

Chapter 1

Introduction of Banking Industry

Introduction

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INTRODUCTION:

The Indian economy is emerging as a one of the strongest economy of the world with the GDP growth of more than 8 % every year. A strongest banking industry is important in every country and can have a significant affect in supporting economic development through efficient financial services. Banking sector play a vital role in growth and development of Indian economy. After liberalization the banking industry in India under gone major changes. The process of liberalization and globalization has strongly influenced the Indian banking sector. A stable and efficient banking sector is an essential precondition to increase the economic level of a country. Liberalization policy introduced in the banking sector in India led to consolidated competition, efficient allocation of resources and introducing innovative methods for mobilizing of saving. The ability of banks to analyze its financial position for improving its competitive position in the market place. Most banks in India are currently focusing an expanding their service network. A growing Indian economy, expanding their various segments. After the recommendations of Narshinham Committee report with the entry of many private players. Indian banking industry has transformed into a customer oriented market. It now consists of multiple products and customer groups and various channels of distribution. It is well known fact that an effective and efficient banking system is important for the long-run growth and development of the economy. So, there is needed to make a comprehensive study into performance of banks in India.

A Banking Sector performs three primary functions in economy, the operation of the payment system, the mobilization of savings and the allocation of saving to investment products.¹ Banking industry has been changed after reforms process.

¹ Ahluvaliya Montek,S. “ Economic Reforms in India since 1991:Has Gradualism Worked ? Journal of Economic Perspective 16(3) pp 67-88

The Government has taken this sector in a basic priority and this service sector has been changed according to the need of present days. Banking sector reforms in India Strive to Banking industry has been changed after reforms process. The Government has taken this sector in a basic priority and this service sector has been India Strive to Banking industry has been changed after reforms process.

The Government has taken this sector in a basic priority and this service sector has been changed according to the need of present days. Banking sector reforms in India Strive to increase efficiency and profitability of the banking institutions as well as brought the existing banking institutions face to face with global competition in globalization process. Different type of banks differs from each other in terms of operations, efficiency, productivity, profitability and credit efficiency. Indian banking sector is an important constituent of the Indian Financial System. The banking sector plays a vital role through promoting business in urban as well as rural area in recent year, without a sound and effective banking system, India can not be considered as a healthy economy.² The main objective of this study to understand of how a bank is able to use the available resources to increase the profitability and performance of banks and banks in India are performed well or not.

Origin of the Word Bank's:

There seems no uniformity amongst the economist about the origin of the word "Bank" According to some authors the word "Bank", itself is derived from the word "Bancus" or "Banque" that is a bench. The early bankers, the Jews in Lombardy, transacted their business on benches in the market place, when, a banker failed, his 'Banco' was broken up by the people; it was called 'Bankrupt'. This etymology is however, ridiculed by mcleod on the ground that "The Italian Money changers as such were never called Banchier in the middle ages."³

²Sheth, Neha "Banking Reforms In India: Problems and Prospects"

³ Rao Ramchandra: "Present Day Banking in India" 1st Edition, Page no – 88.

It is generally said that the word "Bank" has been originated in Italy. In the middle of 12th century there was a great financial crisis in Italy due to war. To meet the war expenses, the government of that period forced a loan on citizens of the country at the interest of 5% per annum. Such loans were known as 'Compare', 'minto' etc. The most common name was 'Monte'. In Germany the word 'Monte' was named as 'Bank' or 'Banke'. According to some writers, the word 'Bank' has been derived from the word bank.

It is also said that the word 'bank' has been derived from the word 'Banco' which means a bench. The Jews money lenders in Italy used to transact their business sitting on benches at different market places. When any of them used to fail to meet his obligations, his 'Banco' or bench would be broken by the angry creditors. The word 'Bankrupt' seems to be originated from broken Banco. Since, the banking system has been originated from money lending business; it is rightly argued that the word 'Bank' has been originated from the word 'Banco'. Whatever be the origin of the word 'Bank' as Professor Ram Chandra Rao says, "It would trace the history of banking in Europe from the middle Ages."⁴

Today the word bank is used as a comprehensive term for a number of institutions carrying on certain kinds of financial business. In practice, the word 'Bank' means which borrows money from one class of people and again lends money to another class of people for interest or profit.

Actually meaning of bank is not specified in any regulation or act. In India, different people have different type of meaning for bank. Normal salary earner knows means of bank that it is a saving institution, for current account holder or businessman knows bank as a financial institutions and many other. Bank is not for profit making, it creates saving activity in salary earner.

⁴ Kaptan, S.S.: "Indian Banking in the Electronic Era" Published by SAROP & SONS, New Delhi – 2003 Page -2.

Meaning of Bank:

A Bank is an institution which accepts deposits from the general public and extends loans to the households, the firms and the government. Banks are those institutions which operate in money. Thus, they are money traders, with the process of development functions of banks are also increasing and diversifying now, the banks are not nearly the traders of money, they also create credit. Their activities are increasing and diversifying. Hence it is very difficult to give a universally acceptable definition of bank. "Banking business" means the business of receiving money on current or deposit account, paying and collecting cheques drawn by or paid in by customers, the making of advances to customers, and includes such other business as the Authority may prescribe for the purposes of this Act"

Definitions of Bank:

Indian Banking Regulation act 1949 section 5 (1) (b) of the banking Regulation Act 1949 Banking is defined as.

"Accepting for the purpose of the landing of investment of deposits of money from public repayable on demand or other wise and withdraw able by cheques, draft, order or otherwise."⁵

"Bank means a bench or table for changing money."⁶

-Greek History

5 Kaptan S.S.: "Indian Banking in the Electronic Era" Published by SAROP & SONS, New Delhi – 2003 Page -2.

6 ibid

“Bank is an establishment for custody of money received from or on Behalf of its customers. Its essential duty is to pay their drafts unit. Its profits arise from the use of the money left employed them.”⁷

-Oxford Dictionary

“Bank is an institution which trades in money, establishment for money, as also for making loans and discounts and facilitating the transmission of remittances from one place to another.”⁸

-Western’s Dictionary

“Bank means the place when money is kept safely, open an account with any bank and make transaction with that bank is simply called as bank”

- Dictionary

“A bank is an establishment which makes to individuals such advances of money or other means of payment as may be required and safely made and to which individuals entrust money or means of payment when not required by them for use.”⁹

- Pro. Kinely

A banker is defined as a person who carries on the business of banking, which is specified as conducting current accounts for his customers, paying cheques drawn on him, and collecting cheques for his customers.¹⁰

- English common law

⁷ Desai, Vasant: “Indian Financial System” Himalaya Publishing House, 2005 Page 162.

⁸ ibid

⁹ Tannan, M.L.: “Banking Law and Practice in India”, Indian Law house, Delhi, 2002, Page No. 2

¹⁰ United Dominions Trust Ltd Vs Kirkwood, 1966, English Court of Appeal, 2 QB 431

“Bank as institutions which collects money from those who it to spare or who are saving it out of their income and lends out to those who required it”

Prof. Crowthers

“A Banker is one who is the ordinary course of his business honors drawn upon him by person from and for whom he receives money on current account”

- Dr H. L. Hart

History of Bank:

The first banks were probably the religious temples of the ancient world, and were probably established sometime during the third millennium B.C. Banks probably predated the invention of money. Deposits initially consisted of grain and later other goods including cattle, agricultural implements, and eventually Precious metals such as gold, in the form of easy-to-carry compressed plates. Temples and palaces were the safest places to store gold as they were constantly attended and well built. As sacred places, temples presented an extra deterrent to would-be thieves. There are extant records of loans from the 18th century BC in Babylon that were made by temple priests/monks to merchants. By the time of Hammurabi's Code, banking was well enough developed to justify the promulgation of laws governing banking operations.¹¹

Ancient Greece holds further evidence of banking. Greek temples, as well as private and civic entities, conducted financial transactions such as loans, deposits, currency exchange, and validation of coinage. There is evidence too of credit, whereby in return for a payment from a client, a moneylender in one Greek port would write a credit note for the client who

¹¹Giuseppe, F and Guido, L. Genoa and the history of finance: A series of firsts? 9 November 2004, (the book can be downloaded at www.giuseppefelloni.it)

could "cash" the note in another City, saving the client the danger of carting coinage with him on his journey. Pythius, who operated as a merchant banker throughout Asia Minor at the beginning of the 5th century B.C., is the first individual banker of whom we have records. Many of the early bankers in Greek city-states were "metics" or foreign residents.

