Bank.

⇒ Business Model

4.2 Types of Private sector banks:

Private sector banking is a type of banking process that involves financial institutions which are primarily owned and operated by private individuals and
business organizations rather than by a government entity. This is in contrast with public sector banking, in which the banking enterprise is owned and operated by the state in some manner. In many nations that are supportive of free enterprise, private sector banking is the most common form of banking available. While a government may not actually control banks and other financial institutions that engage in this form of banking, private sector institutions do typically have to comply with governmental regulations that apply to banking in general.

It is not unusual for private sector banking to play a major role in the economy of a given nation. Since this form of banking along with other private sector business enterprises tends to account for a large portion of the money that moves through an economy, financial analysts will pay close attention to what is happening in the private sector. In some nations, a government bank may sometimes set the standard for issues such as interest rates, with banks in the private sector following the example. Since so much of the economy depends on the activities occurring within the private sector, the current policies and procedures that govern private sector banking within a given nation can often help to slow and eventually reverse an unfavourable economic trend, such as a recession.

Another benefit of private sector banking is the support that the mechanism provides to the free enterprise system within a number of economies. Assuming that the banks associated with the private sector are working in harmony with other private sector businesses and concerns, the potential for growing the economy at a consistent and prudent pace is possible. Banking of this tends to make it easier for companies to obtain funds for expansion projects, the launching of stock offerings, and other vital activities that ultimately benefit both the banks and the companies, as well as consumers in general.

While private sector banking does provide a wide range of benefits, this form of banking has to comply with governmental regulations that are in effect in the nation where the banks are located. This helps to provide a basis or foundation for the operation, allowing all banking concerns to have the opportunity to compete for customers. Typically, the regulations also help to establish guidelines for the creation of financial products that are offered to individual and commercial customers, while still allowing each bank to offer value-added benefits that help
them to stand out among the different choices open to those potential customers.

There are types of Private banks in India;

   a. Old generation private banks.
   b. New generation private banks
   c. Foreign banks operate in India
   d. Co-operative banks

4.2(i) **Old Generation Private Banks:**

The banks, which were not nationalized at the time of bank nationalization that took place during 1969 and 1980’s are known to be the old private-sector banks. These were not nationalized, because of their small size and regional focus. Most of the old private-sector banks are closely held by certain communities their operations are mostly restricted to the areas in and around their place of origin. Their Board of directors mainly consist of locally prominent personalities from trade and business circles. One of the positive points of these banks is that, they lean heavily on service and technology and as such, they are likely to attract more business in days to come with the restructuring of the industry round the corner.

**List of the old private-sector banks in India:**

1. Bank of Rajasthan Ltd.
2. Catholic Syrian Bank Ltd.
3. City Union Bank Ltd.
4. Dhanalakshmi Bank Ltd.
5 Federal Bank Ltd.
6. ING Vysya Bank Ltd.
8. Karnataka Bank Ltd.
10. Lakshmi Vilas Bank Ltd.
4.2(ii) **New Generation Private-Sector Banks**

The banks, which came in operation after 1991, with the introduction of economic reforms and financial sector reforms are called "new private-sector banks". Banking regulation act was then amended in 1993, which permitted the entry of new private-sector banks in the Indian banking sector. However, there were certain criteria set for the establishment of the new private-sector banks, some of those criteria being: The bank should have a minimum net worth of Rs. 200 Crores.

1. The promoters holding should be a minimum of 25% of the paid-up capital.
2. Within 3 years of the starting of the operations, the bank should offer shares to public and their net worth must increased to 300 crores.

**List of the new private-sector banks in India**

1. Bank of Punjab Ltd. (since merged with Centurian Bank)
2. Centurian Bank of Punjab (since merged with HDFC Bank)
3. Development Credit Bank Ltd.
4. HDFC Bank Ltd.
5. ICICI Bank Ltd.
6. IndusInd Bank Ltd.
7. Kotak Mahindra Bank Ltd.
8. Axis Bank (earlier UTI Bank)
9. Yes Bank Ltd.

4.2(iii) **Foreign banks operate in India:**

In 2005, the Reserve Bank released the “Road map for presence of foreign banks in India” laying out a two track and gradualist approach aimed at increasing the efficiency and stability of the banking sector in India. One track was the consolidation of the domestic banking system, both in private and public sectors, and the second track was the gradual enhancement of foreign banks in a synchronised manner. The Road map was divided into two phases,
the first phase spanning the period March 2005 – March 2009, and the second phase beginning after a review of the experience gained in the first phase. However, when the time came to review the experience gained in the first phase, global financial markets were in turmoil and there were uncertainties surrounding the financial strength of banks around the world. At that time it was considered advisable to continue with the current policy and procedures governing the presence of foreign banks in India.

The story of foreign banks in India goes back to the 19th century when the colonial economy brought with it the need for modern banking services, uniform currency and remittances by British army personnel and civil servants. The earliest banking institutions, joint stock banks, agency houses and the presidency banks, established by the merchants during the East India Company regime largely catered to this growing need. While the agency houses and joint stock banks largely failed and disappeared, the three presidency banks would later merge to form the State Bank of India, India’s largest lender. British owned and controlled, these early banks may be considered India’s first ‘foreign banks’. It was decades after their establishment that the first bank owned and controlled by Indians, the Allahabad Bank, would be established.

Milestone events for banking in India such as the passing of the Reserve Bank of India (RBI) Act, 1934, the creation of the central bank in 1935, bank nationalisation in 1969 and 1980 did not impact foreign banks much. They adapted well to the changing economy and retained their niche as service providers and employers of the elite; bringing capital, innovation and best practices from their home countries.

The first phase of banking reforms, triggered by recommendations of the Narasimhan Committee in 1991 and the licensing of the new private sector banks through the next two decades inaugurated an era of change. Meanwhile, the opening-up of the economy to increased participation by foreign players created greater opportunities for foreign banks to work with their multinational clients in India. In the more recent past, foreign banks have followed Indian corporate entities in their outbound expansions.
The survival of the banking system in India through the financial crisis has demonstrated its strengths and most foreign banks present in India believe that India is a market with undeniable potential. However, like their predecessors, they continue to look for the best possible role they can play amidst the challenging political economy, heightened competition and changing financial services regulations.

Foreign banks in pre-independence India

Foreign banks in India today, such as Standard Chartered Bank and HSBC, found their roots in financing the growing trade between Asia and the rest of the world. Traditional trade items at the time were cotton from Mumbai, indigo and tea from Kolkata, rice from Burma, sugar from Java, tobacco from Sumatra, hemp from Manila and silk from Yokohama, all flowing to the west through Indian ports, making India an important destination for these banks.

Standard Chartered Bank’s antecedent, the Chartered Bank of India opened an office in Calcutta in 1858, after receiving a Royal Charter from Queen Victoria. The arrival of the Hong Kong and Shanghai Banking Corporation (HSBC) in 1859 marked the first major inorganic entry by a foreign bank in the country, when it acquired the erstwhile Mercantile Bank in India. The Comptoir d’Escompte de Paris, which would later become one of the entities to form BNP Paribas, started operations in Calcutta in 1860, and represented the French as the second nationality to have a major banking presence in the country after the British.

Major American banking companies were at the time restricted by law from operating outside the US. The relaxation of these laws paved the way for the global expansion of American banks in the early 20th century. Citibank, or as it was known then, The National City Bank of New York, entered India in 1902, and JP Morgan, which had ambitions of entering India as early as 1902, did so in 1922 via an ownership stake in the Calcutta merchant banking firm Andrew Yule and Co. Ltd.

Foreign banks in India today:

As of March 2013, there are 43 foreign banks from 26 countries operating as branches and 46 banks from 22 countries operating as representative offices.
Although the discussion around differential licensing is still nascent, there is one foreign bank present as a credit card issuer with limited banking licence. In addition, a number of foreign banks have also entered India via the NBFC route, while a considerable number have set up captive centres in the country.

Foreign banks present in India as representative offices often have correspondent banking relationships with domestic banks and provide a useful platform for foreign banks to access opportunities for foreign currency lending to Indian corporate and financial institutions.

Foreign banks have less than 1% of the total branch network but about 7% of the total banking sector assets and a sizeable 11% of profits. With 334 branches in all, the share of foreign bank branches is less than1%. (Exhibit 1 and 2)

Exhibit 1: Foreign banks’ share of banking assets and profits

<table>
<thead>
<tr>
<th></th>
<th>Foreign Banks</th>
<th>Public Sector Banks</th>
<th>Private Sector Banks</th>
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<tbody>
<tr>
<td>Number of banks</td>
<td>43</td>
<td>26</td>
<td>20</td>
</tr>
<tr>
<td>Number of branches</td>
<td>327</td>
<td>75,779</td>
<td>16,001</td>
</tr>
<tr>
<td>Share of deposits</td>
<td>4%</td>
<td>77%</td>
<td>19%</td>
</tr>
<tr>
<td>Share of assets</td>
<td>6%</td>
<td>74%</td>
<td>20%</td>
</tr>
<tr>
<td>Share of off-balance sheet assets</td>
<td>63%</td>
<td>18%</td>
<td>19%</td>
</tr>
</tbody>
</table>

Table 4.1

Source: Database on the Indian Economy, a profile of banks 2012-13, RBI
For most foreign banks, their relationship with Indian corporate clients is pivoted around their ability to provide access to global capital and debt markets. Although data relating to individual bank’s exposure to India through onshore credit and offshore ECB and trade finance is not available, taking the total ECB data as a proxy for offshore exposure, it is interesting to see the consistent upward trendline for external debt. Understandably, the onshore exposure and its growth are related to the performance of the economy and market share of foreign banks.

