CHAPTER III

CONCEPTUAL FRAMEWORK OF BANKING IN INDIA

3.1 Origin of Banking

The origin of western type commercial Banking in India dates back to the 18th century. The story of banking starts from Bank of Hindustan established in 1770 and it was first bank at Calcutta under European management. It was liquidated in 1830-32. From Bank of Hindustan in 1770, the evolution of banking in India can be divided into three different periods as follows: Phase I: Early phase of primitive Indian banks to Nationalization of Banks in 1969 Phase II: From Nationalization of India banks in 1969 up to advent of liberalization and banking reforms in 1991 Phase III: From Indian Financial and Banking Sector Reforms 1991 onward In 1786 General Bank of India was set up. Since Calcutta was the most active trading port in India, mainly due to the trade of the British Empire, it became a banking center. Three Presidency banks were set up under charters from the British East India Company- Bank of Calcutta, Bank of Bombay and the Bank of Madras. These worked as quasi central banks in India for many years. The Bank of Calcutta established in 1806 immediately became Bank of Bengal. In 1921 these 3 banks merged with each other and Imperial Bank of India got birth. Imperial Bank of India was later renamed in 1955 as the State Bank of India. Thus, State bank of India is the oldest Bank of India. In 1839, there was a fruitless effort by Indian merchants to establish a Bank called Union Bank. It failed within a decade. Next came Allahabad Bank which was established in 1865 and working even today. The oldest Public Sector Bank in India having branches all over
India and serving the customers for the last 145 years is Allahabad Bank. Allahabad bank is also known as one of India’s Oldest Joint Stock Banks. However, the Oldest Joint Stock bank of India was Bank of Upper India established in 1863 and failed in 1913. The first Bank of India with Limited Liability to be managed by Indian Board was Oudh Commercial Bank. It was established in 1881 at Faizabad. This bank failed in 1958. The first bank purely managed by Indians was Punjab National Bank, established in Lahore in 1895. The Punjab national Bank has not only survived till date but also is one of the largest banks in India. However, the first Indian commercial bank which was wholly owned and managed by Indians was Central Bank of India which was established in 1911. So, Central Bank of India is called India’s First Truly Swadeshi bank.

3.2 Concept of Banking

A bank is a financial intermediary and money creator that create money by lending money to a borrower, thereby creating a corresponding deposit on the bank's balance sheet. Lending activities can be performed directly by loaning or indirectly through capital markets. Due to their importance in the financial system and influence on national economies, banks are highly regulated in most countries. Most nations have institutionalized a system known as fractional reserve banking, central banking, under which banks hold liquid assets equal to only a portion of their current liabilities. In addition to other regulations intended to ensure liquidity, banks are generally subject to minimum capital requirements based on an international set of capital standards, known as the Basel Accords. Banking in its modern sense evolved in the 14th century in the rich cities of Renaissance Italy but in many ways was a
continuation of ideas and concepts of credit and lending that had its roots in
the ancient world.

A bank is a company that provides financial services of various sorts to
various types of customers. Its major function is to gather money from various people
and to lend that money out to other people. One of the most visible things that a bank
does is to take deposits from customers and act as a place for them to store their
money. The customers put money in the bank and then can draw that money out (by
check or in cash form, for example) when they need it. The bank provides them
services in that it allows them to have a secure way to store their money and
convenient ways to get that money back or to pass it on to others.

Banks use the money that has been deposited by customers. This is one way
in which banks make money (they also make money through various fees that they
charge customers for some services). A bank will take in money and hold it while
paying only a very low interest rate to depositors. It will then lend that money out to
others. It may loan it to someone who wants a mortgage, for example, or to a
business that wants to expand. It charges a much higher interest rate to lend the
money than it pays to borrow it. In this way, it makes money. Banks are a very
important part of our economy because they provide us with many financial services
that make it easier to use our money.

Banking means accepting for the purpose of lending or investment of deposits
of money from the public Banking deals with withdraw, deposit, cheque and loan.
Bank is an institution which deals money and credit. Central government is
empowered of banking companies. In banking section most important one is
customer. Customer means a person who has an account with a banker. One person
cannot be called as a customer immediately on opening an account but he will be called as after having regular dealing with a banker. A customer need not always be an individual. In other words it may be firm, companies, co-operatives etc. Bank may classified as three type of account

- fixed deposit account
- saving bank account
- current account

**Fixed deposit account**

Amount is deposit in fixed periods. In fixed deposit, customer gets more benefit than savings account. High rate of interest is offered on such deposit.