The fourth century B.C. saw increased use of credit-based banking in the Mediterranean world. In Egypt, from early times, grain had been used as a form Money in addition to precious metals, and state granaries functioned as banks. When Egypt fell under the rule of a Greek dynasty, the Ptolemies (332-30 B.C.), the numerous scattered government granaries were transformed into a network of grain banks, centralized in Alexandria where the main accounts from all the state granary banks were recorded. This banking network functioned as a trade credit system in which payments were affected by transfer from one account to another without money passing.¹²

In the late third century B.C., the barren Aegean island of Delos, known for its magnificent harbor and famous temple of Apollo, became a prominent banking center. As in Egypt, cash transactions were replaced by real credit receipts and payments were made based on simple instructions with accounts kept for each client. With the defeat of its main rivals, Carthage and Corinth, by the Romans, the importance of Delos increased. Consequently it was natural that the bank of Delos should become the model most closely imitated by the banks of Rome.

Ancient Rome perfected the administrative aspect of banking and saw greater regulation of financial institutions and financial practices. Charging interest on loans and paying interest on deposits became more highly developed and competitive. The development of Roman banks was limited, however, by the Roman preference for cash transactions. During the reign of

¹² Edward Colen "Athenian Economy and Society: A Banking Perspective" Princeton, NJ: Princeton University Press, 1992

the Roman emperor Gallienus (260-268 AD), there was a temporary breakdown of the Roman banking system after the banks rejected the flakes of copper produced by his mints. With the ascent of Christianity, banking became subject to additional restrictions, as the charging of interest was seen as immoral. After the fall of Rome, banking was abandoned in Western Europe and did not revive until the time of the causal.

Ironically, the Papal bankers were the most successful of the Western world, though often goods taken in pawn were substituted for interest in the institution termed the Monte di Pieta. When Pope John XXII (born Jacques d'Euse (1249 - 1334) was crowned in Lyon in 1316, he set up residency in Avignon. Civil war in Florence between the rival Guelph and Ghibelline factions resulted in victory for a group of Guelph merchant families in the city. They took over papal banking monopolies from rivals in nearby Siena and became tax collectors for the Pope throughout Europe. In 1306, Philip IV expelled Jews from France. In 1307 Philip had the Knights Templar arrested and had gotten hold of their wealth, which had become to serve as the unofficial treasury of France. In 1311 he expelled Italian bankers and collected their outstanding credit. In 1327, Avignon had 43 branches of Italian banking houses. In 1347, Edward III of England defaulted on loans. Later there was the bankruptcy of the Peruzzi (1374) and Bardi (1353). The accompanying growth of Italian banking in France was the start of the Lombard moneychangers in Europe, who moved from city to city along the busy pilgrim routes important for trade. Key cities in this period were Cahors, the birthplace of Pope John XXII, and Figeac. Perhaps it was because of these origins that the term Lombard is synonymous with Cahorsin in medieval Europe, and means 'pawnbroker'. Banca Monte dei Paschi di Siena SPA (MPS) Italy is the oldest surviving bank in the world. After 1400, political forces turned against the methods of the Italian free enterprise bankers. In 1401, King Martin I of Aragon expelled them. In 1403, Henry IV of England prohibited them from taking profits in any way in his kingdom. In 1409, Flanders imprisoned and then expelled Genoese bankers. In 1410, all Italian merchants were expelled from Paris. In 1401, the Bank of Barcelona was founded. In 1407, the Bank of

Saint George was founded in Genoa. This bank dominated business in the Mediterranean. In 1403 charging interest on loans was ruled legal in Florence despite the traditional Christian prohibition of usury. Italian banks such as the Lombards, who had agents in the main economic centres of Europe, had been making charges for loans. The lawyer and theologian Lorenzo di Antonio Ridolfi won a case which legalized interest payments by the Florentine government. In 1413, Giovanni di Bicci de' Medici appointed banker to the pope. In 1440, Gutenberg invents the modern printing press although Europe already knew of the use of paper money in China. The printing press design was subsequently modified, by Leonardo da Vinci among others, for use in minting coins nearly two centuries before printed banknotes were produced in the West.¹³ by the 1390s silver was short all over Europe, except in Venice. The silver mines at Kutná Hora had begun to decline in the 1370s, and finally closed down after being sacked by King Sigismund in 1422. By 1450 almost all of the mints of northwest Europe had closed down for lack of silver. The last money-changer in the major French port of Dieppe went out of business in 1446. In 1455 the Turks overran the Serbian silver mines, and in 1460 captured the last Bosnian mine. The last Venetian silver grosso was minted in 1462. Several Venetian Banks failed, and so did the Strozzi bank of Florence, the second largest in the city. Even the smallest of small change became scarce. Modern Western economic and financial history is usually traced back to the coffee houses of London. The London Royal Exchange was established in 1565. At that time moneychangers were already called bankers, though the term "bank" usually referred to their offices, and did not carry the meaning it does today. There was also a hierarchical order among professionals; at the top were the bankers who did business with heads of state, next were the city exchanges, and at the bottom were the pawn shops or "Lombard's". Some European cities today have a Lombard street where the pawn shop was located.

¹³ URL: [Http://en.wikipedia.org/wiki/History_of_bank.asp/15](http://en.wikipedia.org/wiki/History_of_bank.asp/15)

Again the origin of modern banking may be traced to the money dealer in Florence, who received money on deposit and were lenders of money in the 14th century, and the names of the Bardi, Acciajuoli, Peruzzi, Pitti and Medici soon became famous throughout, Europe, as bankers. At one time, Florence is said to have had eighty bankers, though it could boast of no public bank.¹⁴ After the siege of Antwerp trade moved to Amsterdam. In 1609 the Amsterdamsche Wissel bank (Amsterdam Exchange Bank) was founded which made Amsterdam the financial centre of the world until the Industrial Revolution. Banking offices were usually located near centers of trade, and in the late 17th century, the largest centers for commerce were the ports of Amsterdam, London, and Hamburg. Individuals could participate in the lucrative East India trade by purchasing bills of credit from these banks, but the price they received for commodities was dependent on the ships returning (which often didn't happen on Time) and on the cargo they carried (which often wasn't according to plan).

Around the time of Adam Smith (1776) there was a massive growth in the banking industry. Banks played a key role in moving from gold and silver based coinage to paper money, redeemable against the bank's holdings. Such growing internationalization and opportunity in financial services has entirely changed the competitive landscape, as now many banks have demonstrated a preference for the “universal banking” model prevalent in Europe. Universal banks are free to engage in all forms of financial services, make investments in client companies, and function as much as possible as a “one-stop” supplier of both retail and wholesale financial services.

History of Banking in India:

Ancient India

The origin of banking in dates back to the Vedic period. There are repeated references in the Vedic literature to money lending which was quite

¹⁴ Tannan, M.L. “Banking Law and Practice in India”, Indian Law house, Delhi, 2002, Page No. 2.

common as a side business. Later, during the time of the Smritis, which followed the Vedic Period and the Epic age, banking became a full-time business and got diversified with bankers performing most of the functions of the present day. The Vaish community, who conducted banking business during this period. As far back as the second or third century A.D. Manu the great Hindu Jurist, devoted a section of his work to deposits and advances and laid down rules relating to rates of interest to be charged. Still later, that is during the Buddhist period, banking business was decentralized and become a matter of volition. Consequently, Brahmins and Kshatriyas, who were earlier not permitted to take to banking as their profession except under exceptionally rare circumstances, also took to it as their business. During this period banking became more specific and systematic and bills of exchange came in wide use. "Shresthis" or bankers influential in society and very often acted as royal treasurers.

From the ancient times in India, an indigenous banking system has prevailed. The businessmen called Shroffs, Seths, Sahukars, Mahajans, Chettis etc. had been carrying on the business of banking since ancient times. These indigenous bankers included very small money lenders to shroffs with huge businesses, who carried on the large and specialized business even greater than the business.