Although foreign banks largely operate at higher levels of efficiency and maintain low net NPA ratios, due to exposure to the same group of clients, the risks are correlated. Interestingly, one of the biggest challenges facing foreign banks is client selection. Although the Indian economy has grown at a healthy rate, there are only a handful of Indian corporates with credible governance processes and global reputation required to pass muster with the credit divisions of these banks. Increasingly, such clients are also being pursued by domestic banks with larger single obligor limits and greater autonomy to take decisions locally. This automatically segments foreign banks as ‘niche’ service providers which often collides with the ‘universal banking’ policy regime.

Foreign banks: Evolution and approaches to banking in India

Due to the local branch regime and the operating model of choice, foreign banks have, for the large part, remained niche players, focussing on trade finance,
external commercial borrowing, wholesale lending, investment banking and treasury activities. Some large foreign banks have focussed on capturing the retail market but have remained confined to the high end of private banking and wealth management, while a few others have created valuable niche offerings in the areas of transaction banking, cash management and remittance products.

With India emerging as a major Information Technology (IT) service provider in the 21st century, many global banks set up business processing offices (BPO) in India; primarily to take advantage of the low-cost technology and availability of English-speaking employees. Some foreign banks also created centres of excellence that provided services at the higher end of the value chain. Although not in scope for the present survey, these operations of foreign banks have created attractive and large-scale employment opportunities for educated Indians and have been an interesting part of India’s economic, social and cultural landscape.

With the growing importance of IT to banks, foreign bank BPO centres in India have expanded the scope of their services, providing data analytics, and data-backed solutions, that contribute to the efficiency and profitability of these banks globally.

Liberalisation of Foreign Direct Investment (FDI) norms for financial services provided further strategic entry routes for foreign banks in the form of NBFCs that could provide specialised non-banking financial services such as stock broking, merchant banking, leasing and finance and others to specific segments of the economy.

Foreign banking groups present in India as branches also took this opportunity to set up separate entities to provide specialised services. This led to the formation of financial conglomerates or large franchises with multiple entities. In the absence of flexibility on expanding the branch network, the lending NBFCs also created an opportunity for foreign banks targeting retail clients to create the level of outreach required for their operations.

However, the 2006 guidelines on Financial Regulation of Systemically Important NBFCs and Banks’ Relationship With Them and subsequent regulations have significantly limited this opportunity by stipulating consolidated capital market limits and otherwise frowning upon what regulators consider to be ‘regulatory arbitrage’ between a bank and an NBFC engaged in an activity permitted in the bank.
Foreign banks: Bringing global innovation standards to banking practice in India

In addition to setting up the first formal banking institutions in India, foreign banks have made considerable contribution to the banking sector over the years by bringing capital and global best practices as well as grooming talent.

Foreign banks have been innovative in identifying specific needs of the market, creating products, and developing organisational constructs. A good example is the cash management offering in the early 1990s, that targeted inefficiencies in cash collection and check processing, identified as a specific issue for the Indian market. Built around this were products such as Citi cash and Citi check. More importantly, the bank had a dedicated division in the organisation to address the needs of this market and after a successful stint in India, the product was successfully introduced in other emerging markets. There are many such examples, including securitisation, foreign exchange derivatives, travellers’ cheques, channel financing and credit scorecards. Similarly, these banks often introduced risk management practices from their countries and were took steps to become part of the local cultural and community landscape through their initiatives relating to corporate social responsibility, sustainability, and contribution to protection of heritage buildings, local arts and crafts.

Prior to 1990s, foreign banks easily distinguished themselves vis-a-vis public sector banks. They used technology to their advantage to create and often maintain lead in premium services such as integrated cash management, private banking, 24-hour phone banking, internet banking, securitisation, forex and interest rate derivatives trading, risk management and Know Your Customer (KYC) software solutions. The first Automated Teller Machine (ATM) in the country, for instance, was set up by HSBC in 1987. This focus on innovation helped foreign banks build profitable businesses with a relatively high share of investment and fee income.

In the early stages through expatriate employees, and later integrating local talent in a big way, foreign banks trained and nurtured talent in India. In the process, foreign bank executives in India have also become a rich source of talent for their global banking networks. An established global network, ability to specialise, gain access to latest developments in banking technology and services, and the opportunity to gain international experiences were key factors contributing to their talent retention.

The banking landscape changed dramatically post the entry of new private sector banks. Not only did foreign banks face competition from the new private sector banks that were often run by their own ex-employees with the opportunity to take
quick decisions and upscale in a fostering environment using local technology, but also from some of the public sector banks that did well on the back of what was then called ‘computerisation’ and a better way of engaging with the customer.

Exhibit 4: High contribution of investment and fee income to revenues compared to domestic banks

![Bar chart showing contribution of investment and fee income to revenues for different types of banks.

- **Foreign Banks**: 42% Advances, 31% Investments, 14% Fee-based
- **Public Sector Banks**: 69% Advances, 20% Investments, 4% Fee-based
- **Private Sector Banks**: 61% Advances, 22% Investments, 12% Fee-based

Source: Database on the Indian Economy, RBI

2005: First roadmap for foreign banks in India:

One and half decades post liberalisation, a robust regulatory framework governing foreign bank presence in the country became imperative. Twelve new private sector banks had been given licences under the guidelines issued in 1993 and 2001. Beginning with the voluntary merger of Times Bank with HDFC, consolidation of
the newly licensed banks had also started. ICICI and HDFC Bank had established themselves as iconic Indian brands with scale and distribution power. Many public sector banks had been listed and the adoption of technology powered by Indian technology giants had changed the face of Indian banking considerably, putting them on a profitable growth path for the near future. On 28 February 2005, the RBI released a roadmap for the presence of foreign banks in India along with guidelines on ownership and governance in private sector banks. This was indeed a watershed event as it provided the first ever documented policy on foreign banks in the country, and for the first time, spurred a debate about the present and future role of foreign banks in India. It was also no coincidence that the guidelines on private sector bank ownership and foreign bank roadmap were released together. The press release prefacing both documents makes an interesting point about the ‘need for enabling shareholding higher than 10% to facilitate restructuring in the banking system and consolidation.’ Ironically, that debate remains as relevant today as in 2005, despite an Act of Parliament in December 2012 having paved the way for enhanced voting rights upto 26%. The new private sector banks also spurred an opportunity for foreign banks and investors to participate in the Indian banking sector through equity investments. For example, ING hiked its stake in ING Vysya Bank to 44% in 2002, up from 20%, HSBC acquired 14.71% stake in UTI Bank (today known as Axis Bank) in 2003, Temasek Holdings acquired 5% stake in ICICI Bank in 2003 and later increased it to 9%, Rabo bank acquired 20% stake in Yes Bank in 2004 and HSBC acquired 4.74% stake in Yes Bank in 2008. Remarkably, while many foreign banks have set up branches in India, few have followed a consistent growth path over the long-term. One case in point is Bank of America, which sold a successful retail business in India to ABN AMRO Bank in 2001 as a part of its global strategy (consequent upon merger of Bank of America and Nations Bank) to withdraw from international retail operations. In 2001, RBS took over ABN AMRO Bank and the business was rechristened in India as RBS. More recently, this business has been sold to Ratnakar Bank Limited (RBL), a domestic bank. The management of RBL Bank has many of the old Bank of America senior personnel, thus marking a full circle. This is a good example of the changing dynamics of the market, depending on local and international conditions. American Express Bank’s exit from all but the card business, Barclays Bank’s foray in retail and subsequent exit from that business and some of the other banks’
experiments with SME lending and exit have also attracted attention to the flux in the non-corporate banking space. While the ability to enter and exit businesses is an integral part of strategic business decisions, in India, such decisions are often difficult or time-consuming to implement due to a lack of direct and unambiguous regulatory guidance.