**Saving bank account**

It is meant for small savers. Its main objective is to encourage the habit of saving in public. In order to attract the people to saving the money, some commercial banks have introduced a number of new saving schemes. For example Daily saving scheme, children saving scheme, minor’s saving scheme.

**Current account**

A current account is a running account and it can be operated for any number of times without any restriction. It is only safeguard the customer. Therefore, it is suitable for business concerns, companies, institutions and public undertakings. No interests given to current account.
3.3 Objective of Banking

1. To promote and develop in India sound and progressive banking principles, practices and conventions and to contribute to the developments of creative banking.

2. To render assistance and to provide various common services to Members and to the banking industry.
   - To develop and implement new ideas and innovations in banking services, operations and procedures.
   - To organize co-ordination and co-operation on procedural, legal, technical, administrative or professional problems and practices of banks and the banking industry.

3. To initiate advance planning for introduction of new systems or services in the banking industry.

4. To collect, classify and circulate statistical and other information on the structure and working of the banking system.

5. To act as a clearing house for dissemination and exchange of statistical data, information, views and opinions on the systems, procedures and practices, and organization and methods of banks and on the structure, working and operations of the banking system.

6. To explore, plan, co-ordinate and organize detailed surveys on banking, business, resources, personnel and management development programmes of banks and the banking industry.
7. To pool together talents and resources available with members and to organize exchange of expertise and experiences of members for simplifying forms and procedures, for reducing cost of operations, for increasing efficiency and productivity and for such other common purposes as may be necessary or relevant to banks and the banking industry.

8. To organize exchange of credit information and opinions, export information or information and views on any other aspects of interest to banks or the banking industry.

9. To promote education and knowledge of the law and practice of banking.

10. To issue periodical newsletters, bulletins or magazines and publish books, pamphlets or other literature on matters of interest to members and to the banking industry.

11. To project a good public image of banking as a service industry and develop good public relations.

12. To promote harmonious personnel relations in banking industry and to devise ways and means for involving banking personnel in the endeavours of banks for growth and development of banking and the economy of the country.

13. To maintain continuous communications with the representatives of bank employees, to conduct talks, discussions, and negotiations with them and to arrive at Settlements.

14. To provide assistance and guidance to members in interpretation and implementation of Awards, Settlements, etc.
15. To assist, advise and guide all members and the smaller members in particular on all their needs, difficulties and problems of growth, development and working.

16. To act as an agent or a representative of a member or members in respect of matters connected with any of their operations working or administration.

17. To maintain close co-ordination and liaison with Reserve Bank of India, All Financial Institutions, Chambers of Commerce, Organisations of Banking Industry, Management or Educational Institutes, Universities and such other Organisations for realizing the subject and purposes of the Association.

18. Generally to do all and any other thing that may be necessary or relevant for the realization of the objects and purposes of the Association directly or indirectly.

19. To carry on publicity for the purpose of educating public opinion with regard to the scope, importance and activities of the banking industry, for creative growth and development.

20. To do all and such other things as are incidental or conductive to the attainment of any or all of the above objects.

### 3.4 Functions of Banks

**A. Primary Functions of Banks**

The primary functions of a bank are also known as banking functions. They are the main functions of a bank.

These primary functions of banks are explained below.
1. Accepting Deposits

The bank collects deposits from the public. These deposits can be of different types, such as :-

a. Saving Deposits

b. Fixed Deposits

c. Current Deposits

d. Recurring Deposits

a. Saving Deposits

This type of deposits encourages saving habit among the public. The rate of interest is low. At present it is about 4% p.a. Withdrawals of deposits are allowed subject to certain restrictions. This account is suitable to salary and wage earners. This account can be opened in single name or in joint names.

b. Fixed Deposits

Lump sum amount is deposited at one time for a specific period. Higher rate of interest is paid, which varies with the period of deposit. Withdrawals are not allowed before the expiry of the period. Those who have surplus funds go for fixed deposit.

c. Current Deposits

This type of account is operated by businessmen. Withdrawals are freely allowed. No interest is paid. In fact, there are service charges. The account holders can get the benefit of overdraft facility.
d. Recurring Deposits

This type of account is operated by salaried persons and petty traders. A certain sum of money is periodically deposited into the bank. Withdrawals are permitted only after the expiry of certain period. A higher rate of interest is paid.