Mughal Period

Mughal dynasty started with Babur ascending the throne of Agra in 1526 A.D. During Mughal period the indigenous bankers played a very important role in lending money and financing of foreign trade and commerce. They were also engaged in the profitable business of money changing. Banking business was, however particularly during the secular and settled reign of Emperor Akbar was gave the much needed political stability to the country. Every city, big or small had a 'Sheth' also known as a 'Shah' or 'Shroff', who performed a number of banking functions. He was respected by all parts of people as an important citizen. In Principal cities, besides shroffs, there was a 'Nagar Sheth' or 'Town Banker'. They were instrumental in

changing funds from place to place and doing collection business mainly through Hundis. The Hundis were accepted mode of change of money for commercial transactions.¹⁵

Britis Period

The seventeenth century witnessed the coming into India of the English traders. The English traders established their own agency houses at the port towns of Bombay, Calcutta and Madras. These agency houses, apart from engaging in trade and commerce, also carried on the banking business. The development of the means of transport and communication causing deflection of trade and commerce along new routes, changing the nature of trade activities in the country were the other factor which also contributed to the downfall of the indigenous bankers. Partly to fill the void caused by their downfall and partly to finance the growing financial requirements of English trade. The East India Company now came to favor the establishment of the banking institutions patterned after the Western style.¹⁶ The first Joint Stock Bank established in the country was the Bank of Hindustan founded in 1770 by the famous English agency house of M/s. Alexander and Company. The Bengal Bank and The Central Bank of India were established in 1785. The Bank of Bengal, the first of the three Presidency Banks was established in Calcutta in 1806 under the name of bank of Calcutta. It was renamed in 1809 on the grant of the charter as a Bank of Bengal. The two other presidency banks, namely the bank of Bombay and the Bank of Madras, were established in 1840 and 1843 respectively. After the Paper Currency Act of 1862, however the right of the note issue was taken away from them. The Presidency Banks had branches in important towns of the country. The banking crisis of 1913 to 1917 however brought out the serious deficiencies in the existing banking system in the country showing the need for effective co-ordination through the establishment of the Central Bank. After repeated efforts, the three presidency

¹⁵ URL: [Http://www.gatewayfor India .com/History/Muslim-history](http://www.gatewayforindia.com/History/Muslim-history)

¹⁶ URL: [Http://en.wikipedia.org/wiki/banking-in-India](http://en.wikipedia.org/wiki/banking-in-India).

bank was fused into a single bank under the name of the Imperial Bank of India in 1921.

The bank was authorized to hold Government balances and manage public debt. It was not, however, given power to issue notes. The issuing of the currency continued to be close preserving of the Government of India. The branches of the bank were to work as clearing houses. It was mainly a commercial bank competing with other banks. The Imperial Bank of India was nationalized in 1955 by the SBI act.¹⁷

In the wake of the Swadeshi Movement, a number of banks with Indian management were established in the country. The Punjab National Bank Ltd. Was founded in 1895, The Bank of India Ltd in 1906, The Canara Bank Ltd. in 1906. The Indian Bank Ltd. in 1907, the Bank of Baroda Ltd. in 1908, and the Central Bank of India Ltd. in 1911. There have been a number of checks to progress to the Banking Industry in the form of bank failures during the last over 100 years. The series of bank crisis particularly during the time 1913–17, 1939–45 and 1948–53 wiped out many weak units. Loss in trade or industry affected their credit and solvency. It may however, be stated that one of the important reasons for the last banking crisis of 1948–53 was the partition of the country into India and Pakistan. Most of the depositors who were Hindus migrated from Pakistan to India while a major portion of the assets of the banks, which failed remained in Pakistan. Although, Suggestions have been made from time to time that India ought to have a Central Bank. The Royal Commission on Indian currency and finance recommended that a Central Bank should be started in India so as to perfect her credit and currency organization. From 1927 to 1933, there was a proposal and constitutional reforms law process has been made. It was enacted in due course and became law on the 6th march 1934 and the Reserve Bank of India started

¹⁷ The Evaluation of the State Bank of India (The Era of the Imperial Bank of India- 1921-1955, Volume III

functioning with effect from 1st April 1935. Banking regulation act was passed in 1949.¹⁸

Banking After Independence in India:

First Phase: 1948 – 1969

Government took major steps in this Indian Banking Sector Reform after independence. In 1955, it nationalized Imperial Bank of India with extensive banking facilities on a large scale specially in rural and semi-urban areas. The country inherited a banking system that was patterned on the British Banking System. There were many joint stock companies doing banking business and they were concentrating mostly in major cities. Even the financing activities of these banks were confined to the exports of Jute, Tea etc and traditional industries like textile and sugar. There was no uniform law governing banking activity. An immediate concern after the partition of the country was about bank branches located in Pakistan and steps were taken to close some of them as desired by that country. In 1949, as many as 55 banks either went into liquidation or went out of banking business. Banking did not receive much attention of the policy makers and disjointed efforts were made towards the regulation of the banking industry.

Second Phase: Nationalization 1969 – 1990

After independence, India adopted a socialist pattern of society as its goal. This means in non technical language a society with wealth distributed as equitably as possible without making the country a totalitarian state. In 1955, the Imperial Bank of India was nationalized and its undertaking was taken over by State Bank of India. Its transformation into SBI has been effective from July 1, 1955.¹⁹ there were 7 subsidiaries Banks. Their Associate Bank was 1960.

¹⁸ Deshai, Vasant: "Indian Financial System", Himalaya Publishing House, 2005, Page No. 481

¹⁹ Pathak ,Bharti: "Indian Financial System" Pearson Education Pvt. Ltd. – 2004 Page – 401.

The State Banks group including State Bank of Hyderabad, State Bank of Mysore, State Bank of Travancore, State Bank of Bikaner and Jaipur, State Bank of Indore, State Bank of Patiala and State Bank of Saurashtra.

As regards the scheduled banks, there were complaints that Indian Commercial Banks were directing their advances to the large and medium scale industries and big business houses and that the sectors demanding priority such as agriculture, small scale industries and exports were not receiving their due share. This was one of the chief reasons for imposition of social control by amending the banking regulation act, with effect from 1st February 1969. On 19th July 1969, 14 major banks were nationalized and taken over they were as under:

- The Central Bank of India Ltd
- The Bank of India Ltd
- The Punjab National Bank Ltd
- The Bank of Baroda Ltd
- The United Commercial Bank Ltd
- The Canara Bank Ltd
- The United Bank of India Ltd
- The Dena Bank Ltd
- Syndicate Bank Ltd
- The Union Bank of India Ltd
- The Allahabad Bank Ltd
- The Indian Bank Ltd
- The Bank of Maharashtra Ltd
- The Indian Overseas Bank Ltd

Each bank was having deposits of more than Rs. 50 crore and having among themselves aggregate deposits of Rs. 2632 crore with 4130 branches. On 15th April 1980, six more banks were nationalized. These banks were:

- The Andhra Bank Ltd

- The Corporation Bank Ltd
- The New Bank of India Ltd
- The Oriental Bank of Commerce Ltd
- The Punjab & Sind Bank Ltd
- The Vijya Bank Ltd

There were some effects and achievements of nationalized banks. However, there are some problems relating to NPAs, competition, competency, overstaffing, inefficiency etc. for the nationalized bank.²⁰

Third Phase: 1991-2002 Economic Reforms

The Indian economic development takes place in the realistic world from 1991 “Liberalization, Privatization and Globalization” policy. As per “LPG” policy all restriction on the Indian economy was totally dissolved and the soundest phase for the Indian banking system adopt over here. This also changed the scenario of the macro economic world. The budget policy and suggestion provided by shri Dr Man Mohan Singh and the Governor of Reserve Bank of India. As per the guideline the segments for development is having various problem and so the importance of public sector cannot be ignored. The country is flooded with foreign banks and their ATM stations. Efforts are being put to give a satisfactory service to customers. Phone banking and net banking is introduced. The entire system became more convenient and swift. Time is given more importance than money

The financial system of India has shown a great deal of resilience. It is sheltered from any crisis triggered by any external macroeconomics shock as other East Asian Countries suffered. This is all due to a flexible exchange rate regime, the foreign reserves are high, and the capital account is not yet fully

²⁰ Tannan M.L.:“Banking Law and Practice in India”, Indian Law house, Delhi, 2002, Page No. 158,159,171.

convertible, and banks and their customers have limited foreign exchange exposure.

Banking Sector Reforms in India:

The Indian economic development takes place in the realistic world from the 1991 “liberalization privatization globalization” policy. As per “LPG” policy all restriction on the Indian economy was totally dissolved, and the soundest phase for the Indian banking system adopt over here. This also changed the scenario of the Macro economic world. Banking Sector reforms were initiated to upgrade the operating standard health and financial soundness of the banks. The Government of India setup the Narasimham Committee in 1991, to examine all aspects relating to structure, organization and functioning of the Indian banking system the recommendations of the committee aimed at creating a competitive and efficient banking system. Another committee which is Khan Committee was instituted by RBI in December, 1997 to examine the harmonization of the role and operations of development financial institutions and banks. It submitted its report in 1998. The major recommendations were a gradual move towards universal banking, exploring the possibility of gain full merger as between banks, banks and financial institutions.

Then the Verma Committee was established this committee recommended the need for greater use of IT even in the weak public sector banks, restructuring of weak banks but not merging them with strong banks, VRS for at least 25% of the staff. The Banking Sector reforms aimed at improving the policy framework, financial health and institutional infrastructure, there two phase of the banking reforms. Narasimham Committee provided the blue print for the initial reforms in banking sector following the balance of payment crisis in 1991.²¹

²¹ Demetriades and Luinted: “ Reports on Trends and Progress of Banking in India- RBI” 1997, pp320

Banking sector reforms was started in real sence from 1991 to on words. But it was conducted under the various report presented by the various committee. It may happen that the recommendation will not be the all and apply to the banks.