The financial crisis of 2008 and impact on foreign banks:

The aftermath of the financial crisis of 2008, the attention of multinational banks, particularly of those a large presence in the west, turned to their home countries as they struggled with sudden liquidity problems, many of them going to the brink. The rapid collapse of few of the most respectable global investment banks and the domino effect on the global financial system was dramatic enough to cause tectonic shifts in the banking landscape. Although the crisis was truly global in nature, its effects on different economies were varied in impact as well as timing. After the crisis, governments and regulators launched a series of measures to restore their financial systems. This period also saw greater collaboration among regulators on the global platform and greater consensus on systemic risks, financial stability and the challenges of too big to fail financial institutions. Changes in global liquidity conditions as governments embarked on stimulus programmes created a fresh set of challenges and opportunities. The survival of the Indian economy in the immediate aftermath of the crisis had interesting consequences for this liquidity seeking attractive returns. After 2009, India actually granted licences to 13 new foreign banks to commence business in India. Western banks, battered by the global financial crisis and regulatory measures such as increased capital requirements and the pressure to de-leverage their balance sheets had to re-evaluate their investments across emerging markets. Some responded by curtailing their operations, selling off businesses and assets and trimming their exposures to countries increasingly perceived as non-core. Others withdrew all together, leaving behind advisory and capital markets activities that were not capital-intensive.

For most foreign banks, India accounts for a minor part of their parents’ books. Examining the India exposure of foreign banks in the country, 31 foreign banks had less than 1% of their global assets in India whereas Barclays, HSBC, Standard Chartered and Citibank have India exposures between of 1 to 5% of their parent’s asset book (this is the in-country share as offshore exposure data is not available in public domain). This impacts the ability of the champions of long-term growth in India to build consensus within the larger organisation, often losing ground to the faster growing economies. In some ways, the reaction of the foreign banks post-crisis bears out the worst fears that regulators in emerging economies have regarding the behaviour of foreign financial institutions as fair-weather friends.
Although the withdrawal of foreign banks from India has not created a dramatic impact unlike in the Asian or Latin American crisis, the memory of banks withdrawing from the economy lingers with regulators and the public. Consequently it is often not easy to re-enter the market.

Of course, in the Indian context, due to specific Foreign Exchange Management Act (FEMA) and banking regulations restrictions on capital repatriation and liquidity management, the withdrawal was not disruptive. Nevertheless, this led to further tightening of liquidity and capital guidelines and prompted discussion around systemic risk management and local incorporation of foreign banks, eventually culminating in the discussion paper on presence of foreign banks in India in January 2011.

**Branch licences granted to new and existing foreign banks in India**

<table>
<thead>
<tr>
<th>Year</th>
<th>Branch Licence Granted</th>
<th>New Banks commencing operations</th>
</tr>
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<td>16</td>
<td>1</td>
</tr>
<tr>
<td>2010</td>
<td>15</td>
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<td>5</td>
<td>5</td>
</tr>
<tr>
<td>2013</td>
<td>11</td>
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</tr>
</tbody>
</table>

**Figure 4.3**

Source: Database on Indian Economy, RBI, PwC
4.2(iv) **Co-operative banks in India:**

The history of co-operative movement in India is about a century old. The movement was started in India with a view to encourage and promote thrift and mutual help for the development of persons of small means such as agriculturists, artisans and other segments of the society. It was also aimed at concentrating the efforts in releasing the exploited classes out of the clutches of the money lenders. Keeping this as one of the objectives, credit societies were formed under Co-operative Societies Act of 1904.

The 1904 Act was largely based on the English Friendly Societies Act, 1896. Under this Act, only primary credit societies were permitted to register and non-credit and federal organisations of primary co-operative credit societies were left out. This lacuna was bridged by the Co-operative Societies Act, 1912. This Act paved the way for the organisation of central co-operative banks throughout the country. But the provisions of 1912 Act were inadequate to meet the requirements of those states where co-operative movement had made considerable progress. Bombay, the pioneers in this regard passed a new Act, viz., the Bombay Co-operative Societies Act, 1925 for serving the many sided development of the state. Later on, Madras, Bihar and Bengal passed their own Acts in 1932, 1935 and 1940 respectively.

**Structure of Co-operative Banking in India**

India's co-operative banking structure consists of two main segments, viz., agricultural and non-agricultural credit. There are two separate structures in the case of agricultural credit - one for short and medium term credit and the other for long term credit. The co-operative credit structure for short and medium terms is a three tier one with primary agricultural credit societies at the base level, the central co-operative bank at the district level and state co-operative bank at the apex level. Over and above these institutions, grain banks are actively functioning as primary societies in certain states. Though the organisation of central and state co-operative banks was mainly for the benefit of the agricultural credit sector, they serve non-agricultural societies too.
Primary Agricultural Credit Societies

Primary Agricultural Credit Societies (PACS) are the foundation of the co-operative credit structure and form the largest number of co-operative institutions in India. Most of these societies have been organised mainly to provide credit facilities and to inculcate the habit of thrift and economy among their members.

The share capital of a society is divided into units, called shares, contributed by the members. The most important source of finance of PACS is members' deposits. Borrowings constitute the most important element of their working capital. The criteria for borrowings differ from state to state according to their liability. Punctuality in the repayment of loans has hardly been observed by the members with the result that there has been a steep rise in the amount of over dues all over the country.

Primary Agricultural Credit Societies in India:

In India, PACS are passing through an era of crisis. Increasing incidence of non-viability is one of the major setbacks. PACS have made little progress in attracting deposits. In majority of the cases, the deposits were collected through book adjustments by carving certain portion of loan amount. The repaying capacity of the PACS has been dwindled considerably, as a result mounted over dues in the loan outstanding against members. Along with the increasing volume of business the number of PACS running into loss and the amount of loss have increased considerably over the years. The important reasons for this situation are, existence of non-viable and dormant societies, uneven growth of agricultural credit movement, inadequacy of the quantum of loan supplied by them, defective loan policies, delay in loan disbursement, inadequate supervision and defective audit, no linking of credit with marketing, high over dues, ineffective management, neglect of small farmers and domination of vested interests.

District Co-operative Banks in India:

District Co-operative Banks (DCBs) occupy the middle level position in the three tier co-operative credit structure of the country. In the beginning of the formation of PACSs, they could not function effectively without gaining financial support from an outside agency. Over and above this, they were in need of technical
guidance and administrative support. At the same time, there were some societies which have gained strength and posses surplus funds as well as talents. As a precondition to get mutual help it became necessary that all these primary societies form a federation for ensuring rational use of their funds and provide a common place to meet for exchange of ideas and co-operative experience. The formation of DCBs was thus a felt need for mutual help.

The Co-operative Societies Act of 1912 permitted the registration of DCBs. Even before the enactment of this Act, some DCBs were established to cater to the needs of primary societies. In 1906, forerunner of the first DCB was established as a primary society in Uttar Pradesh. At Ajmer in Rajasthan the first DCB was established in 1910. But the first full-fledged DCB as per the provisions of the Act of 1912 was started in Jabalpur District of the Central Province.

Co-operative banks are an important constituent of the Indian Financial System, judging by the role assigned to them, the expectations they are supposed to fulfill, their number, and the number of offices they operate. The co-operative movement originated in the West, but the importance that such banks have assumed in India is rarely paralleled anywhere else in the world. Their role in rural financing continues to be important even today, and their business in the urban areas also has increased in recent years mainly due to the sharp increase in the number of primary co-operative banks.

FEATURES OF CO-OPERATIVES BANKS

Co-operative movement is quite well established in India. Co-operative Institutions are engaged in all kinds of activities namely production, processing, marketing, distribution, servicing, and banking in India and have vast and powerful superstructure. Co-operative Banks are important cogs in this structure. Co-operative Banks:

• Are organized and managed on the principal of co-operation, self-help, and mutual help. They function with the rule of "one member, one vote".

• Function on "no profit, no loss" basis. Co-operative banks, as a principle, do not pursue the goal of profit maximization.
Co-operative bank performs all the main banking functions of deposit mobilization, supply of credit and provision of remittance facilities. Co-operative Banks provide limited banking products and are functionally specialists in agriculture related products. However, co-operative banks now provide housing loans also.

UCBs provide working capital loans and term loan as well.

The State Co-operative Banks (SCBs), Central Co-operative Banks (CCBs) and Urban Co-operative Banks (UCBs) can normally extend housing loans upto Rs 1 lakh to an individual. The scheduled UCBs, however, can lend upto Rs 3 lakh for housing purposes. The UCBs can provide advances against shares and debentures also.

Co-operative bank do banking business mainly in the agriculture and rural sector. However, UCBs, SCBs, and CCBs operate in semi urban, urban, and metropolitan areas also. The urban and non-agricultural business of these banks has grown over the years. The co-operative banks demonstrate a shift from rural to urban, while the commercial banks, from urban to rural.

Co-operative banks are perhaps the first government sponsored, government-supported, and government subsidised financial agency in India. They get financial and other help from the Reserve Bank of India NABARD, central government and state governments. They constitute the "most favoured" banking sector with risk of nationalization. For commercial banks, the Reserve Bank of India is lender of last resort, but co-operative banks it is the lender of first resort which provides financial resources in the form of contribution to the initial capital (through state government), working capital, refinance.

Co-operative Banks belong to the money market as well as to the capital market.

Primary agricultural credit societies provide short term and medium term loans.

Land Development Banks (LDBs) provide long-term loans. SCBs and CCBs also provide both short term and term loans.

