CHAPTER-1
INTRODUCTION

Finance is an important and necessary factor for economic development. Though finance is by no means a substitute for real resources, it has a crucial role in the economic development of the country. The segment of capital and money market dealing with lending and borrowing of funds, essentially for short-term purposes, is represented by commercial banking institutions. Commercial banks act as financial intermediaries, i.e. intermediaries of saving and investment. Savings intermediations are a process by which flow of savings of the community is allocated to finance investment in the economy. The banking system which constitutes the core of the financial sector, plays a critical role in transmitting monetary policy impulses to the entire economic system (Kaur, 2010).

Banking is the kingpin of the chariot of economic progress. The banking system occupies an important role in a nation’s economy. A banking institution is indispensable in a modern society. It plays a pivotal role in the economic development of a country and forms the core of the money market in a developing country. The importance of commercial banks in the process of economic development has been recognized by all. The role becomes more important in planned or developing economies, like India. Banking industry is the blood vascular system of our economy. The performance of banks is completely linked to the growth of the economy, while the nature and quantum of growth is, in turn, linked to the availability of bank credit (Uppal, 2006).

In India, though the money market is still characterized by the existence of both the organized and the unorganized segments, institutions in the organized money market have grown significantly and are playing an increasingly important role. Amongst the institutions in the organized sector of the money market, commercial banks and commercial co-operative banks have been in existence for the past several decades. The Regional Rural Banks came into existence since the middle of seventies. Thus, with the phenomenal geographical expansion of the commercial banks and the
setting up of the Regional Rural Banks during the recent past, the organized sector of money market has penetrated into the rural areas as well. The structure of the Indian Banking System has undergone numerous changes since independence. Two phases of nationalization (1969 and 1980), introduction of Regional Rural Banks in 1975, and permission to New Private Sector Banks and set-up operations since 1993-94 are some of the major changes undergone (Debasish, 2005).

**MEANING OF A BANK**

**Dictionary Meaning**

The Oxford Dictionary defines a bank as an establishment for the custody of money which it pays out on a customer’s order. It has emphasized the deposit taking and payment making functions of a bank to the total exclusion of its money creation role.

**Legal Meaning**

Section (5) (1) (b) of the Banking Regulation Act 1934, defines banking as ‘the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise and withdrawable by cheque, draft, order or otherwise’. Section 5 (1) (c) defines banking company as ‘any company which transacts the business of banking in India’. The essential characteristics of the banking business as defined in Section 5 (b) of the Banking Regulation Act are as follows:

- Acceptance of deposits from the public
- For the purpose of lending or investment
- Repayable on demand or otherwise
- Withdrawable by means of any instrument whether a cheque or otherwise.

Two important functions of commercial banks emerge from the definition given above: acceptance of deposits and lending of funds. For centuries, banks have borrowed and lent money to business, trade and people, charging interest on loans and paying interest on deposits. These two functions are the core activities of banking (Hussain, 1986).
FUNCTIONS OF A BANK

The functions essentially performed by the banks are detailed as under:

Accepting Deposits

It is one of the two major activities of banks. Banks are also called custodians of public money. Basically, the money is accepted as deposit for safekeeping. But since the banks use this money to earn interest from people who need money, banks share a part of this interest with the depositors. However, accepting deposits and keeping track of the money involves a lot of bookkeeping and other operations. Banks maintain to provide following services:

1. An effective branch network to reach the targeted customer base.
2. A system of Intra branch accounting with separate account(s) for each customer.
3. A system of reconciliation at the end of the day.
4. Availability of adequate funds at each branch.
5. Trained staff for effective customer service.
6. Infra-structural inputs like space, stationery, comfortable environment, etc.

