Chapter - II

RATIONAL BEHIND IN STUDYING REFORMS IN THE BANKING SECTOR
Today banks have become a part and of our life. Now banks offer access to a common man and their activities extended area hitherto untouched. Banks cater to the needs of agriculturists, industrialists and traders and to all the other section of the society. As such, an attempt has been made in this chapter to study the various kinds of banking in the market, development of banking and the banking reforms. The analyses are being done in the following paragraphs.

2.1 EVOLUTION OF BANKING

The word 'Bank' is derived from the French word 'Banco' or 'banc' or 'Banque'. Mackeod in his book 'Theory and Practice of Banking' has expressed a different view. According to him, the moneychangers were called 'Bencheri' in the middle ages\(^1\). Another common-held view is that the word 'Bank' might be originated from the German word 'Back' which means a joint stock fund.

\(^{1}\) S.N. Maheswari, Banking Law and Practice, New Delhi, 1999, p1
DEFINITION

We can define bank as intuition whose debts are widely accepted in settlement of other people’s debts to each other. Crowther, thus puts it as “The banker’s business is then to take debts of other people to after his own in exchange and there by to create money”\textsuperscript{2}.

In India, the joint stock companies Act\textsuperscript{1850} was the first legislative enactment in the country that permitted the corporate sector to come into the banking business. The first bank to be established in under this Act was the Oudh commercial bank in 1881 followed by Punjab National Banking as “Accepting for the purpose of lending or investment of deposits of money from the public, repayable on demand or otherwise and with drawable by cheques, draft, order or otherwise\textsuperscript{4}.

2.2 CONCEPT OF BANKING

CENTRAL BANK

Every country has generally one central bank. The central bank acts as the leader of the money market, supervising, controlling and regulating the activities of the commercial banks and other financial institutions. It enforces monetary discipline in the country’s economy. It seeks to manage the issue and circulation of control the creation of bank

\textsuperscript{2} Mithani and Gordon, Banking Theory Law and Practice, Himalaya Publishing House, New Delhi, 2003, p3.
\textsuperscript{3} S.N. Maheswari, Banking Law and Practice, Kalyani New Delhi, 1999, p3
\textsuperscript{4} Gordon, Modern Banking, Anmol, New Delhi, p1.242.
deposits with a view to safeguard the stability in the country. The central bank function in close touch with the government and assists in the implementation of its economic policies. It serves as banker agent and adviser to the government. Thus the central bank is the apex bank of the country in maintaining monetary and economic stability.

**Commercial Banks**

The commercial banks mobilize deposit from the public, which are repayable on demand or at short work notice. They lend to traders and manufactures for short periods. They provide the working capital to the business in the form of overdraft and cash credit. Besides, the banks render a number of agency services such as collection of cheques and bills, and subsidiary services such as discounting bills of exchange, safe keeping the valuables, issue of letters of credit, remittance of funds etc. The services of banks are ever expanding with the change in the need and requirement of the society.

**Co-Operative Banks**

Banks formed on the principle of Co-Operate are called co-operate banks. They provide short-term credit to agriculturists, artisans, small farmers and small-scale industries. Co-Operative banks accept all kinds of deposit and make loan to the members at lower rate of interest. The Co-Operative banks play a very useful role in financing agriculture and allied activities.
**Branch Banking**

Branch banking is a system where the banking business is carried on by a single bank with a network of branches thought the length and breath of the country. The bank will have a head office in one town and branches in different parts of the country. The branch is directed by the branch manager in accordance with the regulations and policies of the head office.

**Unit Banking**

In the unit banking system, the banking operations are carried through a single office and confined to a particular area. The banks maintain no branches. In some exceptional cases the banks are allowed to have branches within a limited area. The size of the bank is usually small and the capital is limited.

**Exchange Banks**

Exchange banks specialize in the financing the foreign trade. They supply necessary foreign exchange required for settlement of transaction in foreign trade. The exchange bank discount foreign bills of exchange. Now-a-days commercial banks themselves undertake foreign exchange business. So there is no separate bank called foreign exchange bank.
Mixed Banking

The banking system, which combines deposit banking with investment banking, is known as Mixed Banking. The Mixed bank receives deposits from public and provides short term, medium term and long term to the industries.