Co-operative banks are financial intermediaries only partially. The sources of their funds (resources) are (a) central and state government, (b) the Reserve Bank
of India and NABARD, (c) other co-operative institutions, (d) ownership funds and, (e) deposits or debenture issues. It is interesting to note that intra-sectoral flows of funds are much greater in co-operative banking than in commercial banking. Inter-bank deposits, borrowings, and credit from a significant part of assets and liabilities of co-operative banks. This means that intra-sectoral competition is absent and intra-sectoral integration is high for co-operative bank.

• Some co-operative bank are scheduled banks, while others are non-scheduled banks. For instance, SCBs and some UCBs are scheduled banks but other co-operative bank are non-scheduled banks. At present, 28 SCBs and 11 UCBs with Demand and Time Liabilities over Rs 50 crore each included in the Second Schedule of the Reserve Bank of India Act.

• Co-operative Banks are subject to CRR and liquidity requirements as other scheduled and non-scheduled banks are. However, their requirements are less than commercial banks.

4.3  Functions of Private sector banks:

The private sector banks play a vital role in the Indian economy. They indirectly motivate the public sector banks by offering a healthy competition to them. The following are their functions:

4.3(i) Offering high degree of Professional Management:

The private sector banks help in introducing a high degree of professional management and marketing concept into banking. It helps the public sector banks as well to develop similar skill and technology.

4.3(ii) Creates healthy competition:

The private sector banks provide a healthy competition on general efficiency levels in the banking system.

4.3(iii) Encourages Foreign Investment:

The private sector banks especially the foreign banks have much influence on the foreign investment in the country.
4.3(iv) Helps to access foreign capital markets:

The foreign banks in the private sector help the Indian companies and the
government agencies to meet out their financial requirements from international
capital markets. This service becomes easier for them because of the presence of
their head offices/other branches in important foreign centres. In this way they help
a large extent in the promotion of trade and industry in the country.

4.3(v) Helps to develop innovation and achieve expertise:

The private sector banks are always trying to innovate new products avenues (new
schemes, services, etc.) and make the industries to achieve expertise in their
respective fields by offering quality service and guidance.

They introduce new technology in the banking service. Thus, they lead the other
banks in various new fields. For example, introduction of computerised operations,
credit card business, ATM service, etc.

The commercial banks serve as the king pin of the financial system of the country.
They render many valuable services. The important functions of the Commercial
banks can be explained with the help of the following chart.

Primary Functions

The primary functions of the commercial banks include the following:

A. Acceptance of Deposits

1. Time Deposits:

These are deposits repayable after a certain fixed period. These deposits are not
withdrawn able by cheque, draft or by other means. It includes the following.

(a) Fixed Deposits:

The deposits can be withdrawn only after expiry of certain period say 3 years, 5
years or 10 years. The banker allows a higher rate of interest depending upon the
amount and period of time. Previously the rates of interest payable on fixed
deposits were determined by Reserve Bank.

Presently banks are permitted to offer interest as determined by each bank. However, banks are not permitted to offer different interest rates to different
customers for deposits of same maturity period, except in the case of deposits of Rs. 15 lakhs and above.

These days the banks accept deposits even for 15 days or one month etc. In times of urgent need for money, the bank allows premature closure of fixed deposits by paying interest at reduced rate. Depositors can also avail of loans against Fixed Deposits. The Fixed Deposit Receipt cannot be transferred to other persons.

(b) **Recurring Deposits:**

In recurring deposit, the customer opens an account and deposit a certain sum of money every month. After a certain period, say 1 year or 3 years or 5 years, the accumulated amount along with interest is paid to the customer. It is very helpful to the middle and poor sections of the people. The interest paid on such deposits is generally on cumulative basis. This deposit system is a useful mechanism for regular savers of money.

(c) **Cash Certificates:**

Cash certificates are issued to the public for a longer period of time. It attracts the people because its maturity value is in multiples of the sum invested. It is an attractive and high yielding investment for those who can keep the funds for a long time.

It is a very useful account for meeting future financial requirements at the occasion of marriage, education of children etc. Cash certificates are generally issued at discount to face value. It means a cash certificate of Rs. 1, 00,000 payable after 10 years can be purchased now, say for Rs. 20,000.

2. **Demand Deposits:**

These are the deposits which may be withdrawn by the depositor at any time without previous notice. It is withdraw able by cheque/draft. It includes the following:

(a) **Savings Deposits:**

The savings deposit promotes thrift among people. The savings deposits can only be held by individuals and non-profit institutions. The rate of interest paid on savings deposits is lower than that of time deposits. The savings account holder gets the advantage of liquidity (as in current a/c) and small income in the form of interests.
But there are some restrictions on withdrawals. Corporate bodies and business firms are not allowed to open SB Accounts. Presently interest on SB Accounts is determined by RBI. It is 4.5 per cent per annum. Co-operative banks are allowed to pay an extra 0.5 per cent on its savings bank deposits.

(b) **Current Account Deposits:**

These accounts are maintained by the people who need to have a liquid balance. Current account offers high liquidity. No interest is paid on current deposits and there are no restrictions on withdrawals from the current account.

These accounts are generally in the case of business firms, institutions and co-operative bodies. Nowadays, banks are designing and offering various investment schemes for deposit of money. These schemes vary from bank to bank.

It may be stated that the banks are currently working out with different innovative schemes for deposits. Such deposit accounts offer better interest rate and at the same time withdraw able facility also. These schemes are mostly offered by foreign banks. In USA, Current Accounts are known as 'Checking Accounts' as a cheque is equivalent to check in America.

**B. Advancing of Loans**

The commercial banks provide loans and advances in various forms. They are given below:

1. **Overdraft:**

This facility is given to holders of current accounts only. This is an arrangement with the bankers thereby the customer is allowed to draw money over and above the balance in his/her account. This facility of overdrawing his account is generally pre-arranged with the bank up to a certain limit.

It is a short-term temporary fund facility from bank and the bank will charge interest over the amount overdrawn. This facility is generally available to business firms and companies.

2. **Cash Credit:**

Cash credit is a form of working capital credit given to the business firms. Under this arrangement, the customer opens an account and the sanctioned amount is credited with that account. The customer can operate that account within the sanctioned limit as and when required.
It is made against security of goods, personal security etc. On the basis of operation, the period of credit facility may be extended further. One advantage under this method is that bank charges interest only on the amount utilized and not on total amount sanctioned or credited to the account.

Reserve Bank discourages this type of facility to business firms as it imposes an uncertainty on money supply. Hence this method of lending is slowly phased out from banks and replaced by loan accounts. Cash credit system is not in use in developed countries.

3. Discounting of Bills:

Discounting of Bills may be another form of bank credit. The bank may purchase inland and foreign bills before these are due for payment by the drawer debtors, at discounted values, i.e., values a little lower than the face values.

The Banker's discount is generally the interest on the full amount for the unexpired period of the bill. The banks reserve the right of debiting the accounts of the customers in case the bills are ultimately not paid, i.e., dishonored.

The bill passes to the Banker after endorsement. Discounting of bills by banks provide immediate finance to sellers of goods. This helps them to carry on their business. Banks can discount only genuine commercial bills i.e., those drawn against sale of goods on Credit. Banks will not discount Accommodation Bills.

4. Loans and Advances:

It includes both demand and term loans, direct loans and advances given to all type of customers mainly to businessmen and investors against personal security or goods of movable or immovable in nature. The loan amount is paid in cash or by credit to customer account which the customer can draw at any time.

The interest is charged for the full amount whether he withdraws the money from his account or not. Short-term loans are granted to meet the working capital requirements where as long-term loans are granted to meet capital expenditure.

Previously interest on loan was also regulated by RBI. Currently, banks can determine the rate themselves. Each bank is, however required to fix a minimum rate known as Prime Lending Rate (PLR).
Classification of Loans and Advances

Loans and advances given by bankers can be classified broadly into the following categories:

(i) Advances which are given on the personal security of the debtor, and for which no tangible or collateral security is taken; this type of advance is given either when the amount of the advance is very small, or when the borrower is known to the Banker and the Banker has complete confidence in him (Clean Advance).

(ii) Advances which are covered by tangible or collateral security. In this section of the study we are concerned with this type of advance and with different types of securities which a Banker may accept for such advances (Secured Advance).

(iii) Advances which are given against the personal security of the debtor but for which the Banker also holds in addition the guarantee of one or more sureties. This type of advance is often given by Banker to persons who are not known to them but whose surety is known to the Banker. Bankers also often take the personal guarantee of the Directors of a company to whom they agree to advance a clean or unsecured loan.

(iv) Loans are also given against the security of Fixed Deposit receipts.

5. Housing Finance:

Nowadays the commercial banks are competing among themselves in providing housing finance facilities to their customers. It is mainly to increase the housing facilities in the country. State Bank of India, Indian Bank, Canara Bank, Punjab National Bank, has formed housing subsidiaries to provide housing finance.

The other banks are also providing housing finances to the public. Government of India also encourages banks to provide adequate housing finance.