Lending Money to the Public

Lending money is one of the two major activities of any bank. In a way, the Bank acts as an intermediary between the people who have the money to lend and those who need the money to carry out business transactions. This activity places its own requirements on the resources of the bank. For effective functioning of this, a bank must possess:

1. Sufficient deposits.
2. Skills to appraise the potential borrowers and the activity.
3. Legal skills for documentation.
4. Legal skills for recovery of its dues through the courts.
5. Skills to follow up and monitor and end-use of money lent by it.
6. An effective credit delivery system.
7. Review of credit portfolio.
**Transfer of Money**

Apart from accepting deposits and lending money, banks also carry out, on behalf of their customers the act of transfer of money—both domestic and foreign—from one place to another. This activity is known as “remittance business”. Banks issue Demand Drafts, Banker’s Cheque, Money Orders, etc. for transferring the money. Banks also have the facility of quick transfer of money known as Telegraphic Transfer or Tele Cash Orders. To deliver this service, a Bank has:

1. An effective branch network or correspondent relationships.
2. A system of inter-branch reconciliation.
3. A system of reconciliation with the correspondents.
4. Availability of funds at all the centres.

**Trustee Business**

Banks also act as trustee for various purposes. For example, whenever a company wishes to issue secured debentures, it has to appoint a financial intermediary as trustee who takes charge of the security for the debenture and looks after the interests of the debenture holders. Such entities necessarily need to have expertise in financial matters and also be of sufficient standing in the market/ society to generate confidence in the minds of potential subscribers to the debenture. While Banks are the natural choice for the customers, banks need to possess the following:

1. A track record of sufficient length.
2. Facilities for safekeeping.
3. Legal skills to take necessary steps for the trusteeship.

**Safe-Keeping**

Bankers are in the business of providing security to the money and valuables of the general public. While security of money is taken care of through offering various types of deposit schemes, security of valuables is provided through making secured space available to general public for keeping these valuables. These spaces are available in the shape of lockers. The lockers are small compartments with dual locking facility built into strong cupboards. These are stored in the bank’s strong room and are fully
secured. Lockers can neither be opened by the hirer nor by the bank individually. Both must come together and use their respective keys to open the locker. To make this facility available to its customers, the bank provides:

1. Physical structures to house the lockers
2. Locker cabinets
3. Security arrangements
4. Record of access to lockers.

**Government Business**

Earlier, the Government business used to be exclusively carried out by the Government Treasuries where all types of transactions took place. However, now banks act on behalf of the Government to accept its tax and non-tax receipts. Most of the Government disbursements like pension payments and tax refunds also take place through banks. While the banks carry out this business for a fee to be paid by the Government, providing this service requires a lot of effort and organization (Aggarwal, 2003).

**ROLE OF BANKS IN ECONOMIC DEVELOPMENT**

Banks play a significant role in the economic development of a country. Banks have control over a largest portion of the supply of money in circulation. Nature and character of production in the country can be influenced by the banks. In fact, banks are regarded as the mainstay of the economic development of a country.
Economic Development through Banking System

The banks contribute in the process of economic development of a country in the following manner:

Helpful in Capital Formation

Banks mobilize the idle and dormant capital of a country and make it available for productive purposes. In fact, banks have designed a number of schemes to attract the prospective customers to encourage the habit of savings among the people.

Creator of Money

Banks are described as factories of credit. They have the power to create money and it helps in the economic development of the country.

Act as a Link between the Organized and Unorganized Sectors

In India, money market consists of organized and unorganized sectors. Both of them are required to be linked for economic development of the country and this function is performed by the banks.

Effective Implementation of Monetary Policy

The effective implementation of monetary policy can be done only through properly organized banking system of the country.

Development of Agriculture and Industries

The progress of a country is established by its industrial and agriculture development. The banks cater to the financial needs of these sectors which result in the economic development of the country.

Act as Catalyst in Social Change

In India, banks are regarded as catalysts in bringing the desired social change in community. Banks are able to achieve the desired change through their sectoral priorities and other social development programmes.

Development of Entrepreneurship

Banks have special drives and specific schemes for the development of entrepreneurship. Banks help in boosting their strength and health.

Flow of National Savings

Banks regulate the flow of national savings. They ensure the diversion of national savings into productive purposes.
Helpful in Mitigating the Effects of Trade Cycles
An effective banking system can help the government in controlling the circulation of money. It helps in mitigating the effects of trade cycles in a country.

Facilitate in Maintaining the Positive Balance of Trade
Banks also help in promoting import and maintaining the balance of trade at favourable position.

The discussion made above leads to the fact that no economy can survive without a sound banking system. Bankers are regarded as public conservators of commercial virtues. Thus, the growth of an economy rests highly on an efficient banking system (Bansal, 2010).