Phase-I Reforms:

Deregulation of Interest Rates :

These banks have been given the right to decide the rate of which they are lending. No debt PLR (Prime Lending Rate) have been decided by RBI but after that authority have been given to the banks to decide the interest rates on their own self.

Reduction in Pre Emptive Reserve:

Under this reform the bank can reduce the reserve available to them. By reducing the reserve they can lese them in banking activity like loans deposits to other advances and in capital market.

Branch Expansion:

Under this reform the bank has been given authority to expand branch as the requirement but the permission of authority.

Introducing of Prudential Norms:

The bank has to follow certain norms that has been as part of reform which includes:

- To ensure Capital Adequacy
- Proper Income Recognition
- Classification of Assets
- Provision against the Doubtful debts

Permission to deal in Capital Market:

Till this reform the bank public sector as well as private sector and foreign banks are not allowed to deal in the capital market. But after this

reform the banks are allowed to deal in the capital market and trade of equity, preference, debenture and other capital market instruments.

Constituting Debt Recovery Tribunals:

Special debt recovery tribunal has been established under 10 to 11 Zones in India. It is exclusively made for the NPA management. It is the main reform suggestion by the Narshimaham Committee.

Freedom to Exercise Human Resource Policy:

The freedom has been given to banks to clear with the human resource of banks. Now banks can appoint their chief executive officers and other officers as and when they require.

Change in the Constitutional Board:

Under this reform the bank can change as per need in the constitutional board of banks they can make change of board of directors. Power and duties also assign to the officers.

This all the reform has been implemented in phase-I but it is not enough. So the second phase of reform has been come and it has been describe as under:

Phase-II Reforms :

The second phase reforms broadly based upon the certain criteria like.

Capital Adequacy Norms :

The Basel norm of capital adequacy was introduced in India following the recommendations of the Narshimaham Committee -1991.

- Capital adequacy ratio to be raised from 8% to 10% by 2002.
- 5% market risk weight of fixed income securities and open foreign exchange position limits.
- Market discipline of the banks

- Capital adequacy ratio is calculated on the based of risk weights on assets on the book of banks.

Assets Quality :

The problem that the banks are facing is NPA. The recommendations of Narshimaham Committee-II were:

- Bank should aim to reduce gross non-performing assets to 3% and Net NPA by 0% at the-2002.
- The income should be recognized at 90 days was reduced from 180 days.
- The credit regulation was reduced from 40% to 10%.

System and Methods :

- Banks to start recruitment of skilled and specialized manpower from the market or the better work face
- Overstaffing will be reducing by the introducing the retirement schemes of VRS
- Flexibility will be given to the public sector banks employees in remuneration structure
- The introduction of computer and technology will be rapid.

Regulation and Supervision

- Board for financial regulation and supervision to be constituted with statutory Powers.
- Greater emphasis on public disclosure as opposed to disclosure to regulators.
- Banking regulation and supervision to be progressively de linked from monetary policy²²

²² [Http://www.allbankingsolutions.com/bankreforms1.htm](http://www.allbankingsolutions.com/bankreforms1.htm)

Legal Amendments

- Broad range of legal reforms to facilitate recovery of problem loans.
- Introduction of laws governing electronic fund transfer.
- Many of the important recommendations of Narasimham Committee II have been accepted and are under implementation the second generation banking reforms concentrate on strengthening the foundation of the banking system by structure technological up graduation and human resource development.²³

Restructuring the Banking Industry:-

- Merger are not to be imported by re-regulators they should be market driven
- Bank to be given a better function autonomy
- Entry of new private sector banks and foreign bank will be continue.

Capital Adequacy and Tire – I and II Capital :-

This capital adequacy was introduced for Indian commercial banks based on the Basel committee proposals (1988) which prescribes the two Tire Capital for banks as follows.

Tire-I Capital:

Also known as core capital the most permanent and readily available support against unexpected losses includes

- Paid up capital, statutory reserve and share premium
- Capital reserve and other disclosed free reserve
- (Less): equity investment in subsidiaries, Intangible assets, losses in the current period, forward losses.

Tire – II Capital :-

It includes:

²³ Pathak Bharti: “Indian Financial System”, Pearson Education Pvt. Ltd., 2004 Page no – 409-418.

- Undisclosed reserve and fully paid up cumulative perpetual shares
- Revaluation reserve arising out of the revaluation of the assets that are undervalued in the banks books
- General provision and loss reserve not attributable to actual diminution in value or identifiable potential loss in any specific assets and available to meet unexpected losses
- Subordinated debt that is fully paid unsecured subordinated debt that is fully paid up.

Tire – II capital should not be more than tire – I capital 100% and subordinated debt instruments should be limited to 50% of tire – I capital.

Types of Banks:

In 1935, 'The State Bank of India Act, was passed, accordingly, 'The Imperial Bank of India' was nationalized and State Bank of India emerged with the objective of extension of banking facilities on a large scale, specifically rural and semi – urban area and for various of the public purposes. In 1969, fourteen major Indian Commercial Banks were nationalized and in 1980, six more were added on to constitute the public sector banks. Commercial Banks in India are classified in Scheduled Bank and Non Scheduled Banks. Scheduled Banks are including nationalized Bank, SBI and its subsidiaries, private sector banks and foreign banks. Non Scheduled Banks are those included in the second Scheduled of the RBI Act, 1934.

Scheduled Banks

The second scheduled of RBI act, create a list of banks which are described as "Scheduled Banks" In the terms of section 42 (6) of RBI act, 1934, the required amount is only Rs. 5 Lakh. The Scheduled Banks enjoy several privileges. It means that scheduled banks carries safety and prestige value compared to non scheduled banks. It is entitled to receive refinance facility as applicable.

Nationalized Banks

The nationalized banks include 14 banks nationalized on 19th July, 1969 and the 6 more nationalized on 15th April, 1980. They are also scheduled banks, after this nationalization the governments try to implement various welfare schemes.

Non Scheduled Banks

The commercial banks not included in the 2nd schedule of the RBI act are known as non scheduled banks. They are not entitled to facilities like refinance and rediscounting of bills etc, from RBI. They are engaged in lending money discounting and collection bills and various agency services. They insist higher security for loans.²⁴

Old Private Bank

These banks all registered under Companies Act, 1956. Basic difference between Co-operative bank and Private Banks is its aim. Co-operative banks work for its member and private banks are work for own profit.

New Private Banks

These banks lead the market of Indian banking business in very short period because of its variety of services and approach to handle customer and also because of long working hours and speed of services. This is also registered under the Company Act 1956. Between old and new private banks there is wide difference.

Foreign Banks

Foreign Banks mean multi-countries bank. In case of Indian foreign banks are such banks which open its branch office in India and their head office are outside of India. E.g. HSBC Bank, City Bank, Standard Chartered Bank etc.