2. Granting of Loans and Advances

The bank advances loans to the business community and other members of the public. The rate charged is higher than what it pays on deposits. The difference in the interest rates (lending rate and the deposit rate) is its profit.

The types of bank loans and advances are :-

a. Overdraft

b. Cash Credits

c. Loans

d. Discounting of Bill of Exchange

a. Overdraft

This type of advances is given to current account holders. No separate account is maintained. All entries are made in the current account. A certain amount is sanctioned as overdraft which can be withdrawn within a certain period of time say three months or so. Interest is charged on actual amount withdrawn. An overdraft facility is granted against a collateral security. It is sanctioned to businessman and firms.
b. Cash Credits

The client is allowed cash credit upto a specific limit fixed in advance. It can be given to current account holders as well as to others who do not have an account with bank. Separate cash credit account is maintained. Interest is charged on the amount withdrawn in excess of limit. The cash credit is given against the security of tangible assets and / or guarantees. The advance is given for a longer period and a larger amount of loan is sanctioned than that of overdraft.

c. Loans

It is normally for short term say a period of one year or medium term say a period of five years. Now-a-days, banks do lend money for long term. Repayment of money can be in the form of instalments spread over a period of time or in a lumpsum amount. Interest is charged on the actual amount sanctioned, whether withdrawn or not. The rate of interest may be slightly lower than what is charged on overdrafts and cash credits. Loans are normally secured against tangible assets of the company.

d. Discounting of Bill of Exchange

The bank can advance money by discounting or by purchasing bills of exchange both domestic and foreign bills. The bank pays the bill amount to the drawer or the beneficiary of the bill by deducting usual discount charges. On maturity, the bill is presented to the drawee or acceptor of the bill and the amount is collected.
B. Secondary Functions of Banks

The bank performs a number of secondary functions, also called as non-banking functions.

These important secondary functions of banks are explained below:

1. Agency Functions

The bank acts as an agent of its customers. The bank performs a number of agency functions which includes:-

a. Transfer of Funds
b. Collection of Cheques
c. Periodic Payments
d. Portfolio Management
e. Periodic Collections
f. Other Agency Functions

a. Transfer of Funds

The bank transfer funds from one branch to another or from one place to another.

b. Collection of Cheques

The bank collects the money of the cheques through clearing section of its customers. The bank also collects money of the bills of exchange.
c. Periodic Payments

On standing instructions of the client, the bank makes periodic payments in respect of electricity bills, rent, etc.

d. Portfolio Management

The bank also undertakes to purchase and sell the shares and debentures on behalf of the clients and accordingly debits or credits the account. This facility is called portfolio management.

e. Periodic Collections

The bank collects salary, pension, dividend and such other periodic collections on behalf of the client.

f. Other Agency Functions

They act as trustees, executors, advisers and administrators on behalf of its clients. They act as representatives of clients to deal with other banks and institutions.

2. General Utility Functions

The bank also performs general utility functions, such as :-

a. Issue of Drafts, Letter of Credits, etc.
b. Locker Facility
c. Underwriting of Shares
d. Dealing in Foreign Exchange
e. Project Reports
f. Social Welfare Programmes
g. Other Utility Functions
a. Issue of Drafts and Letter of Credits

Banks issue drafts for transferring money from one place to another. It also issues letter of credit, especially in case of import trade. It also issues travellers' cheques.

b. Locker Facility

The bank provides a locker facility for the safe custody of valuable documents, gold ornaments and other valuables.

c. Underwriting of Shares

The bank underwrites shares and debentures through its merchant banking division.

d. Dealing in Foreign Exchange

The commercial banks are allowed by RBI to deal in foreign exchange.

e. Project Reports

The bank may also undertake to prepare project reports on behalf of its clients.

f. Social Welfare Programmes

It undertakes social welfare programmes, such as adult literacy programmes, public welfare campaigns, etc.
g. Other Utility Functions

It acts as a referee to financial standing of customers. It collects creditworthiness information about clients of its customers. It provides market information to its customers, etc. It provides travellers’ cheque facility.