STRUCTURE OF COMMERCIAL BANKS
Indian commercial banks comprise of various types of entities. They are different on the basis of functions they perform. So, it will be more appropriate to classify these banks on the basis of functions performed by them. The constituents of the Indian banking system can be listed as follows.

SCHEDULED COMMERCIAL BANKS
Scheduled commercial banks are those which have been included in the Second Schedule of the Reserve Bank of India Act, 1934. In terms of ownership and function, commercial banks can be classified into four categories: public sector banks, private sector banks, foreign banks in India and regional rural banks. There are 25 public sector banks, 21 private sector banks and 36 foreign banks as on March 2011.

Public Sector Banks
Public sector banks are the banks in which the government has a major holding. These can be classified into two groups: State Bank of India and its associates; and nationalized banks.
State Bank Group

State Bank of India came into existence on July 1, 1955. This marked the beginning of the first phase of nationalisation of banks. The main objective of nationalisation was extending banking facilities on a large scale, particularly in the rural and semi-urban areas. The other objectives for which the bank was established were as follows:

Source: RBI Report on trends and progress of Banking in India 2010-11
• To promote agricultural finance and to remedy the defects in the system of agricultural finance.
• To help the Reserve Bank in its credit policies.
• To help the government to pursue the broad economic policies.

State Bank group includes those banks in which majority of shares are held by Government of India. At present State Bank Group includes State Bank of India and its five subsidiaries:

(i) State Bank of Bikaner & Jaipur
(ii) State Bank of Hyderabad
(iii) State Bank of Mysore
(iv) State Bank of Patiala
(v) State Bank of Travancore.

The 107 year old State Bank of Saurashtra with 460 branches across the country was merged with State Bank of India on September 15, 2008, and State Bank of Indore was merged with SBI on August 26, 2010. SBI is now planning to position itself as ‘Universal Bank’ catering to the diverse needs of the society, by converting its branches into ‘super shoppe’ selling all its products-banking, insurance, mutual funds and credit cards.

NATIONALISED BANKS

Nationalised banks are those banks in which the Government holds major or full stake. Except the Reserve Bank of India, which was nationalized in 1948, there was no other public sector bank till 1969. With the nationalization of banks in 1969, 14 banks, each of which had more than Rs. 50 crore in time and demand liabilities came in the public sector. This was subsequently followed by the nationalization of 6 more private sector commercial banks, each of which had crossed the deposit limit of Rs. 200 crore in 1980. Thus, there were total 20 nationalized banks. But in the year 1983, New Bank of India merged with the Punjab National Bank and the total of public sector banks reduced to 19. Till now there are 20 public sector banks operating in India and 19 nationalised Banks and IDBI Bank. IDBI Bank (Private Sector Bank) has been merged with IDBI Limited (Public Sector Bank) with effect from April 02, 2005. The nationalised banks are a
dominant segment in commercial banking. The bulk of the banking business in the country is in the public sector.

Public sector banks have expanded their branch network and catered to the socio-economic needs of a large mass of the population, especially the weaker section and in the rural areas (Debasish, 2005).

**LIST OF NATIONALISED BANKS**

- Allahabad Bank
- Andhra Bank
- Bank of Baroda
- Bank of India
- Bank of Maharashtra
- Canara Bank
- Central Bank of India
- Corporation Bank
- Dena Bank
- Indian Bank
- Indian Overseas Bank
- Oriental Bank of Commerce
- Punjab National Bank
- Punjab & Sind Bank
- Syndicate Bank
- Union Bank of India
- United Bank of India
- UCO Bank
- Vijaya Bank
- IDBI Bank (other public sector bank)

**Private Sector Banks**

For over two decades, after the nationalisation of 14 larger banks in 1969, no bank was allowed to be set up in the private sector. Narsimham Committee, in its first report, recommended the freedom of entry into financial system. The committee recommended that there should not be difference between the public and private sector banks, and any restriction in operation in this regard should be removed. Private sector banks are those banks in which the equity is held by private shareholders, i.e., there is no government shareholding. Private sector banks include the old private sector banks and the new private sector banks. The new private sector banks are those banks which came into existence after the introduction of financial sector reforms in 1991. Today, there are 21 private sector banks: 14 old private sector banks and 7 new private sector banks. List of old private sector banks is given as under:
LIST OF OLD PRIVATE SECTOR BANKS