Borrowers of housing finance get tax exemption benefits on interest paid. Further housing finance up to Rs. 5 lakh is treated as priority sector advances for banks. The limit has been raised to Rs. 10 lakhs per borrower in cities.

6. Educational Loan Scheme:

The Reserve Bank of India, from August, 1999 introduced a new Educational Loan Scheme for students of full time graduate/post-graduate professional courses in private professional colleges.
Under the scheme all public sector banks have been directed to provide educational loan up to Rs. 15,000 for free seat and Rs. 50,000 for payment seat student at interest not more than 12 per cent per annum. This loan is on clean basis i.e., without calling for security.

This loan is available only for students whose annual family income does not exceed Rs. 1,00,000. The loan has to be repaid together with interest within five years from the date of completion of the course. Studies in respect of the following subjects/areas are covered under the scheme.

(a) Medical and dental course.
(b) Engineering course.
(c) Chemical Technology.
(d) Management courses like MBA.
(e) Law studies.
(f) Computer Science and Applications.

This apart, some of the banks have other educational loan schemes against security etc., one can check up the details with the banks.

7. Loans against Shares/Securities:

Commercial banks provide loans against the security of shares/debentures of reputed companies. Loans are usually given only up to 50% value (Market Value) of the shares subject to a maximum amount permissible as per RBI directives. Presently one can obtain a loan up to Rs.10 lakhs against the physical shares and up to Rs. 20 lakhs against dematerialized shares.

8. Loans against Savings Certificates:

Banks are also providing loans up to certain value of savings certificates like National Savings Certificate, Fixed Deposit Receipt, Indira Vikas Patra, etc. The loan may be obtained for personal or business purposes.

9. Consumer Loans and Advances:

One of the important areas for bank financing in recent years is towards purchase of consumer durables like TV sets, Washing Machines, Micro Oven, etc. Banks also provide liberal Car finance.

These days banks are competing with one another to lend money for these purposes as default of payment is not high in these areas as the borrowers are
usually salaried persons having regular income? Further, bank’s interest rate is also higher. Hence, banks improve their profit through such profitable loans.

10. Securitization of Loans:

Banks are recently trying to securities a part of their part of loan portfolio and sell it to another investor. Under this method, banks will convert their business loans into a security or a document and sell it to some Investment or Fund Manager for cash to enhance their liquidity position.

It is a process of transferring credit risk from the banker to the buyer of securitized loans. It involves a cost to the banker but it helps the bank to ensure proper recovery of loan. Accordingly, securitization is the process of changing an illiquid asset into a liquid asset.

11. Others:

Commercial banks provide other types of advances such as venture capital advances, jewel loans, etc.

1. Effective October 18, 1994 banks were free to determine their own prime lending rates (PLRs) for credit limit over Rs. 2 lakh. Data relate to public sector banks.

2. The stipulation of minimum maturity period of term deposits was reduced from 30 days to 15 days, effective April 29, 1998. Data relate to public sector banks.

3. The change in the Bank Rate was made effective from the close of business of respective dates of change except April 29, 1998.


C. Credit Creation

Credit creation is one of the primary functions of commercial banks. When a bank sanctions a loan to the customer, it does not give cash to him. But, a deposit account is opened in his name and the amount is credited to his account. He can withdraw the money whenever he needs.

Thus, whenever a bank sanctions a loan it creates a deposit. In this way the bank increases the money supply of the economy. Such functions are known as credit creation.
Secondary Functions

The secondary functions of the banks consist of agency functions and general utility functions.

A. Agency Functions

Agency functions include the following:

(i) Collection of cheques, dividends, and interests:

As an agent the bank collects cheques, drafts, promissory notes, interest, dividends etc., on behalf of its customers and credit the amounts to their accounts.

Customers may furnish their bank details to corporate where investment is made in shares, debentures, etc. As and when dividend, interest, is due, the companies directly send the warrants/cheques to the bank for credit to customer account.

(ii) Payment of rent, insurance premiums:

The bank makes the payments such as rent, insurance premiums, subscriptions, on standing instructions until further notice. Till the order is revoked, the bank will continue to make such payments regularly by debiting the customer's account.

(iii) Dealing in foreign exchange:

As an agent the commercial banks purchase and sell foreign exchange as well for customers as per RBI Exchange Control Regulations.

(iv) Purchase and sale of securities:

Commercial banks undertake the purchase and sale of different securities such as shares, debentures, bonds etc., on behalf of their customers. They run a separate 'Portfolio Management Scheme' for their big customers.

(v) Act as trustee, executor, attorney, etc:

The banks act as executors of Will, trustees and attorneys. It is safe to appoint a bank as a trustee than to appoint an individual. Acting as attorneys of their customers, they receive payments and sign transfer deeds of the properties of their customers.
(vi) Act as correspondent:

The commercial banks act as a correspondent of their customers. Small banks even get travel tickets, book vehicles; receive letters etc. on behalf of the customers.

(vii) Preparations of Income-Tax returns:

They prepare income-tax returns and provide advices on tax matters for their customers. For this purpose, they employ tax experts and make their services available to their customers.

B. General Utility Services

The General utility services include the following:

(i) Safety Locker facility:

Safekeeping of important documents, valuables like jewels are one of the oldest services provided by commercial banks. 'Lockers' are small receptacles which are fitted in steel racks and kept inside strong rooms known as vaults. These lockers are available on half-yearly or annual rental basis.

The bank merely provides lockers and the key but the valuables are always under the control of its users. Any customer cannot have access to vault.

Only customers of safety lockers after entering into a register his name account number and time can enter into the vault. Because the vault is holding important valuables of customers in lockers, it is also known as 'Strong Room'.

(ii) Payment Mechanism or Money Transfer:

Transfer of funds is one of the important functions performed by commercial banks. Cheques and credit cards are two important payment mechanisms through banks. Despite an increase in financial transactions, banks are managing the transfer of funds process very efficiently.

Cheques are also cleared through the banking system. Correspondent banking is another method of transferring funds over long distance, usually from one country to another. Banks, these days employ computers to speed up money transfer and to reduce cost of transferring funds.

Electronic Transfer of funds is also known as 'Chequeless banking' where funds are transferred through computers and sophisticated electronic system by using code words. They offer Mail Transfer, Telegraphic Transfer (TT) facility also.
(iii) Traveller cheques:

Traveller’s Cheques are used by domestic traveller as well as by international travellers. However the use of traveller's cheques is more common by international travellers because of their safety and convenience. These can be also termed as a modified form of traveller's letter of credit.

A bank issuing travellers cheques usually have banking arrangement with many of the foreign banks abroad, known as correspondent banks. The purchaser of traveller's cheques can encase the cheques from all the overseas banks with whom the issuing bank has such an arrangement.

Thus traveller's cheques are not drawn on specific bank abroad. The cheques are issued in foreign currency and in convenient denominations of ten, twenty, fifty, one hundred dollar, etc. The signature of the buyer/traveller is written on the face of the cheques at the time of their purchase.

The cheques also provide blank space for the signature of the traveller to be signed at the time of encashment of each cheque. A traveller has to sign in the blank space at the time of drawing money and in the presence of the paying banker.

The paying banker will pay the money only when the signature of the traveller tallies with the signature already available on the cheque.

A traveller should never sign the cheque except in the presence of paying banker and only when the traveller desires to en-cash the cheque. Otherwise it may be misused. The cheques are also accepted by hotels, restaurants, shops, airlines companies for respectable persons.

Encashment of a traveller cheque abroad is tantamount to a foreign exchange transaction as it involves conversion of domestic currency into a foreign currency.

When a traveller cheque is lost or stolen, the buyer of the cheques has to give a notice to the issuing bank so that stop order can be issued against such lost/stolen cheques to the banks where they are permitted to be encased.

It is also difficult to the finder of the cheque to draw cash against it since the encasher has to sign the cheque in the presence of the paying banker. Unused travellers cheques can be surrendered to the issuing bank and balance of cash obtained.

The issuing bank levies certain commission depending upon the number and value of travellers cheques issued.
(iv) **Circular Notes or Circular Letters of Credit:**

Under Circular Letters of Credit, the customer/traveller negotiates the drafts with any of the various branches to which they are addressed. Thus the traveller can obtain funds from many of the branches of banks instead only from a particular branch. Circular Letters of Credit are therefore a more useful method for obtaining funds while travelling to many countries.

It may be noted that travellers letter of credit are usually paid for in advance. In other words, the traveller first makes payments to the issuing bank before obtaining the Circular Notes.

(v) **Issue "Travellers Cheques":**

Banks issue travellers cheques to help carry money safely while travelling within India or abroad. Thus, the customers can travel without fear, theft or loss of money.

(vi) **Letters of Credit:**

Letter of Credit is a payment document provided by the buyer's banker in favour of seller. This document guarantees payment to the seller upon production of document mentioned in the Letter of Credit evidencing dispatch of goods to the buyer.

The Letter of Credit is an assurance of payment upon fulfilling conditions mentioned in the Letter of Credit. The letter of credit is an important method of payment in international trade. There are primarily 4 parties to a letter of credit.