3.5 Classification of Banks

Today is the age of specialization and we can find specialization in all fields including banking. The banks have specialized in a particular line of finance. Various types of banks have developed to suit the economic development and requirements of the country. The principal banking institutions of a country may be classified into the following types:

(i) Central Banks
(ii) Commercial Banks
(iii) Industrial or Development Banks
(iv) Exchange Banks (Authorized dealers in foreign exchange)
(v) Co-operative Banks
(vi) Land Mortgage Banks
(vii) Indigenous Banks
(viii) Savings Banks
(ix) Supranational Bank
(x) International Banks

(i) Central Banks:

Central Bank is the bank of a country a nation. Its main function is to issue currency known as 'Bank Notes'. This bank acts as the leader of the banking system
and money market of the country by regulating money and credit. These banks are the bankers to the government, they are bankers' banks and the ultimate custodian of a nation’s foreign exchange reserves. The aim of the Central Bank is not to earn profit, but to maintain price stability and to strive for economic development with all-round growth of the country. There is now hardly any country which does not have a Central Bank of its own. It acts as a great engine of growth of a State.

In India, the RBI was established in 1935 and this Bank has since been functioning as the Central Bank of the country (this is not to be confused with 'Central Bank of India', which is only a commercial bank). The Central Bank of different countries is known by different names like Reserve Bank in India, Bank of England in U.K., Federal Reserve System in U.S.A., etc.

(ii) Commercial Banks:

A bank, which undertakes all kinds of ordinary banking business, is called a commercial bank. It is so called because it provides money and credit for commercial and trade activities. They receive short and medium term deposits from the public and grant short-term loans, and advances. They supply working capital to industries and enable them to carry on production and manufacturing activities. They grant loans and advances on the stocks of agricultural commodities, industrial goods, etc. They discount internal and foreign bills and thereby finance the International trade. They also perform certain agency services such as collection of cheques, dividends, interest on investments, issue of drafts, letter of credit, Travelers' Cheques, Investment Advisory Services, etc.
(iii) Industrial Banks or Financial Institutions:

An Industrial Bank is one which specialises by providing loans and fixed capital to industrial concerns by subscribing to share and debenture issued by public companies. They play an important role in the establishment and growth of industries. The block capital required for the acquisition of fixed assets, etc., is supplied by investment banks. They provide long-term loans and credits for periods varying between 5 and 15 years for industries to acquire fixed assets. They may serve as catalytic agents in mobilisation of capital in other forms of assistance such as, underwriting, guarantee, etc. These banks are nowadays grouped as 'Development Financial Institutions'. These banks are very popular in Germany and Japan. In India, we have several Industrial Finance Corporations in addition to the "Industrial Development Bank of India". Both, Development Financial Institutions and Commercial banks, nowadays, finance infrastructural development activities, which include construction of transport facilities, building of power-supply stations, etc.

(iv) Exchange Banks (Authorized Dealers in Foreign Exchange):

These types of banks are primarily engaged in transactions involving foreign exchange. They deal in foreign bills of exchange import and export of bullion and otherwise participate in the financing of foreign trade. They do a number of incidental services such as opening of letters of credit, issue of Foreign Currency Drafts and Travellers' Cheques and supply of information about foreign customers. They provide credit and loans in foreign currency and also accept deposits in Foreign Currency. They require huge capital and trained staff as it is a risky business. They maintain branches in foreign countries at important trade centres. In the past foreign banks operating in India would deal in foreign exchange and were known as exchange
banks. Nowadays, many Indian banks deal in foreign exchange with special authorisation from Reserve bank of India and known as Authorised Dealers in Foreign Exchange. As per Foreign Exchange Regulation Act banks dealing in Foreign Exchange related activities require the permission of Reserve Bank of India. This is applicable to both Indian and Foreign Banks.