²⁴ *ibid*, Page No-21

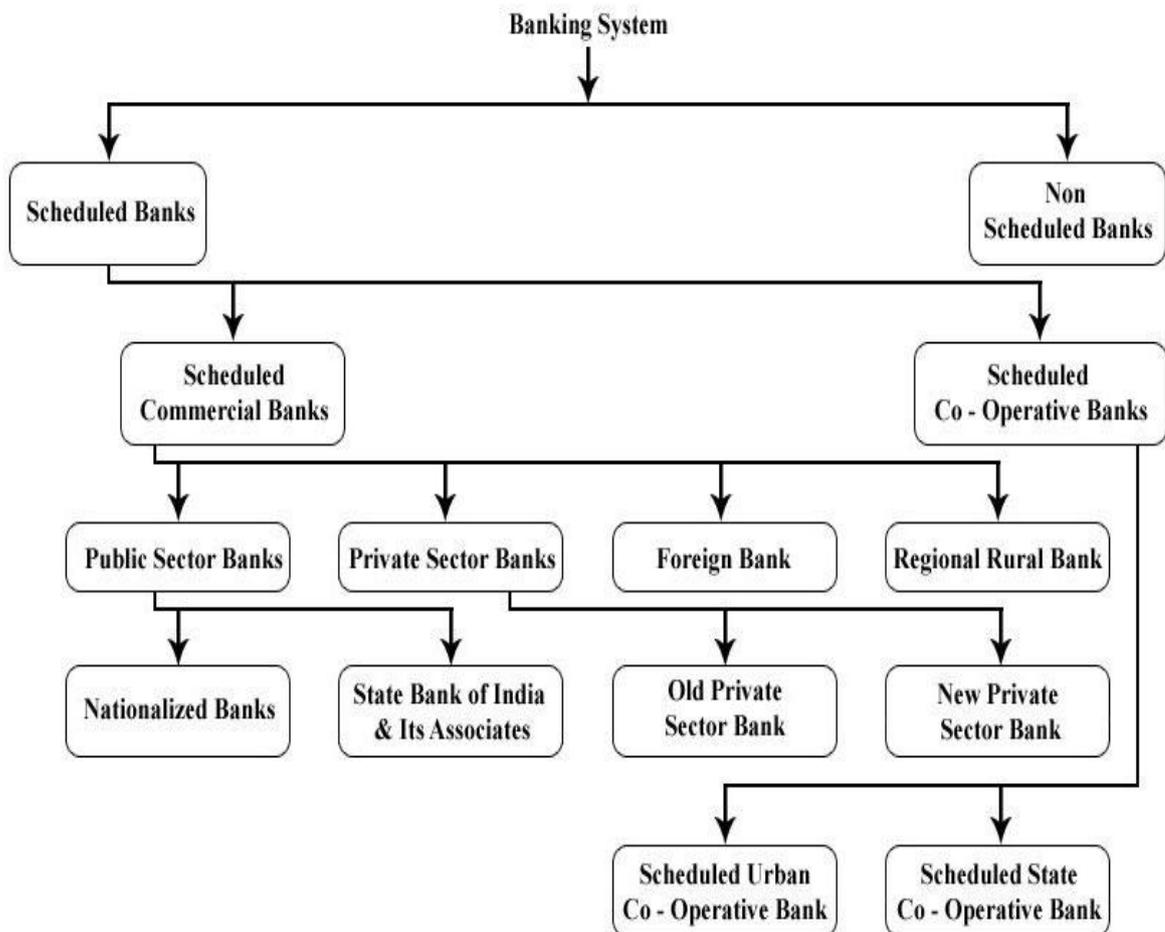
Co-operative Banks

Co-operative Banks another component of the Indian bank with the enactment of the Co-operative Credit Societies were sated owing to the increasing demand of Co-operative Credit, a new Act of the 1994, which provide for the increasing demand of Co-operative Central banks by a union of primary credit societies or by a union of primary credit socialites and individuals.

Indian Banking Structure:

The structure of Indian banking system that developed during the pre-independence period was without any purposive control and direction. There were no comprehensive banking laws except the Bank Charter Act 1876 which regulated the three presiding bank and the Indian Companies Act 1913 provided some safe guards against bank failures.

Banking structure in India



Role of Reserve Bank of India:

The Reserve Bank of India (RBI) is the central banking system of India and controls the monetary policy of the Rupee as well as currency reserves. The institution was established on 1 April 1935 during the British Raj in accordance with the provisions of the Reserve Bank of India Act, 1934 and plays an important part in the development strategy of the government. It is a member bank of the Asian Clearing Union. The Reserve Bank of India was constituted under the Reserve Bank of India Act, 1934 to regulate the issue of bank notes and the maintenance of reserves with a view to securing the monetary stability in India and generally to operate the currency and credit system of the country to its advantage.²⁵

The central bank was founded in 1935 to respond to economic troubles after the First World War. The Reserve Bank of India was set up on the recommendations of the Hilton Young Commission. The commission submitted its report in the year 1926, though the bank was not set up for another nine years. The Preamble of the Reserve Bank of India describes the basic functions of the Reserve Bank as to regulate the issue of bank notes, to keep reserves with a view to securing monetary stability in India and generally to operate the currency and credit system in the best interests of the country. The Central Office of the Reserve Bank was initially established in Kolkata, Bengal but was permanently moved to Mumbai in 1937. The Reserve Bank continued to act as the central bank for Myanmar till Japanese occupation of Burma and later up to April 1947, though Burma seceded from the Indian Union in 1937. After partition, the Reserve Bank served as the central bank for Pakistan until June 1948 when the State Bank of Pakistan commenced operations. Though originally set up as a shareholders' bank, the RBI has been fully owned by the government of India since its nationalization in 1949.

²⁵ Indian Institute of Banking & finance, "Banking Product and Service", Taxman Publication, July 2004, Page – 10.

Between 1950 and 1960, the Indian government developed a centrally planned economic policy and focused on the agricultural sector. The administration nationalized commercial banks and established, based on the Banking Companies Act, 1949 (later called Banking Regulation Act) a central Bank regulation as part of the RBI. Furthermore, the central bank was ordered to support the economic plan with loans. As a result of bank crashes, the reserve bank was requested to establish and monitor a deposit insurance system. It should restore the trust in the national bank system and was initialized on 7 December 1961. The Indian government founded funds to promote the economy and used the slogan Developing Banking. The Gandhi administration and their successors restructured the national bank market and nationalized a lot of institutes. As a result, the RBI had to play the central part of control and support of this public banking sector.

Between 1969 and 1980 the Indian government nationalized 20 banks. The regulation of the economy and especially the financial sector was reinforced by the Gandhi administration and their successors in the 1970s and 1980s. The central bank became the central player and increased its policies for a lot of tasks like interests, reserve ratio and visible deposits. The measures aimed at better economic development and had a huge effect on the company policy of the institutes. The banks lent money in selected sectors, like agri-business and small trade companies.²⁶

The branch was forced to establish two new offices in the country for every newly established office in a town. The oil crises in 1973 resulted in increasing inflation, and the RBI restricted monetary policy to reduce the effects. A lot of committees analyzed the Indian economy between 1985 and 1991. Their results had an effect on the RBI. The Board for Industrial and Financial Reconstruction, the Indira Gandhi Institute of Development

²⁶ Mukharjee, Ananya: "Corporate Governance Reforms in India" Journal of Business Ethics, vol- 37, May 2002, pp 253

Research and the Security & Exchange Board of India investigated the national economy as a whole, and the security and exchange board proposed better methods for more effective markets and the protection of investor interests. The Indian financial market was a leading example for so-called "financial repression" (Mackinnon and Shaw). The Discount and Finance House of India began its operations on the monetary market in April 1988; the National Housing Bank, founded in July 1988, was forced to invest in the property market and a new financial law improved the versatility of direct deposit by more security measures and liberalization.

The national economy came down in July 1991 and the Indian rupee was devalued. The currency lost 18% relative to the US dollar, and the Narsimham Committee advised restructuring the financial sector by a temporal reduced reserve ratio as well as the statutory liquidity ratio. New guidelines were published in 1993 to establish a private banking sector. This turning point should reinforce the market and was often called neo-liberal. The central bank deregulated bank interests and some sectors of the financial market like the trust and property markets.

The National Stock Exchange of India took the trade on in June 1994 and the RBI allowed nationalized banks in July to interact with the capital market to reinforce their capital base. The central bank founded a subsidiary company—the Bharatiya Reserve Bank Note Mudran Limited—in February 1995 to produce banknotes. The Foreign Exchange Management Act from 1999 came into force in June 2000. It should improve the foreign exchange market, international investments in India and transactions. The RBI promoted the development of the financial market in the last years, allowed online banking in 2001 and established a new payment system in 2004 - 2005 (National Electronic Fund Transfer).²⁷ The Security Printing & Minting Corporation of India Ltd., a merger of nine institutions, was founded in 2006

²⁷ Ray Amal, K. "India's Social Development in Decade of Reforms: 1990-1991/199-2000" Social Indicator Research , Vol-87, July 2008, pp 410

and produces banknotes and coins.

Function of Reserve Bank of India:

As a central bank, the Reserve Bank has significant powers and duties to perform. For smooth and speedy progress of the Indian Financial System, it has to perform some important tasks. Among others it includes maintaining monetary and financial stability, to develop and maintain stable payment system, to promote and develop financial infrastructure and to regulate or control the financial institutions.

[A] Traditional Function

Traditional functions are those functions which every central bank of each nation performs all over the world. Basically these functions are in line with the objectives with which the bank is set up. It includes fundamental functions of the Central Bank. They comprise the following tasks.

Issue of the Currency Note

The RBI has the sole right or authority or monopoly of issuing currency notes except one rupee note and coins of smaller denomination. These currency notes are legal tender issued by the RBI. Currently it is in denominations of Rs. 2, 5, 10, 20, 50, 100, 500, and 1,000. The RBI has powers not only to issue and withdraw but even to exchange these currency notes for other denominations. It issues these notes against the security of gold bullion, foreign securities, rupee coins, exchange bills and promissory notes and government of India bonds.

Banker to the Banks

The RBI being an apex monetary institution has obligatory powers to guide, help and direct other commercial banks in the country. The RBI can control the volumes of banks reserves and allow other banks to create credit in that proportion. Every commercial bank has to maintain a part of their reserves with its parent's viz. the RBI. Similarly in need or in urgency these

banks approach the RBI for fund. Thus it is called as the lender of the last resort.