Universal Banking

Universal banking is a name given to banks engaged in diverse kind of banking activities. The banks do broad based and comprehensive activities. The activities including making loans and advances for long-term, providing Working capital, corporate advisory services, insurance, depository services, brokerage, venture capital, underwriting new debt and equity shares etc. The mergers of ICICI and ICICI bank is move towards setting up of universal banking.

Scheduled Bank

Scheduled bank is one, which is registered in the second scheduled of the Reserve Bank of India. The following conditions should be fulfilled by a bank for inclusion in the schedule.

(1) The bank concerned must be carrying on a business of banking in India.

(2) The bank must have paid-up capital and reserve of an aggregate value not less then 5 Lakhs.

(3) It must satisfy Reserve Bank of India that its affairs are not being conducted in a manner detrimental to the depositors.
**Non Scheduled Bank**

Bank which is not included in second schedule of the Reserve bank of India is known as Non-Scheduled bank. The non-schedule banks come within the direct purview of the credit control measures of the Reserve bank. They are entitled to borrowings and rediscounting facilities from the Reserve Bank of India.

**Development Banks**

A development bank may be defined as a financial Institution concerned with providing all types of financial assistance to business units in the form of loans, underwriting, investment and guarantee operations and promotion activities.

A development bank is like a living organism that reacts to its socio-economic environment and its success depends on reacting most aptly to the environment- A.G Kheradjou.

The development banks main object is to promote industrial development in the country. The development service to sick industrial units by providing soft loan.(Repayable in longer period with lower rate of interest) They also help industries in management techniques by promoting management training. In India we have development bank such as:

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REGIONAL RURAL BANK

In 1976, Regional Rural Banks were set up mainly to cater the needs of marginal farmers and agriculture labours. Marginal farmers are those with less income from their lands and who work in others land to increase their income further. Regional Rural banks are owned by three parties such as 50% of the capital is contributed by the central governments, 35% by the sponsoring commercial banks and the remaining 15% is contributed by state government. These banks are mostly in backward area and they will finance only small and marginal farmers with less than 5 acres of land.

Exim banks

Export import bank was setup on January 1st, 1982 to provide export and import finance. It was started with an initial paid up capital of Rs.500 crores contributed by the government of India. It references commercial banks in export finance. It provides line of credit to the foreign importers of Indians goods. It provides other assistance the
export bills belong to the commercial banks. It helps Indian exports and importers and trades of third countries. It also finances joint ventures in foreign countries.

**E-BANKING**

E-Banking is performing basic banking transactions electronically to the customers round the clock globally. E-Banking is more of science then art. E-Banking enables the customers to perform the basic banking transactions by sitting at their office or at home through PC or LAPTOP. Customers can access the banks website for viewing their account details and perform the transactions on account as per their requirements. E-Banking increased speed of response to customers convenience. It provides efficient, economic and quality service to the customers.

E-Banking will operate internet, extranet and internet.

E-bankig has unique advantages. Such as, convenience to full banking service, low cost is banking service, low cost banking, just In Time, Better customer relation. World Wide 24 Hours, 7 days a week banking service, cost saving infrastructure. Presently the SFNB is the world's largest commercial online service bank with an asset worth US$ 41 million. ICICI has come up as the first Indian bank on the Internet.
**TELE BANKING**

Telebanking is one of the service channel offered by banks. Through service can made to the customers at anytime 24 hours, 365 days per year. Telebanking is not a replacement to the personal service. The customer can use telebanking for check account balance. Verify deposits and determine if a cheque has cleared or not. We can also use to transfer funds, a loan payment. Personal ID number is required to access the accut through telebanking services. This assures the confidentiality and security to all. At any time a telebanking customer can change the ID number by following the menu instructions given by over the phone to keep the account information secure.

**CORE BANKING**

Under the system of core banking all the branches of the bank are brought under internet and a customer is given a ID number and the customer can have bank operation in any of the branches of the bank. For example State Bank of India is introducing core banking. A customer who has a bank account in Namakkal SBI branch can operate his account from any one of the SBI branches throughout the world.

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NON-BANKING FINANCIAL INSTITUTION

In an Indian economic scenario, the financial intermediation is being conducted by a wide range of financial intuitions including banks. These NFBC institutions are not regarded as banking companies. Hence, they do not come under the control of RBI and there is no minimum liquidity ratio or cash ratio. But the RBI has classified them into several categories for the purpose of exercising control over them. This classifications does not include the public sector non-banking financial institutions like LIC, SFC, IFCI, ICICI etc.. The NBFC sector is presently divided into several categories such as equipment leasing company, investment Company, Hire purchase Finance company, Housing Finance Company, Loan Company, Mutual benefit financial Company, Residuary Non-banking Company and non-banking non-financial Company. In India there were 7,063 Non-banking institutions in 1981 has increased to 24,009 in 1990 at a compound annual growth rate of 14%.