*(v)* Co-operative Banks:

They are organized on co-operative principles of mutual help and assistance. They grant short-term loans to the agriculturists for purchase of seeds, harvesting and for other cultivation expenses. They accept money on deposit from and make

*(vi)* Land-mortgage Banks (Presently known as Agriculture and Rural Development Banks):

They are agriculture development banks. The Land-mortgage banks supply long-term loans for a period up to 15 years for development of land to improve agricultural yields. They grant loan for permanent improvements in agricultural lands. They create negotiable bonds out of real estate like land, buildings, etc. They raise funds by floating debentures and by borrowing from the government. The Agriculture Finance Corporation was the first Indian Institution to set up finance for development of Agriculture. The National Bank for Agriculture and Rural Development (NABARD) was constituted by the Government to promote rural development.
(vi) Indigenous Banks:

The Central Banking Enquiry Commission defined an indigenous banker as an individual or firm accepting deposits and dealing in indigenous lending of money to the needy. They form unorganised part of the banking structure, i.e., these are unrecognized operators in receiving deposits and lending money. In India the Marwaris, the Multanis, the Jains, the Sowcars, the Nattukottaichettiars are some of the leading indigenous bankers who charge high rates of interest on their lending. In rural areas, they still provide substantial finance to agriculturists and small traders.

(viii) Savings Banks:

These are institutions which collect the periodical savings of the general public. Their main object is to promote thrift and saving habits among the middle and lower income sections of the society. They have certain restrictions on number of withdrawals in a year to discourage spending. In almost all countries, postal authorities also run savings bank accounts and their working is regulated by the government. The first savings bank was started in Hamburg in 1765. In India, we have postal savings accounts. These days separate savings banks as such are very rare. In India, all commercial banks have savings accounts. The minimum balance which is required to be kept in the accounts differs from banks to banks. The rate of interest payable on the accounts by banks is determined by RBI. Presently it is 4.5 per cent per annum. Co-operative banks are normally allowed to pay an additional 0.5 per cent interest per annum. Interest rate on savings accounts with post offices is determined by Government of India.
(ix) Supranational Banks:

Special Banks have been created to deal with certain international financial matters. World Bank is otherwise known as International Bank for Reconstruction and Development (IBRD) which gives long-term loans to developing countries for their economic and agricultural development. Asian Development Bank (ADB) is another Supranational Bank which provides finance for the economic development of poor Asian countries. They generally provide finance at concessional interest rates and for long-term needs. These institutions are the creations of World bodies promoted by various countries or central banks of different countries. The European Central Bank established in June 1998 by countries in the European Union is another example of Supranational Bank.

(x) International Banks:

International Banks are those which are operating in different countries. While, the registered office/head office is situated in one country, they operate through their branches in other countries. They specialize in Banking business pertaining to foreign trade like opening of letters of credit, providing short-term finance in foreign currency, issue of performance guarantee, arranging foreign currency credits, etc. They are the main traders in International Currencies like US 'dollars', Japanese 'Yen', the new-born European Currency 'Euro', etc. They also perform Currency Risk Management functions for clients. These banks are also known as Multinational Banks since, they operate from many countries. These banks make possible the flow of money/credit from one country to from the above, it can be understood that the classification of banks cannot be rigid. We find that banks are providing finance in more than one field that is why, it is rightly said that they are "Departmental stores of Finance".
3.6 Organization Structure of Banking

Evolution of the Indian Banking Industry:

The Indian banking industry has its foundations in the 18th century, and has had a varied evolutionary experience since then. The initial banks in India were primarily traders' banks engaged only in financing activities. Banking industry in the pre-independence era developed with the Presidency Banks, which were transformed into the Imperial Bank of India and subsequently into the State Bank of India. The initial days of the industry saw a majority private ownership and a highly volatile work environment. Major strides towards public ownership and accountability were made with nationalisation in 1969 and 1980 which transformed the face of banking in India. The industry in recent times has recognised the importance of private and foreign players in a competitive scenario and has moved towards greater liberalisation.

Phases of Evaluation of Banking Industry

![Diagram of Evolution of the Indian Banking Industry]

Fig. 3.1
In the evolution of this strategic industry spanning over two centuries, immense developments have been made in terms of the regulations governing it, the ownership structure, products and services offered and the technology deployed. The entire evolution can be classified into four distinct phases.

- **Phase I- Pre-Nationalisation Phase (prior to 1955)**

- **Phase II- Era of Nationalisation and Consolidation (1955-1990)**

- **Phase III- Introduction of Indian Financial & Banking Sector Reforms and Partial Liberalisation (1990-2004)**

- **Phase IV- Period of Increased Liberalisation (2004 onwards)**

**Current Structure**

Currently the Indian banking industry has a diverse structure. The present structure of the Indian banking industry has been analyzed on the basis of its organised status, business as well as product segmentation.