Banker to the Government

The RBI being the apex monetary body has to work as an agent of the central and state governments. It performs various banking functions such as to accept deposits, taxes and make payments on behalf of the government. It works as a representative of the government even at the international level. It maintains government accounts, provides financial advice to the government. It manages government public debts and maintains foreign exchange reserves on behalf of the government. It provides overdraft facility to the government when it faces financial crunch.

Exchange Rate Management

It is an essential function of the RBI. In order to maintain stability in the external value of rupee, it has to prepare domestic policies in that direction. Also it needs to prepare and implement the foreign exchange rate policy which will help in attaining the exchange rate stability. In order to maintain the exchange rate stability it has to bring demand and supply of the foreign currency (U.S Dollar) close to each other.

Credit Control Function

Commercial bank in the country creates credit according to the demand in the economy. But if this credit creation is unchecked or unregulated then it leads the economy into inflationary cycles. On the other credit creation is below the required limit then it harms the growth of the economy. As a central bank of the nation the RBI has to look for growth with price stability.

Supervisory Function

The RBI has been endowed with vast powers for supervising the banking system in the country. It has powers to issue license for setting up new banks, to open new branches, to decide minimum reserves, to inspect

functioning of commercial banks in India and abroad, and to guide and direct the commercial banks in India.

[B] Developmental Function

Along with the routine traditional functions, central banks especially in the developing country like India have to perform numerous functions. These functions are country specific functions and can change according to the requirements of that country. The RBI has been performing as a promoter of the financial system since its inception. Some of the major development functions of the RBI are maintained below.²⁸

Development of the financial System

The financial system comprises the financial institutions, financial markets and financial instruments. The sound and efficient financial system is a precondition of the rapid economic development of the nation. The RBI has encouraged establishment of main banking and non-banking institutions to cater to the credit requirements of diverse sectors of the economy.

Development of Agriculture

In an agrarian economy like ours, the RBI has to provide special attention for the credit need of agriculture and allied activities. It has successfully rendered service in this direction by increasing the flow of credit to this sector. It has earlier the Agriculture Refinance and Development Corporation (ARDC) to look after the credit, National Bank for Agriculture and Rural Development (NABARD) and Regional Rural Banks (RRBs).

Provision of Industrial Finance

Rapid industrial growth is the key to faster economic development. In this regard, the adequate and timely availability of credit to small, medium and large industry is very significant. In this regard the RBI has always been

²⁸ URL/Http://Finance India market.com/investment.

instrumental in setting up special financial institutions such as ICICI Ltd. IDBI, SIDBI and EXIM BANK etc.

Provision of Training

The RBI has always tried to provide essential training to the staff of the banking industry. The RBI has set up the bankers' training colleges at several places. National Institute of Bank Management i.e NIBM, Bankers Staff College i.e BSC and College of Agriculture Banking i.e CAB are few to mention.

Collection of Data

Being the apex monetary authority of the country, the RBI collects process and disseminates statistical data on several topics. It includes interest rate, inflation, savings and investments etc. This data proves to be quite useful for researchers and policy makers.

Publication of the Reports

The Reserve Bank has its separate publication division. This division collects and publishes data on several sectors of the economy. The reports and bulletins are regularly published by the RBI. It includes RBI weekly reports, RBI Annual Report, Report on Trend and Progress of Commercial Banks India., etc. This information is made available to the public also at cheaper rates.

Promotion of the Banking Habits

As an apex organization, the RBI always tries to promote the banking habits in the country. It institutionalizes savings and takes measures for an expansion of the banking network. It has set up many institutions such as the Deposit Insurance Corporation-1962, UTI-1964, IDBI-1964, NABARD-1982, NHB-1988, etc. These organizations develop and promote banking habits

among the people. During economic reforms it has taken many initiatives for encouraging and promoting banking in India.

Promotion of Export through Re-Finance

The RBI always tries to encourage the facilities for providing finance for foreign trade especially exports from India. The Export-Import Bank of India (EXIM Bank India) and the Export Credit Guarantee Corporation of India (ECGC) are supported by refinancing their lending for export purpose.

[C] Supervisory Function

The reserve bank also performs many supervisory functions. It has authority to regulate and administer the entire banking and financial system. Some of its supervisory functions are given below.

Granting Licenses to the Banks

The RBI grants license to banks for carrying its business. License is also given for opening extension counters, new branches, even to close down existing branches.

Bank Inspection

The RBI grants license to banks working as per the directives and in a prudent manner without undue risk. In addition to this it can ask for periodical information from banks on various components of assets and liabilities.

Control over NBFIS

The Non-Bank Financial Institutions are not influenced by the working of a monetary policy. However RBI has a right to issue directives to the NBFIs from time to time regarding their functioning. Through periodic inspection, it can control the NBFIs.

Implementation of the Deposit Insurance System

The RBI has set up the Deposit Insurance Guarantee Corporation in order to protect the deposits of small depositors. All bank deposits below Rs.

One lakh are insured with this corporation. The RBI work to implement the Deposit Insurance Scheme in case of a bank failure.²⁹

[D] Traditional Banking Functions

In very general terms, the traditional functions of a commercial bank can be classified under following main heads:

Receiving of Money on Deposit

This is the most important function of banks, as it is largely by means of deposits that a bank prepares the basis for several other activities. The money power of a bank, by which it helps largely the business community and other customers, depends considerably upon the amounts it can borrow by way of deposits. The deposits of a bank can take the form of fixed, savings or current deposits.

Lending of Money

This function is not only very important but is the chief source of profit for banks. By lending money banks place funds at the disposal of the borrower, in exchange for a promise of payment at a future date, enabling the borrowers to carry on their Business/productive activities and meet their other requirements. Banks thus, help their clients to meet their needs with the money lent to them and return the money with interest as per agreed terms. The advances of a bank can take the form of loans, cash, credits, bills purchase / discount facilities.³⁰

Transferring Money From Place to Place

This function is also one of the important functions of banks. Banks allow the facilities of transfer of funds by issuing demand drafts, Telegraphic / Telephonic Transfers, Mail Transfer etc.

²⁹ URL: <http://kalyan-city.blogspot.com/2010/09/functions-of-reserve-bank-of-india-rbi.html>

³⁰ Dr. Bhattacharya, K. M. And Agarwal, O. P. "Basics of Banking and Finance Published by Himalaya Publishing House, 2006 Page – 20.

Miscellaneous Functions

Safe custody of valuables, issue of various forms of credits e.g. letters of credit, traveler's cheques and furnishing guarantees on behalf of customers and providing fee based services are also important functions performed by banks.

Functions of Commercial Banks:

Acceptance of deposits

An important function of commercial banks is to attract deposit from the public. Those people who have cash account and want their safety; they deposit that amount of banks. Commercial banks accept deposits every class and source and take responsibility to repay the deposit in the same currency whenever they are demanded by depositors.

Lending

Another function of commercial banks is to make loans and advance out of the deposit receive in various forms. Bank Apply the accumulated public deposits to productive uses by way of loans and advances, overdraft and cash credits against approved securities.

Investments

Now-a-days commercial banks are also involved in Investment. Generally investment means long term and medium term investments.

Challenges in Banking Sector

There has been considerable widening and deepening of the Indian financial system in the recent years. The enhanced role of the Banking sector in the Indian Economy, the increasing levels of deregulation and the increasing levels of competition have placed numerous demands on our Banks. The adverse consequences of malfunction of the Banking system could be more severe than in the past. Hence, focus of RBI, the regulator & supervisor of Indian Banking system is at ensuring greater financial stability.

While operating in this highly demanding environment, the banking system is exposed to various risks & challenges few of them are discussed as under:

Improving Risk Management System

RBI had issued guidelines on asset liability management and Risk Management Systems in Banks in 1999 and Guidance Notes on Credit Risk Management and Market Risk Management in October 2002 and the Guidance note on Operational Risk Management in 2005. Though Basel II focuses significantly on risks its implementation cannot be seen as an end in itself. The current business environment demands an integrated approach to risk management. It is no longer sufficient to manage each Risk Independently. Banks in India are moving from the individual segment system to an enterprise wide Risk Management System. This is placing greater demands on the Risk Management skills in Banks and has brought to the forefront, the need for capacity building, while the first priority would be risk integrating across the entire Bank, the desirability of Risk aggregation across the Group will also need attention. Banks would be required to allocate significant resources towards this objective over the next few years.

Rural Coverage

Indian local banks specially state bank groups having a good coverage and many branches in rural areas. But that is quite lacking technical enhancement. The services available at cities are specifically not available to rural branches, which are necessary if banks want to compete now a day.

Technological Problems

That is true that Indian banks were already started computerized workings and so many other technological up gradation done but is this sufficient? In metro cities Indian local banks are having good comparable technology but that cannot be supported and comparable by the whole network of other cities and village branches.