2.3 GROWTH OF BANKING IN INDIA

After nationalization of 14 banks the commercial banks have made in all banking operations. It mobilizes the deposits, deployment of credit and geographical coverage are accounted for most of the growth in the banking system.

8Gordon. Modern Banking, Anmol, Delhi, 2003, p-1.203
9Vasanth Desai, The Indian Financial Sysytem and Development, Himalaya Publishing House, New Delhi, 205, p-516
The population per bank office improved from 64,00 to 16,000 over the same period. Per capita deposit expand from Rs.88 in 1969 to 8,247 in 1999-2000. During 1999-2000, the growth of aggregate deposits of scheduled commercial banks (SCBs) decelerated to 14.3 per cent in 1999-2000 as against 13.8 per cent in 1998-1999 especially after Nov. 1999 with the revival in industrial activity. Scheduled commercial bank non-SLR investment in the form of commercial papers, shares, debentures and bonds showed a lower increase of Rs.13,027 crore during 1999-2000 than Rs.15,921 crore during 1998-1999.
The following table shows the growth of banking sector from 1960 June to March 2000.

Table 2.1 Growth of banking Sectors

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</thead>
<tbody>
<tr>
<td>Number of scheduled</td>
<td>73</td>
<td>74</td>
<td>148</td>
<td>264</td>
<td>270</td>
<td>281</td>
<td>297</td>
</tr>
<tr>
<td>Commercial Banks (Including RRBs other schedule commercial banks)</td>
<td>-</td>
<td>-</td>
<td>73</td>
<td>183</td>
<td>196</td>
<td>196</td>
<td>196</td>
</tr>
<tr>
<td>Of Which: RRBs other schedule commercial banks</td>
<td>-</td>
<td>-</td>
<td>75</td>
<td>81</td>
<td>84</td>
<td>85</td>
<td>100</td>
</tr>
<tr>
<td>Number of Bank offices</td>
<td>8,262</td>
<td>18,730</td>
<td>32,419</td>
<td>51,385</td>
<td>59,752</td>
<td>62,367</td>
<td>67,339</td>
</tr>
<tr>
<td>Population per offices</td>
<td>64</td>
<td>32</td>
<td>21</td>
<td>15</td>
<td>14</td>
<td>15</td>
<td>15</td>
</tr>
</tbody>
</table>

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The threat of new entrants and substitute products as well as the rivalry among existing bank are becoming increasingly apparent in the Indian banking industry.

During the first half of the 20th century the banking system progressed rapidly. The deposits in banks increased from Rs.82 crore in 1910 to Rs.957 crore in 1948\(^1\). The following Table2.2 shows the banking Infrastructure in India 2005\(^1\).

Since bank nationalization in 1969, there has been significant growth in the geographical coverage of banks and the amount of resources mobilized by banks.


\(^1\) Analyst, The ICFAI, University Press, November 2005, p81.
Table 2.2. Banking infrastructures in India

<table>
<thead>
<tr>
<th>Banks</th>
<th>Total</th>
<th>Of which</th>
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<tbody>
<tr>
<td></td>
<td>Branches</td>
<td>Rural</td>
<td>Semi-urban</td>
<td>Urban</td>
</tr>
<tr>
<td>Commercial Banks</td>
<td>46,068</td>
<td>19,266</td>
<td>10,900</td>
<td>15,902</td>
</tr>
<tr>
<td>Foreign Banks</td>
<td>237</td>
<td>0</td>
<td>2</td>
<td>235</td>
</tr>
<tr>
<td>Other scheduled and non-scheduled banks</td>
<td>5,420</td>
<td>1,143</td>
<td>1,776</td>
<td>2,501</td>
</tr>
<tr>
<td>RRBs</td>
<td>14,483</td>
<td>12,062</td>
<td>2,045</td>
<td>376</td>
</tr>
<tr>
<td>Total</td>
<td>66,208</td>
<td>32,471</td>
<td>14,723</td>
<td>19,014</td>
</tr>
</tbody>
</table>

An important development in the financial sector in the recent has been the diversification and growth of para-banking activities. In 1994 banks were also allowed to undertake departmentally para-banking activities, such as leasing, hire purchase, factoring etc.. Presently banks can undertake para-banking activities either through subsidiaries or in-house or both.
2.4 Reforms made in the Banking Sector.