The buyer or importer, the bank which issues the letter of credit, known as opening bank, the person in whose favour the letter of credit is issued or opened (The seller or exporter, known as 'Beneficiary of Letter of Credit'), and the credit receiving/advising bank.

The Letter of Credit is generally advised/sent through the seller's bank, known as Negotiating or Advising bank. This is done because the conditions mentioned in the Letter of Credit are, in the first instance; have to be verified by the Negotiating Bank. It is mostly used in international trade.

(vii) **Acting as Referees:**

The banks act as referees and supply information about the business transactions and financial standing of their customers on enquiries made by third parties. This is
done on the acceptance of the customers and help to increase the business activity in general.

(viii) Provides Trade Information:

The commercial banks collect information on business and financial conditions etc., and make it available to their customers to help plan their strategy. Trade information service is very useful for those customers going for cross-border business. It will help traders to know the exact business conditions, payment rules and buyers' financial status in other countries.

(ix) ATM facilities:

The banks today have ATM facilities. Under this system the customers can withdraw their money easily and quickly and 24 hours a day. This is also known as 'Any Time Money'. Customers under this system can withdraw funds i.e., currency notes with a help of certain magnetic card issued by the bank and similarly deposit cash/cheque for credit to account.

(x) Credit cards:

Banks have introduced credit card system. Credit cards enable a customer to purchase goods and services from certain specified retail and service establishments up to a limit without making immediate payment. In other words, purchases can be made on credit basis on the strength of the credit card.

The establishments like Hotels, Shops, Airline Companies, Railways etc., which sell the goods or services on credit forward a monthly or fortnightly statements to the bank.

The amount is paid to these establishments by the bank. The bank subsequently collects the dues from the customers by debit to their accounts. Usually, the bank receives certain service charges for every credit card issued. Visa Card, BOB card are some examples of credit cards.

(xi) Gift Cheques:

The commercial banks offer Gift cheque facilities to the general public. These cheques received a wider acceptance in India. Under this system by paying equivalent amount one can buy gift cheque for presentation on occasions like Wedding, Birthday.
(xii) Accepting Bills:

On behalf of their customers, the banks accept bills drawn by third parties on its customers. This resembles the letter of credit. While banks accept bills, they provide a better security for payment to seller of goods or drawer of bills.

(xiii) Merchant Banking:

The commercial banks provide valuable services through their merchant banking divisions or through their subsidiaries to the traders. This is the function of underwriting of securities. They underwrite a portion of the Public issue of shares, Debentures and Bonds of Joint Stock Companies.

Such underwriting ensures the expected minimum subscription and also convey to the investing public about the quality of the company issuing the securities. Currently, this type of services can be provided only by separate subsidiaries, known as Merchant Bankers as per SEBI regulations.

(xiv) Advice on Financial Matters:

The commercial banks also give advice to their customers on financial matters particularly on investment decisions such as expansion, diversification, new ventures, rising of funds etc.

(xv) Factoring Service:

Today the commercial banks provide factoring service to their customers. It is very much helpful in the development of trade and industry as immediate cash flow and administration of debtors' accounts are taken care of by factors. This service is again provided only by a separate subsidiary as per RBI regulations.

4.4 Advantages of Private sector banks:

The importance of private sector in Indian economy over the last 15 years has been tremendous. The opening up of Indian economy has led to free inflow of foreign direct investment (FDI) along with modern cutting edge technology, which increased the importance of private sector in Indian economy considerably.

Previously, the Indian market were ruled by the government enterprises but the scene in Indian market changed as soon as the markets were opened for
investments. This saw the rise of the Indian private sector companies, which prioritized customer's need and speedy service. This further fueled competition amongst same industry players and even in government organizations.

The post 1990 era witnessed total investment in favour of Indian private sector. The investment quantum grew from 56% in the first half of 1990 to 71% in the second half of 1990. This trend of investment continued for over a considerable period of time. These investments were especially made in sector like financial services, transport and social services.

The late 1990s and the period thereafter witnessed investments in sector like manufacturing, infrastructure, agriculture products and most importantly in Information technology and telecommunication. The present trend shows a marked increase in investment in areas covering pharmaceutical, biotechnology, semiconductor, contract research and product research and development.

The importance of private sector in Indian economy has been very commendable in generating employment and thus eliminating poverty. Further, it also effected the following –

- Increased quality of life
- Increased access to essential items
- Increased production opportunities
- Lowered prices of essential items
- Increased value of human capital
- Improved social life of the middle class Indian
- Decreased the percentage of people living below the poverty line in India
- Changed the age old perception of poor agriculture based country to a rising manufacturing based country
- Effected increased research and development activity and spending
- Effected better higher education facilities especially in technical fields
- Ensured fair competition amongst market players
- Dissolved the concept of monopoly and thus neutralized market manipulation practices.

The importance of private sector in Indian economy can be witnessed from the tremendous growth of Indian BPOs, Indian software companies, Indian private banks and financial service companies. The manufacturing industry of India is flooded with private Indian companies and in fact they dominate the said industry.
Manufacturing companies covering sectors like automobile, chemicals, textiles, agri-foods, computer hardware, telecommunication equipment, and petrochemical products were the main driver of growth.

The Indian BPO sector is more concentrated with rendering services to overseas clients. The KPO sector is engaged in delivering knowledge based high-end services to clients. It is estimated, that out of the total US $15 billion KPO service business around US $12 billion of business would be outsourced to India by the end of 2010.

Banks and financial institutions are not just users of technology. They have driven (and continue to drive) innovations in technology. ATMs were widespread before the PC revolution, the SWIFT network allowed global electronic money transfer before there was any Internet. Stock and commodity exchanges trade trillions electronically every day.

We tend to take this technology for granted, and are only reminded about it when the ATM machine is down, or the POS machine refuses to recognize our credit card. But in reality, no banking or financial transaction today can be completed without technology.

Keeping up with all of this can be a challenge for the IT departments of banks and financial institutions. In a recent study conducted by Value Notes for Anunta, we found that the biggest challenge faced by CTOs was in integration. The other big challenge is around retaining and attracting IT talent.

![Figure 4.4](image-url)
This pains of integration were felt by all financial institutions, in different degrees. The head of IT at an insurance company told us, “Integration with banks is a great challenge. We get business due to Bancassurance, but some of the PSU banks did not let us look at their systems.” The CIO of a pre-liberalization private bank felt that data portability from old applications to new applications was a major challenge.

Private banking is personalised financial and banking services offered to a bank's high net worth individuals (HNIs). In India, it is offered by foreign banks and a few private sector banks. Banks like Citibank, Standard Chartered, HSBC, HDFC, ICICI and the likes offer such services. The main advantage of private banking is that a dedicated relationship manager is assigned to the customer who takes care of all his/her banking and financial needs. Be it a simple thing like wanting cash delivered at your doorstep, or complex financial planning for your kids, or your retirement, drafting a will, investing short-term surplus money, or buying a complex structured product - all of it is taken care of by the private banker.

Private banking is offered to high net worth customers. Depending on the perception of your financial wealth, the bank would offer you these services.

Different banks have different norms for customers eligible for such services. Some banks offer private banking to clients with 30 lakh investible surplus, while some others give them to those with 1 crore and above.

Your wealth would include things like fixed deposits, your investments in mutual funds the balance in your savings account and so on.

The private banker helps you in all your banking and wealth management needs. To start with, the banker has to understanding the customer. So a private banker has initial meetings with the client to understand his/her risk profile, cash flows, needs and wants.

Based on the details obtained from such meetings, he develops an asset-allocation ratio for the client.

Using this model, he allocates the client's wealth into various assets that he feels opportune, such as equities, debt or real estate.

Within each category, he offers various products. Once a portfolio is restructured and built, it is monitored on a monthly or quarterly basis. The private banker comes up with appropriate strategies to enhance returns from the portfolio.
A private banker's role is to anticipate and understand client needs and to help achieve his immediate and long-term wealth goals. So whether you run a business, or are employed or a professional, a private banker should be able to help you.

4.5 Modern trends in Private sector banks:

When the new generation private sector banks started operations in 1993, they had to compete against established players, some of whom had been in business for over a century. The market was dominated by the state-owned banks, which had strong branding as well as a widespread branch network.

There were also foreign banks operating in India. While the foreign banks were not big in terms of the branch network, they had innovative products and a very customer focused approach to the business. The new generation private sector banks had to carve out a niche for themselves within this framework.

Thus the first decade was spent focusing on the corporate banking model. The second decade - post 2000 - saw them scaling up the retail banking and consumer lending businesses.

What impact have the new banks had? Today, they have a market share of 20 per cent in deposits and advances. This has been achieved in a growing market, indicating that private sector banks have successfully capitalised on the growth of the Indian economy. But more than acquiring market share, the real contribution of private sector banks has been to transform the way banking is done in India. In the late 1990s, there would have been maybe a few hundred ATMs.

The new banks developed the concept of direct selling agents who reached out to customers with credit products, taking loans to the customer's doorstep. Not only did the private sector banks expand in this manner, their example forced public sector banks to also adopt similar strategies.