- Catholic Syrian Bank
- City Union Bank
- Dhanlaxmi Bank
- Federal Bank
- ING Vysya Bank
- Jammu & Kashmir Bank
- Karnataka Bank
- Karur Vysya Bank
- Lakshmi Vilas Bank
- Nainital Bank
- Ratnakar Bank
- SBI Commercial and International Bank
- South Indian Bank
- Tamilnad Mercantile Bank

LIST OF NEW PRIVATE SECTOR BANKS

- Axis Bank
- Development Credit Bank
- HDFC Bank
- ICICI Bank
- IndusInd Bank
- Kotak Mahindra Bank
- Yes Bank

FOREIGN BANKS

Foreign Banks are those banks, which are registered or which have their headquarters in other countries but they are operating in India. The presence of foreign banks in the country increased rapidly after the financial sector reforms, which were initiated in 1991. The presence of foreign banks in India has benefited the financial system by enhancing competition, transfer of technology and specialised skills resulting in higher efficiency and greater customer satisfaction. Foreign Banks are active players in money market and foreign exchange market which has contributed to increase the liquidity and deepening of these markets in terms of both volumes and products (Aggarwal, 2003).
LIST OF FOREIGN BANKS

- A B Bank Ltd
- Abu Dhabi Commercial Bank
- American Express banking Corporation
- Antwerp Diamond Bank NV
- Bank International Indonesia
- Bank of America National Association
- Bank of Baharin and Kuwait B.S.C.
- Bank of Ceylon
- Bank of Nova Scotia
- Barclays Bank PLC
- BNP Paribas
- China Trust Commercial Bank
- Citi Bank
- Commonwealth Bank of Australia
- Credit Agricole
- Credit Suisse AG
- DBS Bank Ltd.
- Deutsche Bank (Asia)
- First Rand Bank
- HSBC Ltd.
- JP Morgan Chase Bank
- JSC VTB
- Krung Thai Bank
- Mashreqbank PSC
- Mizuho Corporate Bank
- Oman International Bank S.A.O.G.
- Sber Bank
- Shinhan Bank
- Societe Generale
- Sonali Bank
- Standard Chartered Bank
- State Bank of Mauritius
- The Bank of Tokyo-Mitsubishi
- The Royal Bank of Scotland
- UBS AG
- United Overseas Bank Ltd

EVOLOUTION OF COMMERCIAL BANKING IN INDIA

Indigenous Bankers

The origin of banking in India is traceable in ancient times. The main functions of the bank are to accept deposits and grant loans. These functions of accepting deposits and lending money were performed by a section of the community in the vedic periods also. During Ramayana and Mahabharat eras, banking, which was a side business during the vedic period, became a full time business activity for the people in this age. During the smriti period, which
ollowed the Vedic period and the Epic age, the banker performed the functions of the modern banks. The banking business was carried on by the members of vaish community and Manu speaks of earning through interest as the business of Vaishyas. Indigenous bankers used to maintain a regular system of accounts and the borrowers used to sign the loan deeds.

**Mughal and British Periods**

Indian history reveals that during early Muslim and Mughal rule in India, indigenous bankers did grant loans both for domestic and foreign trade. They assisted the state during periods of crisis. Hundis were most commonly used. Not only this, during Mughal rule, the issue of various kinds of metallic money in different parts of the country gave the indigenous bankers great opportunities for developing the very profitable business of money changing and the most important among them were appointed mini officers, revenue collectors, bankers and money changers to the Government in various parts of the empire. A few of the indigenous bankers were quite famous and wielded great influence in the country. They were known as ‘Jagat Seth’ and possessed as great power as the private banker’s of any western country.