**Organisational Structure**

The entire organised banking system comprises of scheduled and non-scheduled banks. Largely, this segment comprises of the scheduled banks, with the unscheduled ones forming a very small component. Banking needs of the financially excluded population is catered to by other unorganised entities distinct from banks, such as, moneylenders, pawnbrokers and indigenous bankers.
Scheduled Banks

A scheduled bank is a bank that is listed under the second schedule of the RBI Act, 1934. In order to be included under this schedule of the RBI Act, banks have to fulfil certain conditions such as having a paid up capital and reserves of at least 0.5 million and satisfying the Reserve Bank that its affairs are not being conducted in a manner prejudicial to the interests of its depositors. Scheduled banks are further classified into commercial and cooperative banks. The basic difference between scheduled commercial banks and scheduled cooperative banks is in their holding pattern. Scheduled cooperative banks are cooperative credit institutions that are registered under the Cooperative Societies Act. These banks work according to the cooperative principles of mutual assistance.

Scheduled Commercial Banks (SCBs):

Scheduled commercial banks (SCBs) account for a major proportion of the business of the scheduled banks. As at end-March, 2009, 80 SCBs were operational in India. SCBs in India are categorized into the five groups based on their ownership and/or their nature of operations. State Bank of India and its six associates (excluding State Bank of Saurashtra, which has been merged with the SBI with effect from August 13, 2008) are recognised as a separate category of SCBs, because of the distinct statutes (SBI Act, 1955 and SBI Subsidiary Banks Act, 1959) that govern them. Nationalised banks (10) and SBI and associates (7), together form the public sector banks group and control around 70% of the total credit and deposits businesses in India. IDBI Ltd. has been included in the nationalised banks group since December 2004. Private sector banks include the old private sector banks and the new generation private sector banks- which were incorporated according to the revised guidelines
issued by the RBI regarding the entry of private sector banks in 1993. As at end-March 2009, there were 15 old and 7 new generation private sector banks operating in India.

Foreign banks are present in the country either through complete branch/subsidiary route presence or through their representative offices. At end-June 2009, 32 foreign banks were operating in India with 293 branches. Besides, 43 foreign banks were also operating in India through representative offices.

![Diagram of Indian Banking Industry]

**Regional Rural Banks (RRBs)**

were set up in September 1975 in order to develop the rural economy by providing banking services in such areas by combining the cooperative specialty of local orientation and the sound resource base which is the characteristic of commercial banks. RRBs have a unique structure, in the sense that their equity
holding is jointly held by the central government, the concerned state government and
the sponsor bank (in the ratio 50:15:35), which is responsible for assisting the RRB by
providing financial, managerial and training aid and also subscribing to its share
capital.

Between 1975 and 1987, 196 RRBs were established. RRBs have grown in
geographical coverage, reaching out to increasing number of rural clientele. At the
end of June 2008, they covered 585 out of the 622 districts of the country. Despite
growing in geographical coverage, the number of RRBs operational in the country has
been declining over the past five years due to rapid consolidation among them. As a
result of state wise amalgamation of RRBs sponsored by the same sponsor bank, the
number of RRBs fell to 86 by end March 2009.

**Scheduled Cooperative Banks:**

Scheduled cooperative banks in India can be broadly classified into urban
credit cooperative institutions and rural cooperative credit institutions. Rural
cooperative banks undertake long term as well as short term lending. Credit
cooperatives in most states have a three tier structure (primary, district and state
level).

**Non-Scheduled Banks:**

Non-scheduled banks also function in the Indian banking space, in the form of
Local Area Banks (LAB). As at end-March 2009 there were only 4 LABs operating in
India. Local area banks are banks that are set up under the scheme announced by the
government of India in 1996, for the establishment of new private banks of a local
nature; with jurisdiction over a maximum of three contiguous districts. LABs aid in
the mobilisation of funds of rural and semi urban districts. Six LABs were originally licensed, but the license of one of them was cancelled due to irregularities in operations, and the other was amalgamated with Bank of Baroda in 2004 due to its weak financial position.