It was banks like ours which made sure that housing loans and other kinds of loans were made available in hundreds of cities and towns in India. It is one thing to say that the demand existed, but what was also required was products and the distribution network to reach those products to the people. This was a major contribution of the new generation private sector banks.

The Indian market is a growing market and to keep succeeding one has to explore the existing opportunities well. The banking sector is expected to grow at 2.5 to
three times the country's GDP growth rate. For individual banks, a lot will depend on their underlying business strategy. The differentiator will be a bank's efficiency and innovation. How well it manages risk - and, therefore, profitability - will also be a key factor.

For banks, a large part of their IT investments in the last few years has gone toward rolling out core–banking solutions. But now, investments in deployment of other applications, outsourcing of infrastructure and processes have picked up.

According to the CII–BCG IT End User Survey 2013, new private banks and foreign banks have adopted IT the most, followed by nationalized banks and the old private sector banks. New Indian private banks and foreign banks extensively use applications, provide facilities such as unified customer information and branchless banking, and have developed alternate channels of banking. However, nationalized and old private sector banks have used applications across their systems in a limited manner, and not focused heavily on improving customer service and developing alternate banking channels. Unlike most of their peers, old private–sector banks are yet to significantly outsource select business processes and the management of their IT infrastructure.

As far as adoption of new technologies like cloud computing and data analytics is concerned, new Indian private banks and foreign banks have been quite keen, and have started making efforts to leverage the advantages of such technologies. In contrast, nationalized banks and old private sector banks are yet to make headway in this area.

4.5(a) Business trends driving IT adoption

The Indian banking sector is expected to witness strong growth in the coming years, primarily driven by the huge pool of potential customers, favorable demographics, increasing household incomes, and an increasing focus on semi–urban and rural areas.

Some of the key trends that will shape the future of Indian banking are:

4.5(ii) Focus on retail banking:

Rapid accumulation of wealth in households and emergence of the “next billion” consumer segment would drive growth in retail banking, both for high net worth individuals, as well as, for the emerging middle class.
4.5(iii) Increasing banking footprint:
Banks will have to expand their networks extensively by setting up branches and ATMs. The industry will follow the model of low-cost branch network, involving smaller sized branches.

4.5(iv) Lower margins:
The sector would face downward pressure on margins in retail as well as corporate banking. Banks will invest in innovative technologies to improve efficiency and lower costs.

4.5(v) Financial inclusion:
Financial inclusion, which requires banks to come up with innovative solutions to cater to low ticket-size customers, is a central item on the Government’s agenda. The Ministry of Finance has mandated public sector banks to focus on financial inclusion. At the same time, private banks have also started focussing on this. The current business models are not economically viable, and new models such as the business correspondent approach will have to be radically different in terms of distribution, technology, HR practices, and risk management.

4.5(vi) Key areas of opportunity:
IT will play a critical role in the growth of the banking sector. The larger banks have successfully implemented the basic IT infrastructure required to run their operations, and the next tier is also moving toward greater IT adoption through increased outsourcing of its IT functions. Larger investments would be needed to upgrade existing systems and develop new ones to meet the growing and ever-changing business requirements.

Customer relationship management: Banks would invest in developing IT solutions to adapt to the increasing needs of their customers, and to manage client relationships effectively. Some of the steps banks are expected to take include:

Develop superior capabilities in data analytics to develop customer insights, improve customer services, and identify potential cross-selling opportunities—Identify innovative means of targeting customers, such as social media and digitization—Target growth in automated, standardized products to reduce lead time, and allow effective selling of low-risk products

4.5(vii) Back-end management:
Banks are expected to spend on upgrading their IT systems to make their internal processes efficient and cost-effective. Future IT spends will include:—Use of cloud computing to improve efficiency, reduce costs, and scale up operations without
incurring additional expenses on hardware, software, and manpower– Implementation of tools for better HR management, especially in PSU banks– Migration to paperless transactions & processing, such as cheque truncation system– Increased investments in areas such as automated data flow, data storage as per KYC norms and document management, to ensure compliance with regulations

4.5(viii) **Data warehousing:**
To manage the growing volume of business transactions, banks would increasingly spend on data warehousing that can enable efficient decision making by providing a repository of historical data through systematic design. This would require a vast suite of applications, giving rise to multiple opportunities for IT providers.

4.5(ix) **E–payments and mobile banking:**
For the next generation of tech–savvy customers, mobile is emerging as the preferred medium of conducting banking transactions. Private banks are developing capabilities to provide mobile banking services to their customers. Nationalized banks, too, are starting to adopt this technology. Going forward, banks will invest in development of systems and applications that will cater to the demand for such services from the new breed of technology–friendly customers, helping banks to build lasting client relationships.

4.5(x) **Payment systems:**
An increasing portfolio of products across delivery channels, and coupled with newer methods of making payments, would require banks to invest in development of new payment systems to ensure protection of customer funds and internal security.

4.5(xi) **ATM outsourcing:**
Another major opportunity for IT providers lies in the ATM space. The rollout of ATMs is on the rise to cater to the population in tier 2 and tier 3 cities. There is an increasing trend towards outsourcing of ATM management, with many banks embracing total outsourcing models, which encompasses management of installation, ATM services as well as assets.

4.5(xii) **Regulations:**
One of the important drivers of IT spending by banks will be the guidelines put forth by the RBI that pertain to the use of IT. Automated data flow, the subject of the central bank’s approach paper released in November 2012, is a case in point.
The RBI’s other guidelines for banks include greater use of technology with regard to upgrades in RRBs, KYC norms, and the cheque truncation system.

**Role of Regulators in Private Banking in India**

Due to its nature, PB in India has to deal with multiple regulators whose policies influence the working of the sector at different levels. Thus, apart from the Reserve Bank of India (RBI) and Securities and Exchange Board of India (SEBI), private banking products and services are also influenced by the Forwards Markets Commission (FMC) and the Insurance Regulatory and Development Authority (IRDA).

At the beginning of the 21st century, the biggest banks in the industrial world have become complex financial organizations that offer a wide variety of services to international markets and control billions of dollars in cash and assets. Supported by the latest technology, banks are working to identify new business niches, to develop customized services, to implement innovative strategies and to capture new market opportunities. With further globalization, consolidation, deregulation and diversification of the financial industry, the banking sector will become even more complex.

Although, the banking industry does not operate in the same manner all over the world, most bankers think about corporate clients in terms of the following:

- **Commercial banking** - banking that covers services such as cash management (money transfers, payroll services, bank reconcilement), credit services (asset-based financing, lines of credits, commercial loans or commercial real estate loans), deposit services (checking or savings account services) and foreign exchange;

- **Investment banking** - banking that covers an array of services from asset securitization, coverage of mergers, acquisitions and corporate restructuring to securities underwriting, equity private placements and placements of debt securities with institutional investors.

Over the past decade there has been an increasing convergence between the activities of investment and commercial banks, because of the deregulation of the financial sector. Today, some investment and commercial banking institutions compete directly in money market operations, private placements, project finance, bonds underwriting and financial advisory work.
Furthermore, the modern banking industry has brought greater business diversification. Some banks in the industrialized world are entering into investments, underwriting of securities, portfolio management and the insurance businesses. Taken together, these changes have made banks an even more important entity in the global business community.

Private sector Banks have pioneered internet banking, phone banking, anywhere banking, mobile banking, debit cards, Automatic Teller Machines (ATMs) and combined various other services and integrated them into the mainstream banking arena, while the PSBs are still grappling with disgruntled employees in the aftermath of successful VRS schemes. Also, following India’s commitment to the WTO agreement in respect of the services sector, foreign banks, including both new and the existing ones, have been permitted to open up to 12 branches a year with effect from 1998-99 as against the earlier stipulation of 8 branches.

- The bank marketing is than an approach to market the services profitability. It is a device to maintain commercial viability. The changing perception of bank marketing has made it a social process. The significant properties of the holistic concept of management and marketing has made bank marketing a device to establish a balance between the commercial and social considerations, often considered to the opposite of each other. A collaboration of two words banks and marketing thus focuses our attention on the following:
  - Bank marketing is a managerial approach to survive in highly competitive market as well as reliable service delivery to target customers.
  - It is a social process to sub serve social interests.
  - It is a fair way of making profits
  - It is an art to make possible performance-orientation.
  - It is a professionally tested skill to excel competition.

Users of Banking Services: The emerging trends in the level of expectation affect the formulation of marketing mix. Innovative efforts become essential the moment it finds a change in the level of expectations. There are two types of customers using the services of banks, such as general customers and the industrial customers.

General Users: Persons having an account in the bank and using the banking facilities at the terms and conditions fixed by a bank are known as general users of
the banking services. Generally, they are the users having small sized and less frequent transactions or availing very limited services of banks.

Industrial Users: The industrialists, entrepreneurs having an account in the bank and using credit facilities and other services for their numerous operations like establishments and expansion, mergers, acquisitions etc. of their businesses are known as industrial users. Generally, they are found a few but large sized customers.