**The Agency Houses, The Presidency Banks and The Imperial Bank of India**

The English traders who came to India in the 17th century could not make much use of the indigenous bankers mainly due to their ignorance of the latter’s language and the latter’s experience of the finance of the trade. Therefore, although the East India Company established connections with these bankers, borrowed funds from them and for the first few years collected a portion of land revenue through them. The English agency houses in Calcutta and Bombay began to conduct banking business besides their commercial business. From this time, the business and the power of indigenous bankers began to decline. The continuous wars and chaos that resulted from the break-up of the Mughal Empire also weakened the system of indigenous banking a great deal. Further, they lost their profitable money-changing business from 1835 when a uniform currency was established throughout the country. The
decline of indigenous banking and gradual expansion of English trade and power in India led the establishment of banks on Western lines. With the reduced resources and a smaller scale of business, indigenous banks began to find themselves handicapped in the competition and they began to lose ground to them. Though these banks lost their business in the urban areas, they continued to have a separate existence in the rural areas where the modern banks could not penetrate. Banking on the modern lines, began with the foundation of the Agency Houses of Calcutta and Bombay in the 18th and early 19th centuries. These Agency houses were mainly trading concerns interested in tea and indigo, and began to serve as bankers to the East India Company and the European merchants in India. The indigenous bankers conducted their business mainly with their own resources, but in contrast to these, the Agency houses had no capital of their own and depended upon deposits for their funds.

The first joint stock bank, the Bank of Hindustan, was established in the country in 1770 by one of the Agency Houses in Calcutta, and its business was closely connected with this house. But it was liquidated in 1832 when the firm with which it was connected failed.

**Presidency Banks**

Another group of banks was established by the Acts of Indian legislature. These banks may be divided into two groups—the first consisting of three Presidency banks amalgamated into Imperial Bank of India in 1920 and the second of the Indian joint stock banks. The first Presidency Bank, under the name of Bank of Calcutta, was established in Calcutta in 1806. The other two presidency banks were—The Bank of Bombay established in 1840 with a capital of Rs. 52.25 lakh and the Bank of Madras formed in 1843 with a capital of Rs. 30 lakh. To each of these banks the Government had subscribed Rs. 3 lakh. The bulk of share capital had come from private shareholders, mostly Europeans. These banks were given the monopoly of Government Banking. After 1823, they were also given the right of note issue which was taken by the
Government in 1862. The Presidency Banks Act imposed restrictions upon all the three banks to safeguard the interest of the Government and the public which had deposited funds with them. But the restrictions were continued even after the Banks had built up a very solid position by careful management. In 1920, these Presidency Banks were amalgamated and a new bank-Imperial Bank of India was formed. This step was taken to protect these banks against the competition of foreign Banks.

**Joint Stock Banks**

Several joint stock banks were established after 1813 by the British settlers in India. But most of these banks could not stay for long as they did not confine themselves to banking business only. In 1860, an important Act was passed which permitted the starting of joint stock banks on the basis of limited liability. A large number of banks were established, but without any careful plan and objectives. Most of them failed in a short time destroying public confidence in banks. In 1856, the Allahabad Bank was established under European management. This is the only bank among the started about this period, which maintains it, identity and is one of the nationalised banks even today. In 1881, the Oudh Commercial Bank was the first bank established on limited liability basis under Indian management. In 1894, the Punjab National Bank was also established under Indian management and is one of the nationalised banks at present. Under the stimulus of the Swadeshi Movement, a number of joint banks were established between 1906 and 1913 such as the Bank of India, the Central Bank of India, the Bank of Baroda, the Canara Bank, the Indian Bank and the Bank of Mysore. On the one hand, the first-half of the 20th century witnessed a mushroom growth of banks; while on the other, there were a large number of bank failures during the same period. One of very serious drawback of the Indian banking system was the absence of any worthwhile control over the activities of commercial banks.

The establishment of RBI in 1935 as the central bank of the country filled a big gap in India’s banking structure and met one of the necessary
conditions for a healthy growth of the banking in the country. The year 1949 marked the beginning of a new era in the history of Indian banking when comprehensive legislation was passed to control the activities of other commercial banks. Under this legislation, the RBI was given very wide powers of control and supervision.

**Exchange Banks**

In addition to the Indian joint stock banks, a number of foreign banks, with head offices in parent countries, carried on business in India through their branches. They financed the foreign trade of the country by purchasing and discounting foreign bills of exchange, by making advances against shipping documents and by issuing foreign letter of credit. Because they were financed and officered by non-Indians, therefore, the Central Banking Inquiry Committee suggested that they should be required to take out a licence and should undertake to appoint Indians to the executive posts.