Corporate Governance

Banks not only accept and deploy large amount of uncollateralized public funds in fiduciary capacity, but they also leverage such funds through credit creation. Banks are also important for smooth functioning of the payment system. Profit motive cannot be the sole criterion for business decisions. It is a significant challenge to banks where the priorities and incentives might not be well balanced by the operation of sound principles of Corporate Governance. If the internal imbalances are not re-balanced immediately, the correction may evolve through external forces and may be painful and costly to all stakeholders. The focus, therefore, should be on enhancing and fortifying operation of the principles of sound Corporate Governance.

Customer Services

There are concerns in regard to the Banking practices that tend to exclude vast sections of population, in particular pensioners, self employed and those employed in unorganized sector. Banks are expected to oblige to provide Banking services to all segments of the population, on equitable basis. Further, the consumers interests are at times not accorded full protection and their grievances are not properly attended to by Banks. Banks are expected to encourage greater degree of financial inclusion in the country setting up of a mechanism for ensuring fair treatment of consumers; and effective redressed of customer grievances.

Branch Banking

Traditionally Banks have been looking to expansion of their Branch Network to increase their Business. The new private sector banks as well as the foreign banks have been able to achieve business expansion through other means. Banks are examining the potential benefits that may accrue by tapping the agency arrangement route and the outsourcing route. While proceeding in this direction banks ought not to lose sight of the new risks that they might be assuming in outsourcing. Hence they have to put in place appropriate strategies and systems for managing these new risks.

Competition

With the ever increasing pace and extent of globalization of the Indian economy and the systematic opening up of the Indian Banking System to global competition, banks need to equip themselves to operate in the increasingly competitive Environment. This will make it imperative for Banks to enhance their systems and procedures to international standards and also simultaneously fortify their financial positions.

Transparency and Disclosures

In order to bring about meaningful disclosure of the true financial position of banks to enable the users of financial statements to study and have a meaningful comparison of their positions, a series of measures were initiated by RBI. It covered a No. of aspects such as capital adequacy, asset quality, profitability, country risk exposure, risk exposures in derivatives, segment reporting and related party disclosures etc.

With a view to moving closer towards international best practices and International Accounting Standards and the disclosure need under pillar 3 of Basel II, RBI has proposed enhanced disclosures of certain qualitative aspects. Banks are required to formulate a formal disclosure policy that addresses the banks' approach for determining what disclosures it will make and the internal controls over the disclosure process.³¹

Known Your Customer Guidelines

The guidelines were revisited in the context of the recommendations made by the financial action task force on Anti Money Laundering Standards and on Combating Financing of Terrorism. Compliance with these standards both by the banks/financial institutions and the country has become necessary for international financial relationships. Compliance with this requirement is a significant challenge to the entire banking industry to fortify itself against

³¹ Narendra Jadhav: "Challenges to Indian Banking Published by Macmillan India Limited, 1996, Page No. 54

misuse by anti social persons / entities and thus project a picture of solidarity and financial integrity of the Indian Banking system to the international community.³²

Problem and Prospect of Banking in India:

During the post reform period and due to the situation of Liberalization, Privatization and Globalization, Indian banking sector is facing some problems and challenges. These are as under

- Low Profitability and Productivity
- Lack of Integrity
- Increase of Administrative Expenses
- Survival of loss making branches
- Scandals
- Lack of Professional Behavior
- Lack of professional and friendly approaches with customer
- Non-performing Assets
- Customer oriented market
- Problem of customer satisfaction
- Depression period running over the country
- Managing work force
- Management of technological advancement

However banks have some prospects in present environment. By converting threats into opportunities, the bank can have better advantages these opportunities are as under.

- Offering of innovative products
- Door to door service approach
- Customer relationship management
- Professional approaches

³² Dr. Bhattacharya, K. M. and Agarwal, O.P. "Basics of Banking and Finance Published by Himalaya Publishing House, 2006, Page– 54.

- Managerial excellence
- Marketing and technological advancement
- Customized and cyber services
- Branch expansion
- Deposit Mobilization
- NPA management
- Asset reconstruction
- Motivational HRM policies
- Change in lending process
- Merger and acquisition
- Total quality management concept

Banking Product Portfolio:

Deposits

There are many products in retail banking like Fixed Deposit, Savings Account, Current Account, Recurring Account, NRI Account, Corporate Salary Account, Free Demat Account, Kid's Account, Senior Citizen Scheme, Cheque Facilities, Overdraft Facilities, Free Demand Draft Facilities, Locker Facilities, Cash Credit Facilities, etc. They are listed and explained as follows:

Fixed Deposits

The deposit with the bank for a period, which is specified at the time of making the deposit, is known as fixed deposit. Such deposits are also known as FD or term deposit . FD is repayable on the expiry of a specified period. The rate of interest and other terms and conditions on which the banks accepted FD were regulated by the RBI, in section 21 and 35A of the Banking Regulation Act 1949. Each bank has prescribed their own rate of interest and has also permitted higher rates on deposits above a specified amount. RBI has also permitted the banks to formulate FD schemes specially meant for senior citizen with higher interest than normal.

Saving Accounts

Saving bank account is meant for the people who wish to save a part of their current income to meet their future needs and they can also earn in interest on their savings. The rate of interest payable on by the banks on deposits maintained in savings account is prescribed by RBI.

Now-a-days the fixed deposit is also linked with saving account. Whenever there is excess of balance in saving account it will automatically transfer into fixed deposit and if there is shortfall of funds in savings account, by issuing cheque the money is transferred from fixed deposit to saving account. Different banks give different name to this product.

Current Accounts

A current account is an active and running account, which may be operated upon any number of times during a working day. There is no restriction on the number and the amount of withdrawals from a current account. Current account, suit the requirements of a big businessmen, joint stock companies, institutions, public authorities and public corporation etc.

Recurring Deposit

A variant of the saving bank a/c is the recurring deposit or cumulative deposit a/c introduced by banks in recent years. Here, a depositor is required to deposit an amount chosen by him. The rate of interest on the recurring deposit account is higher than as compared to the interest on the saving account. Banks open such accounts for periods ranging from 1 to 10 years. There curing deposit account can be opened by any number of persons, more than one person jointly or severally, by a guardian in the name of a minor and even by a minor.

NRI Account

NRI accounts are maintained by banks in rupees as well as in foreign currency. Four types of Rupee account can be open in the names of NRI: Apart from this, foreign currency account is the account in foreign currency. The account can be open normally in US Dollar, Pound Sterling, and Euro.

The accounts of NRIs are Indian millennium deposit, Resident foreign currency, housing finance scheme for NRI investment schemes.³³

Corporate Salary account

Corporate Salary account is a new product by certain private sector banks, foreign banks and recently by some public sector banks also. Under this account salary is deposited in the account of the employees by debiting the account of employer. The only thing required is the account number of the employees and the amount to be paid them as salary. In certain cases the minimum balance required is zero. All other facilities available in savings a/c are also available in corporate salary account.

Kid's Account

Children are invited as customer by certain banks. Under this, Account is opened in the name of kids by parents or guardians. The features of kid's account are free personalized cheque book which can be used as a gift cheque, internet banking, investment services etc.

Senior Citizenship scheme

Senior citizens can open an account and on that account they can get interest rate somewhat more than the normal rate of interest. This is due to some social responsibilities of banks towards aged persons whose earnings are mainly on the interest rate.

Loans and Advances

The main business of the banking company is lending of funds to the constituents, mainly traders, business and industrial enterprises. The major portion of a bank's funds is employed by way of loans and advances, which is the most profitable employment of its funds. There are three main principles of bank lending that have been followed by the commercial banks and they are

³³ URL: [Http://www.sendmoney.org/different type of bank account php](http://www.sendmoney.org/different_type_of_bank_account_php)

safety, liquidity, and profitability. Banks grant loans for different periods like short term, medium term, and long term and also for different purpose.

Personal Loans

This is one of the major loans provided by the banks to the individuals. There the borrower can use for his/her personal purpose. This may be related to his/her business purpose. The amount of loan is depended on the income of the borrower and his/her capacity to repay the loan.

Housing Loans

NHB is the wholly own subsidiary of the RBI which control and regulate whole industry as per the guidance and information. The purpose of loan is mainly for purchase, extension, renovation, and land development.

Education Loans

Loans are given for education in country as well as abroad.

Vehicle Loans

Loans are given for purchase of scooter, auto-rickshaw, car, bikes etc. Low interest rates, increasing income levels of people are the factors for growth in this sector. Even for second hand car finance is available.

Professional Loans

Loans are given to doctor, C.A, Architect, Engineer or Management Consultant. Here the loan repayment is normally done in the form of equated monthly.