Bank Marketing In the Indian Perspective:

The formulation of business policies is substantially influenced by the emerging trends in the national and international scenario. The GDP, per capita income, expectation, the rate of literacy, the geographic and demographic considerations, the rural or urban orientation, the margins in economic systems, and the spread of technologies are some of the key factors governing the development plan of an organization, especially banking organization. In ours developing economy, the formulation of a sound marketing mix is found a difficult task. The nationalization of the Reserve Bank of India (RBI) is a landmark in the development of Indian Banking system that have paved numerous paths for qualitative-cum quantities improvements in true sense. Subsequently, the RBI and the policy makers of the public sector commercial banks think in favour of conceptualizing modern marketing which would bring a radical change in the process of quality up gradation and village to village commercial viability.

As a result, the market place has been redefined with new rules of the game. Banks are transforming to universal banking, adding new channels with lucrative pricing and freebees to offer. New channels squeezed spreads, demanding customers better service, marketing skills heightened competition, defined new rules of the game pressure on efficiency. Need for new orientation diffused customer loyalty. Bank has led to a series of innovative product offerings catering to various customer segments, specifically retail credit.
4.6 Marketing practices in Private sector banks:

Bank Marketing is the aggregate function directed at providing service to satisfy customer’s financial needs and wants, more effectively than the competition keeping in view the organizational objective.

Marketing Approach to Banking Services

- Identifying the customer’s financial needs and wants.
- Develop appropriate banking products and services to meet customer’s needs.
- Determine the prices for the products/services developed.
- Advertise and promote the product to existing and potential customer of financial services.
- Set up suitable distribution channels and bank branches.
- Forecasting and research of future market needs

- The total potential presently available and its present share in the total market for deposits, advances and other services.
- Core customer segments i.e. which customers provide highest profit and business potential, so that they always get the desired attention.
- Core products and services, i.e. which services or products best match there requirements of customers in general and core customers in particular and provide high business and profit potential, so that action is taken to improve such products further to make them more acceptable.
- What products are supplementary products and keep the core products and services, as high business and profit potentials.
- Core competitors, i.e. which competitors are posing major threat in serving the core customer segments and which core products and services are they offering to the clients, so that if possible, bank can explore the possibility of offering similar products or services.
- Core appeal i.e. which advantage should be offered and communicated to customers in general to differentiate one’s own organization in terms of pricing, servicing, conveniences etc.
- Potential products to suit the changing environment, so that they meet the change in customer’s needs over a time period.
Potential customers who could be brought to bank’s fold.

The new private sector banks have outperformed the scheduled commercial banks in other categories in the last few years. Moreover, the share of the public sector banks in total credit and deposits of scheduled commercial banks has fallen and that of the private sector banks has risen. The private sector banks with their repertoire of skill, technology, customer-friendly approach and market oriented product formulation are poised to emerge as leading players in the banking sector in days to come. By posing stiff competition to the established players in the banking industry, they are serving the cause of bringing out the best in the public sector banks also. It is, therefore, only fair to expect that in the emerging banking scene, the private banks will be a major force to reckon with. With a view to clean their balance sheets, the Ministry of Finance has directed all RRBs to reduce their gross NPA ratio below 5% by 2010. At present, as many as 13 of them have the ratio over 10% (Ray 2009). Thus, it can be derived that though the problem loans have exhibited a declining trend, yet, the problem remains and is continuing.

The first task before the Private sector Banks is to formulate that Bank marketing mix which suits the national socio-economic requirements. Some have 4P's and some have 7P's of marketing mix. The common P’s of bank marketing mix are as follows:-

4.6(i) Product

First among the P's of bank marketing is product mix. Product stands for both goods and service combination offered to the public to satisfy their needs. In the highly regulated banking industry all offered the same type of products. But the drawback is that no brand can be marketed with unique selling proposition for long because it can be copied immediately. Thus, it is better to focus on some selected ideas relating to products, which have immediate operational utility as well as feasibility on banks.

In the evolution of bank products, the products can be categorized into three groups. They are Core products, Formal products, and augmented product. Core products are those products, which define the business. For a bank, some of the core products are Savings Bank Account, Current Account, Term deposit, Recurring deposit, Cash credit, Term loan, overdraft and the like. In the line
product evolution, the next type of product is Formal product. Formal product is usually a combination of two or more core products and they have strong marketing content as they cater to some specific customer needs augmented product is made out of formal product which itself has a strong marketing content. It is further reinforced through value addition. A very good example for augmented product is Smart Money Account with Hong Kong Bank. When one opens a Smart Money Account, an account holder will also get free Any Time Money Card.

4.6(ii) Price

Price is a critical and important factor of bank marketing mix due numerous players in the industry. Most consumers will only be prepared to invest their money in search of extraordinary or higher returns. They are ready to pay additional value if there is a perception of extra product value. This value may be improved performance, function, services, reliability, promptness for problem solving and of course, higher rate of return.

4.6(iii) Promotion

One of the most important elements of marketing mix of services is promotion. The promotion is to inform and remind individuals and persuade them to accept, recommend or use of a product service or ideas. Promotion is a demand stimulating aid through communication. When a bank comes out with a new product, it makes its target customer segment aware of it only through marketing promotion. It may be in various forms like press advertisement, sales campaign, word of mouth, personal interaction directly mailing. Making the customer may be enough if the product is unique or in great demand.

Bank Marketing is actually is the marketing of reliability and faith of the people. It is the responsibility of the banking industry to take people in favor through word of mouth publicity, reliability showing through long years of establishment and other services.

4.6(iv) Place

The most important element in distribution strategy relate to this issue of location of the banks to render their service. Distribution means delivery of the products or service at the right time and at the right place. The place where the banking
products or service are delivered is an important element in bank marketing. The place strategy of Indian banks has been on the basis of too many parameters. Prior sanctions from RBI and responsibility of banks towards development of banking habit in remote unbanked areas have been some of the important given parameters. So from the marketing stand point, place strategy is not fully positive to Indian baulks. The choice of location and time to make a product available will have significant impact on the customers. Customers often need to avail banking services fast for this they require the bank branches near to their official area or the place of easy access.

**4.6(v) Process**

The process is crucial to the bank marketing strategy. It gives value to the buyer and an element of uniqueness to the product. It is very significant because it provides competitive advantage to the bank. The importance of process in bank marketing strategy is based on 'value chain concept' given by Michael Porter (1996). The concept basically stresses close attention to all the organizational activities which go into marketing the final product to the customer. In the banking context, a typical value chain would encompass all activities right from the product conceptive stage down to its marketing at branch level. All these ultimately lead to the customer's satisfaction with the product that the customer has purchased.

**4.6(vi) People**

The Indian banking industry is not an exception to the modern forces of changes and competition. Many new ideas and strategies have been introduced since the introduction of the new economic policy. Like any other service industry, banking is a labour intensive industry. The human factor plays a pivotal role in the running of the businessmen unlike machine have varying attitudes, moods, heterogeneous cultures, feelings and above all, different aspirations. People are crucial to the success of any business. It is far more so in a service oriented industry like banking.

**4.6(vii) Physical Evidence**

Physical evidence is the strategic tool for the bank marketer. Banking products are intangible. Tangibilising the intangible commodity is a major challenge to the bank
marketer. One among the important methods is the upkeep of branch premises and interior decor. This is relevant not only from the point of view of physical evidence but also for tangibilisation strategy. Another strategy is imaginative designing of bank stationery used by customers. Product packaging could be another tangibilisation strategy and marketers called it as a separate 'P' of marketing strategy.

4.6(viii) Personal Selling

Due to the characteristics of banking services, personal selling is the way that most banks prefer in expanding selling and use of them. Personal selling occurs in two ways. First occurs in a way that customer and banker perform interaction face to face at branch office. In this case, whole personnel, bank employees, chief and office manager, takes part in selling. Second occurs in a way that customer representatives go to customers’ place. Customer representatives are specialist in banks’ services to be offered and they shape the relationship between bank and customer.

4.6(ix) Public Relations

Public relations in banking should provide avenues for establishing most effective communication system, creating sympathy about relationship between bank and customer, and giving broadest information about activities of bank.

Social Banking in India

The concepts of social control emerged after takeover of banks operating in 1955 and 1959, in 1967 to serve better the needs of development in conformity with national priorities. It was seen that every bank in India had to earmark a minimum percentage of their loan portfolio to sectors identified as ‘priority sector’.

Social banking provides the basic financial support required by the economically weaker sections of the society and thereby enables them to participate and benefit from the developmental programmes of the Government. Once this is achieved, social banking leads to the desired goal of sustainable development. Social banking plays a pivotal role for poverty alleviation through the network of commercial banks, cooperative banks, Regional Rural Banks, microfinance institutions, primary agriculture credit societies and Self Help Groups. However, availability of
credit alone may not alleviate poverty. It is also important to carry out other allied reform which enables better absorption of microfinance. Thus, the banks and financing institutions enable and ensure flow of credit to the poor to strengthen their economy.