**Imperial Bank of India and State Bank of India**

The Presidency Banks were amalgamated into the Imperial Bank of India, which was brought into existence on 27th January, 1921 by the Imperial Bank of India Act 1920. However, this Act gave no power to issue notes and thus, left it without control over the currency of the country. But it was allowed to hold Government balances and to manage public debt and clearing houses till the establishment of RBI in 1935. After Independence, there was a strong demand for the nationalisation of Imperial Bank of India. However, the government was not in favour of its nationalisation. The rural Banking Enquiry Committee (1950), too recommended against its nationalisation. But the Rural Credit Survey Committee recommended the nationalisation of the Imperial Bank of India. In pursuance of this recommendation, the Government of India set up the SBI on July 1, 1955, which took over the business of the Imperial Bank of India (Sultan).
GROWTH OF BANKS IN INDIA

On the eve of independence, Indian Banking inherited 2,876 branches, serving an average population of 82,000 with Rs. 860 crore deposits and Rs. 760 crore advances along with the responsibility of recuperating the war-torn economy saddled with poverty and unemployment. Banking system has made a tremendous progress since then.

Nationalisation of Commercial Banks

In 1969, 14 banks were nationalised to promote macro-economic objectives such as economic growth and better regional balance of economic activities. The nationalization was effected by an ordinance, which was later replaced by an Act of parliament known as the Banking Companies Act, 1970. The banking sector was identified as key instrument for economic development. Fourteen erstwhile private sector banks were nationalized on July 19, 1969, and another six, viz. Andhra Bank, Corporation Bank, New Bank of India, Oriental Bank of Commerce, Punjab & Sind Bank and Vijaya Bank with deposit liabilities of Rs. 200 crore and above in 1980. One of the objectives of nationalization was to extend the reach of organized banking services to rural areas and to neglected sectors of the society. With a view to achieving these objectives, the policy-makers imposed a strict credit rationing approach, prescribed formula-based lending and high-directed credit obligations.

Lead Bank Schemes

The Reserve Bank of India launched the Lead Bank Scheme in December 1969 to mobilize deposits and to step up lending to weaker sections of the economy. Under this scheme, a ‘Lead Bank’ designated for the district was responsible for taking lead role in surveying the credit needs of the population, development of banking and of credit facilities in the district allotted to it.

Branch Expansion

The number of bank branches rose significantly between 1951 and 1967, as a result of which the average population per branch fell from 1,36,000 in 1951 to 65,000 in 1969. Between 1969 and 1992, there was a rapid expansion
of branch network. The number of bank branches increased from 8,262 to 60,570 reflecting a rapid growth of banking activity. The banking system spread to rural areas. As banks were mainly tools in the hands of the government, banks had no incentive to make profits and improve the financial health. Nationalization killed competition and stifled innovations in banking. Trade unions became strong in banks with political patronage and they resisted any form of change in the banking system.

**Banking Environment**

Banks functioned in a regulated environment with administered interest rate structure, quantitative restrictions on credit flows, fairly high reserve requirements, and pre-emption of significant proportion of lendable resources for the priority and the government sectors. These resulted in sub-optimal use of credit, low levels of investment and growth, decline in productivity and erosion of profitability of the banking sector in general. The Government realised the need to upgrade the operating standards, health and financial soundness of banks to internationally accepted levels.

**Reformatory Phase**

A series of reforms were undertaken from 1985 onwards, the first phase of comprehensive reforms in the banking sector was undertaken in June 1992 by implementing the recommendations of Narasimham Committee-I (1991) on the financial system. The major objective of the reforms was to create a viable and efficient banking system, which would thereby improve the productivity and efficiency of the financial sector. The Reserve Bank of India laid down clear policies for asset classification, income recognition, loan-loss provisioning and investment valuation with mandatory compliance of the Bank for International Settlements (BIS) capital adequacy standards. Competition was infused in the banking system for the first time in 1993 when the RBI granted permission to set up private sector banks and foreign bank branches. The chief merit of the reform process was that reform measures were undertaken and implemented gradually and cautiously. The first phase of the banking reforms is complete.
The second phase of banking reforms is underway. The second generation reforms are those that did not form part of the first generation reforms but needed to be prioritised in the agenda for the next decade. The second generation banking reforms aim to strengthen the banking sector through rigorous operational, prudential and accounting norms, improvement in the credit delivery system and to move towards international best practices in areas relating to banking policy, and legislation. It is expected that the Indian banking system will emerge as strong and efficient in the new millennium (Pathak, 2011).