Consumer Durable Loans

Under this, loans are given for acquisition of T.V, Cell phones, A.C, Washing Machines, Fridge and other items.³⁴

³⁴URL: <http://www.wisegeek.com/what-are-different-types-of-bank-accounts.htm>

Loans against Shares and Securities

Finance against shares is given by banks for different uses. Now-a-days finance against shares are given mostly in demat shares. A margin of 50% is normally accepted by the bank on market value. For these loans the documents required are normally DP notes, letter of continuing security, pledge form, power of attorney. This loan can be used for business or personal purpose.

Retail Banking Services:

Credit Cards

A credit card is an instrument, which provides immediate credit facilities to its holder to avail variety of goods and services at the merchant outlets. It is made of plastic and hence popularly called as Plastic Money. Such cards are issued by bank to persons with minimum income ranging between RS 50000 and RS 100000 per annum and are accepted by a variety of business establishments which are notified by the card issuing bank. Some banks insist on the cardholder being their customers while others do not. Few banks do not charge any fee for issuing credit cards while others impose an initial enrolment fee and annual fee also. If the amount is not paid within the time duration the bank charges a flat interest of 2.5%. Leading Indian Banks such as: SBI, BOB, Canara Bank, ICICI, HDFC and a few foreign banks like Citi Bank, Standard Chartered etc are the important issuers of credit card in India.

Debit Cards

It is a new product introduced in India by Citibank a few years ago in association with MasterCard. A debit card facilitates purchases or payments by the cardholder. It debit money from the account of the cardholder during a transaction. This implies that the cardholder can spend only if his account permits.³⁵

³⁵ URL: [Http://www.hdfcbank.com/debit-cards-lending.htm](http://www.hdfcbank.com/debit-cards-lending.htm)

Net Banking

This facilitates the customers to do all their banking operations from their home by using the internet facility. With Net Banking one can carry out all banking and shopping transactions safely and with total confidentiality.

Automated Teller Machines (ATM)

ATMs feature user-friendly graphic screens with easy to follow instructions. The ATMs Interact with customers in their local language for increased convenience .ICICI Bank's ATM network is one of the largest and most widespread ATM network in India.

Smart Card

The smart card, a latest additional to the world of banking and information Technology has emerged as the largest volume driven end-product in the world due to its data portability, security and convenience. Smart Card is similar in size to today's plastic payment card; it has a memory chip embedded in it. The chip stores electronic data and programmes that are protected by advanced security features. When coupled with a reader, the smart card has the processing power to serve many different applications. As an access-control device, smart Cards make personal and business data available only to appropriate users. To ensure the confidentiality of all banking service, smart cards have mechanisms offering a high degree of security. These mechanisms are based on private and public key cryptography combined with a digital certificate, one of the most advanced security techniques currently available. In fact, it is possible to connect to the web banking service without a smart card.

Banking Services

In this changing scenario, the role of banks is very important for the growth and development of customers as well as economy. Banking Sector is offering traditional and other service as under:

- Regular Saving and current accounts
- Regular fixed deposits

- ATM services
- Credit cards
- Demat cards
- Student banking
- Special NRI Services
- Home loan, Vehicle loan
- Tele and internet banking
- Online trading
- Business multiplies A/Cs
- Insurance
- Relief bonds & mutual fund
- Loans against shares
- Retail banking
- Special deposit scheme
- Senior citizen – special deposit scheme
- Other facilities for customers

Innovative Strategy for the Success

Innovative strategy is not a new word today, to being in current market with increasing market share need some extraordinary workout. As per our opinion these following strategy can help banks to sustain and can increase their market share.

Developing Customized Services

Top management should focus on customer expectation and demands of existing customer and new target audience. By customer survey and employee's suggestion bank should introduce new innovative / customized services to create a loyal customer and that loyal customer will base to stand in tuff competition. Also allocate some additional power to branch manager to create and provide a unique service for their customer as per local needs.

Improve Rural Network

In India, rural banking have its own advantages due to its own characteristics, like need of village people, micro finance, small savings etc., debit cards,

credit cards, ATM. and micro finance and many more services are demanding a special attention. Moreover “India is living in village” that sentence create and idea of potential customer

Merger and Consolidation

The smaller banks with firm financials as well as the large ones with weak income statements would be the obvious targets for the larger and better compatible banks. The pressure on capital structure in particular is expected to trigger a phase of consolidation in The Banking Industry. This trend already started in India ex. Punjab National Bank and Centurion Bank merged and now it's Centurion Bank of Punjab Ltd.

Flexibility in Operation

For flexibility in operation banks should give certain operational freedom to its branches to face certain situation let us see example or Types of loans and relative documentation of loans should be less complicated like, to a get personal loans how can a farmer (non IT payer) can show IT returns? Other relative property documents hold be considered. In short this point focuses on bank should decrease inflexibility with security.³⁶

Online Banking

The precursor for the modern home online banking services were the distance banking services over electronic media from the early 1980s. The term online became popular in the late '80s and referred to the use of a terminal, keyboard and TV (or monitor) to access the banking system using a phone line. 'Home banking' can also refer to the use of a numeric keypad to send tones down a Phone line with instructions to the bank. Online services started in New York in

³⁶ Dr.Ajmera: –“Enhancing Banking Competitiveness through Innovative Strategies” - UGC – National Seminar on Global Competitiveness of Indian industries and opportunities and threats on 19th Feb 2007

1981 when four of the city's major banks (Citibank, Chase Manhattan, Chemical and Manufacturers Hanover) offered home banking services using the videotex system. Because of the commercial failure of videotex these banking services never became popular except in France where Phone line with instructions to the bank. Online services started in New York in 1981 when four of the city's major banks (Citibank, Chase Manhattan Chemical and Manufacturers Hanover) offered home banking services using the videotex system. Because of the commercial failure of videotex these banking services never became popular except in France where the use of videotex (Minitel) was subsidised by the telecom provider and the UK, where the Prestel system was used.

The UK's first home online banking services was set up by Bank of Scotland for customers of the Nottingham Building Society (NBS) in 1983. The system used was based on the UK's Prestel system and used a computer, such as the BBC Micro, or keyboard (Tandata Td1400) connected to the telephone system and television set. The system (known as 'Home link') allowed on-line viewing of statements, bank transfers and bill payments. In order to make bank transfers and bill payments, a written instruction giving details of the intended recipient had to be sent to the NBS who set the details up on the Home link system.³⁷ typical recipients were gas, electricity and telephone companies and accounts with other banks. Details of payments to be made were input into the NBS system by the account holder via Prestel. A cheque was then sent by NBS to the payee and an advice giving details of the payment was sent to the account holder. BACS was later used to transfer the payment directly. Stanford Federal Credit Union was the first financial institution to offer online internet banking services to all of its members in October 1994. Today, many banks are internet only banks. Unlike their predecessors, these internet only banks do not maintain brick and mortar bank branches. Instead, they typically differentiate themselves by offering better interest rates and online banking features.

³⁷ Ceonin, Mary.J. "Banking and Finance on the Internet" Publisher John Wiley and Sons, 1997

Meaning

Online banking (or Internet banking) allows customers to conduct financial transactions on a secure website operated by their retail or virtual bank, credit union or building society.

Transactional

Performing a financial transaction such as an account to account transfer, paying a bill, wire transfer and applications apply for a loan, new account, etc.

- Electronic Bill Presentment and Payment - EBPP
- Funds transfer between a customer's own checking and savings accounts, or to another customer's account
- Investment purchase or sale
- Loan applications and transactions, such as repayments of enrolments

Non Transactional

(e.g., online statements, check links, co browsing, chat)

- Bank statements
- Financial Institution Administration
- Support of multiple users having varying levels of authority
- Transaction approval process
- Wire transfer

Future of Indian Banking

The Reserve Bank of India in its 'road map' for the banking industry has indicated that the Indian market will be opened for international banks by in nearer future. It is expected that many foreign banks would gain entry in the Indian markets to tap the vast potential that exists today. These banks with the help of advanced technology, adequate capital for investment, and their customer centric approach will be able to attract the profitable customers from the existing banks. A fierce competition between the existing banks and the new entrants is likely to provide impetus for business growth. To effectively meet the competitive challenges from such banks, the Indian banking industry

will have to gear up and adopt the global best practices, which make them stronger and comparable with the international banks.

The new foreign banks entering the Indian market will strive for creating a strong customer base. These banks with their large resources availability in the form of capital are likely to infuse the latest IT based technological solutions for quality financial services. The Indian commercial banks have experienced the shift of preference of the new generation customers from 'personalized banking' to 'technological banking'. This techno-savvy customer groups prefers to complete banking transactions from their home or offices rather than visiting the bank branch. They have very little loyalty to their bankers and given a slightest improved technology to shift their banking needs from the existing to another bank. In the face of the threat of losing profitable customers to the new entrants in the banking sector, the existing commercial; banks will have to evolve suitable market strategies aimed at attracting the existing ones.

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