**Business Segmentation**

The entire range of banking operations are segmented into four broad heads—retail banking businesses, wholesale banking businesses, treasury operations and other banking activities. Banks have dedicated business units and branches for retail banking, wholesale banking (divided again into large corporate, mid corporate) etc.

**Business Segmentation**

![Diagram showing business segmentation](source: D&B Industry Research Service)

**Retail banking**

It includes exposures to individuals or small businesses. Retail banking activities are identified based on four criteria of orientation, granularity, product
criterion and low value of individual exposures. In essence, these qualifiers imply that retail exposures should be to individuals or small businesses (whose annual turnover is limited to Rs. 0.50 billion) and could take any form of credit like cash credit, overdrafts etc. Retail banking exposures to one entity is limited to the extent of 0.2% of the total retail portfolio of the bank or the absolute limit of Rs. 50 million. Retail banking products on the liability side includes all types of deposit accounts and mortgages and loans (personal, housing, educational etc.) on the assets side of banks. It also includes other ancillary products and services like credit cards, demat accounts etc.

The retail portfolio of banks accounted for around 21.3% of the total loans and advances of SCBs as at end-March 2009. The major component of the retail portfolio of banks is housing loans, followed by auto loans. Retail banking segment is a well diversified business segment. Most banks have a significant portion of their business contributed by retail banking activities. The largest players in retail banking in India are ICICI Bank, SBI, PNB, BOI, HDFC and Canara Bank. Among the large banks, ICICI bank is a major player in the retail banking space which has had definitive strategies in place to boost its retail portfolio. It has a strong focus on movement towards cheaper channels of distribution, which is vital for the transaction intensive retail business. SBI’s retail business is also fast growing and a strategic business unit for the bank. Among the smaller banks, many have a visible presence especially in the auto loans business. Among these banks the reliance on their respective retail portfolio is high, as many of these banks have advance portfolios that are concentrated in certain usages, such as auto or consumer durables. Foreign banks have had a somewhat restricted retail portfolio till recently. However, they are fast expanding in
this business segment. The retail banking industry is likely to see a high competition scenario in the near future.

**Wholesale banking**

Wholesale banking includes high ticket exposures primarily to corporates. Internal processes of most banks classify wholesale banking into mid corporates and large corporates according to the size of exposure to the clients. A large portion of wholesale banking clients also account for off balance sheet businesses. Hedging solutions form a significant portion of exposures coming from corporates. Hence, wholesale banking clients are strategic for the banks with the view to gain other business from them. Various forms of financing, like project finance, leasing finance, finance for working capital, term finance etc. form part of wholesale banking transactions. Syndication services and merchant banking services are also provided to wholesale clients in addition to the variety of products and services offered.

Wholesale banking is also a well diversified banking vertical. Most banks have a presence in wholesale banking. But this vertical is largely dominated by large Indian banks. While a large portion of the business of foreign banks comes from wholesale banking, their market share is still smaller than that of the larger Indian banks. A number of large private players among Indian banks are also very active in this segment. Among the players with the largest footprint in the wholesale banking space are SBI, ICICI Bank, IDBI Bank, Canara Bank, Bank of India, Punjab National Bank and Central Bank of India. Bank of Baroda has also been exhibiting quite robust results from its wholesale banking operations.
Treasury Operations

Treasury operations include investments in debt market (sovereign and corporate), equity market, mutual funds, derivatives, and trading and forex operations. These functions can be proprietary activities, or can be undertaken on customer’s account. Treasury operations are important for managing the funding of the bank. Apart from core banking activities, which comprises primarily of lending, deposit taking functions and services; treasury income is a significant component of the earnings of banks. Treasury deals with the entire investment portfolio of banks (categories of HTM, AFS and HFT) and provides a range of products and services that deal primarily with foreign exchange, derivatives and securities. Treasury involves the front office (dealing room), mid office (risk management including independent reporting to the asset liability committee) and back office (settlement of deals executed, statutory funds management etc.).

Other Banking Businesses

This is considered as a residual category which includes all those businesses of banks that do not fall under any of the aforesaid categories. This category includes para-banking activities like hire purchase activities, leasing business, merchant banking, factoring activities etc.