**Narasimham Committee (on Financial Sector Reforms-1991)**

The main recommendations of the Committee were:

- Reduction of Statutory Liquidity Ratio (SLR) to 25% per cent over a period of five years.
- Progressive reduction in Cash Reserve Ratio (CRR).
- Phasing out of directed credit programmes and redefinition of the priority sector.
- Deregulation of interest rates so as to reflect emerging market conditions.
- Adoption of uniform accounting practices in regard to income recognition, asset classification and provisioning against bad and doubtful debts.
- Imparting transparency to bank balance-sheets and making more disclosures.
- Setting up of special tribunals to speed up the process of recovery of loans.
- Setting up of Asset Reconstruction Funds (ARFs) to take over from banks a portion of their bad and doubtful advances at a discount.
- Setting up one or more rural banking subsidiaries by Public Sector Banks.
- Permitting RRBs to engage in all types of banking business.
- Abolition of branch licensing.
- Liberalising the policy with regard to allowing foreign banks to open offices in India.
- Rationalisation of foreign operations of Indian banks.
- Giving freedom to individual banks to recruit officers.
- Inspection by supervisory authorities based essentially on the internal audit and inspection reports.
- Ending duality of control over banking system by Banking Division and RBI.
- Speedy liberalisation of capital market.
- Supervision of merchant banks, mutual funds, leasing companies, etc. by a separate agency to be set up by RBI and enactment of a separate legislation providing appropriate legal framework for mutual funds and laying down prudential norms for these institutions.

Several recommendations have been accepted and are being implemented in a phased manner. Among these are the reductions in SLR/CRR, adoption of prudential norms for asset classification and provisions, introduction of capital adequacy norms deregulation of most of the interest rates, allowing entry to new entrants in private sector banking sector, etc.

**Narasimham Committee-II (1998)**

The major recommendations of this committee are:

- Capital adequacy requirements should take into account market risks also.
- In the next three years, entire portfolio of Govt. securities should be marked to market.
- CAR to be raised to 10% from the present 8%; 9% by 2000 and 10% by 2002.
- An asset should be classified as doubtful if it is in the substandard category for 18 months instead of the present 24 months.
- NPA level should be brought down to 5% by 2000 and 3% by 2002.
- Banks having high NPAs should transfer their doubtful and loss categories to Asset Reconstruction Company (ARC) which would issue Govt. bonds representing the realisable value of the assets.
• A provision of 1% on standard assets is required.
• Banks should update their operational manuals which should form the basic document of internal control systems.
• To rationalize staff strengths, an appropriate VRS must be introduced.
• A weak bank should be one whose accumulated losses and net NPAs exceed its net worth or one whose operating profits less its income on recap bonds is negative for three consecutive years.

The Narasimham Committee seeks to consolidate the gains made in the Indian financial sectors while improving the quality of portfolio, providing greater operational flexibility, autonomy in the internal operations of the banks and FIs so to nurture in a healthy competitive and vibrant financial sector (Mishra and Deashish, 2005).

CONCLUSION

Banking industry is the blood vascular system of our economy. The performance of banks is completely linked to the growth of the economy, while the nature and quantum of growth is, in turn, linked to the availability of bank credit. Banks play a significant role in the economic development of a country. Banks have control over a largest portion of the supply of money in circulation. Nature and character of production in the country can be influenced by the banks. In fact, banks are regarded as the mainstay of the economic development of a country. The structure of the Indian Banking System has undergone numerous changes since independence. Two phases of nationalization (1969 and 1980), introduction of Regional Rural Banks in 1975, and permission to New Private Sector Banks and set-up operations since 1993-94 are some of the major changes undergone. The major objective of the reforms was to create a viable and efficient banking system, which would thereby improve the productivity and efficiency of the financial sector. The Reserve Bank of India laid down clear policies for asset classification, income recognition, loan-loss provisioning and investment valuation with mandatory compliance of the Bank for International Settlements (BIS) capital adequacy standards.
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