Products of the Banking Industry

The products of the banking industry broadly include deposit products, credit products and customized banking services. Most banks offer the same kind of products with minor variations. The basic differentiation is attained through quality of
service and the delivery channels that are adopted. Apart from the generic products like deposits (demand deposits – current, savings and term deposits), loans and advances (short term and long term loans) and services, there have been innovations in terms and products such as the flexible term deposit, convertible savings deposit (wherein idle cash in savings account can be transferred to a fixed deposit), etc. Innovations have been increasingly directed towards the delivery channels used, with the focus shifting towards ATM transactions, phone and internet banking. Product differentiating services have been attached to most products, such as debit/ATM cards, credit cards, nomination and demat services.

**Banking Product and Services**

![Fig. 3.4](image)

Other banking products include fee-based services that provide non-interest income to the banks. Corporate fee-based services offered by banks include treasury products; cash management services; letter of credit and bank guarantee; bill discounting; factoring and forfeiting services; foreign exchange services; merchant
banking; leasing; credit rating; underwriting and custodial services. Retail fee-based services include remittances and payment facilities, wealth management, trading facilities and other value added services.

3.7 Concept of Bank Performance Analysis

The performance of banks has become a major concern of planners and policy makers in India, since the gains of real sector economy depend on how efficiently the financial sector performs the function of financial intermediation. Efficiency, productivity and profitability of banks have become an important issue in India. In the financial market, banks still play a predominant role. In order to compete with non-bank financial institutions, banks should increase their levels of efficiency, productivity and profitability. Recently, number of initiatives (inventions and innovations) have been taken to increase efficiency, productivity and profitability of the banks, such as introducing Technology ATM. Tele-Banking, Internet Banking etc. As product innovations and financial deregulation take place, competitive pressures rise and force bank to operate more efficiently. In this context, the major issues and problems like poor quality of assets, high NPA’s, low spread, more idle funds, poor efficiency, low credit, poor recovery of loans, poor customer satisfaction, lack of autonomy in HRM policies, customer retention, and many others have being faced by the banks. Therefore, there is a need to evaluate the performance of banks.

3.8 Parameters in Bank Performance

Banks are exposed to credit risk, liquidity risk, interest risk, market risk, operational risk and management/ownership risk. It is the credit risk which stands out as the most dreaded one. Though often associated with lending, credit risk arises
whenever a party enters into an obligation to make payment or deliver value to the bank. The nature and extent of credit risk, therefore, depend on the quality of loan assets and soundness of investments. Based on the income, expenditure, net interest income, NPAs and capital adequacy one can comment on the profitability and the long run sustenance of the bank. Further, a comparative study on the performance of various banks can be done using a ratio analysis of different parameters. The parameters like total deposits, total advances, total business, non-performing assets, non-interest income, spread ratio, productivity, profitability, per branch performance, per employee performance, etc. assume important performance indicators in banks.

3.9 Types of Performances

The performance of banks can be classified into different kind’s viz. profitability performance, productivity performance, management efficiency performance, liquidity performance, etc. The performance analysis helps to identify progress of banks during the period when performance analysis is conducted. It gives a clear idea about growth and also points out where the banks need to work more when it comes to improving overall performance.

3.10 Relevance of Bank Performance Analysis

After economic reforms, the banking sector has under gone lot of changes. Technology has made the sector to grow at a very fast phase. Today, because of competition around efficiency, productivity and profitability has gained lot of importance. A study with regard to performance of banks in Goa should be undertaken because the state has large number of banks, which provide services to its customers. The performance analysis can reveal to us, which are the banks which
performing well in the state and which of them have to take more efforts for its survival. The study will also be useful in knowing as to which sector banks are performing better as compared to other. The findings of the study will immensely benefit the banks in Goa in particular and the entire banking sector in the country in general, policy makers, researchers, etc.

Conclusion

Chapter 3 has focused conceptual understanding of banking in India in terms of understanding of origin of banking, concept of banking, objectives of banking, different functions, classification of banks, organizational structure of banking, banking performance analysis, parameters used to understand banks performance, different types of performance, need and importance of banks, performance analysis and so on. This chapter has thrown light on thorough understanding of banking, functions and how the analysis of banks performance is carried out. This better conceptual understanding of banking has enabled to study the performance of banks systematically and meaningfully.