The banking sector reforms currently underway in India must be seen as a component of the overall scheme of structural reforms. The overall package is aimed at enhancing the productivity and efficiency of the economy and to increase international competitiveness. The reforms are comprehensive in scope and include liberalization and deregulation of domestic investment. Reforms of the public sector to impart greater efficiency of operations and reform of the tax system to create a structure with moderate rates of tax, broader base of taxation and greater ease of administration. Reforms are closely inter-related and progress in one is helps to achieve in others.

Banking reforms

To analyze problems that the financial sector faced and suggest remedial measures, various study group and committees were setup.

Dehejia Committee

In order to determine “the extent to which credit needs of industry and trade are likely to be inflated and how such trends could be checked” in 1968 a committee under the chairmanship of shri V.T. Dehejia was formed.
**Recommendations of Dehejia committee**

1. There should be appraisal of credit application received by the bankers with reference to present and projected total financial position as shown by cash flow analysis and forecast submitted by borrowers.

2. The total cash credit requirements of the borrower should be segregated into "Hard Core" component represents minimum requirements of materials, finished goods and other requirements for production. Short-term component funds required for temporary.

**Tandon Committee**

The recommendation of the Dehejia committee regarding the loopholes in the exiting credit system and change in the lending policy of the banks remained unimplemented. These changes were to be effected to borrower plan his credit needs and the banker. A committee was, therefore appointed by the RBI in July 1974 under the chairmanship of P.L.Tandon.

**Recommendations**

1. A borrower should supply to the banker information regarding his operational plans well in advance. The banker must carry out a realistic appraisal of such plans.
2. The main function of a banker as a lender is to supplement the borrower's resource to carry an acceptable level of current assets.

**Chore Committee**

Having implemented the recommendations of the Tandon committee, the RBI in March 1979 appointed another committee under the chairmanship of Shri K.B. Chore.

**Recommendation**

1. The quarterly statement is at present requires to be submitted by the borrowers.

2. The banks should strictly ensure that review of the entire borrower accounts whose credit limits of Rs.10 lakhs and above.

3. The banks can fix separate credit limits wherever feasible.

4. No frequent sanction of temporary credit limits.

5. The over dependence on bank credit to be reduced.


**Marathe Committee**

The Marathe committee was appointed the RBI in October 1982, to review the working of the operation aspects of credit authorization scheme.
Recommendations

1. Computation of permissible bank finance as per Tandon committee to be impracticable.

2. The banks would continue to advance loans for working capital as per suggestion by Tandon committee.

3. The concept of fast track implies that subject to fulfillment of certain conditions.

4. The bank can release approval from the RBI 50% of additional credit required by borrowers.

Narasimham Committee

The Narasimham committee was appointed by RBI in 1991.

Recommendations

1. The bank should fix 10% of the aggregate bank credit.

2. The System should be reviewed after a period of 3 years to assess the need to continue or terminate the programme as also the stipulation of the concessional rate of interest.

3. The social purpose of bank credit should be to enhance productivity in agriculture and small industry.
Recent Reforms

In reforms they studies various aspect of the Indian monetary system and proposed measures to improve it's functioning. The recent went into the different aspects of the entire financial system and offered suggestions to revamp it, to improve it's functioning. These were also the various study groups, which suggested up new institutions, introduction of new products, regulation of capital market institutions and so on. Union agreement in October 1993 paved way for computerization in banks.

✓ IFCI converted into a company and its made public issue rose over Rs.600 crore.
✓ Bank lending norms liberalized and banks given freedom to decide level of holding of individual items of inventories and receivables.
✓ Guidelines issued to banks to ensure qualitative improvement in bank customer service as a follow-up on the committee on customer service in banks.
✓ Floating interest rate on financial assistance introduced by some all India developed banks.
✓ The prime rate of SBI and most other banks on general advances of over Rs.2 lakh has come down by 4-percentage point to 15 percent between 1991-92 and 1994-95.
✓ Interest rates on deposits and advances of all co-operative banks deregulated, subject to a minimum lending rate of 12 percent.
IMPACT OF REFORMS

Consequent upon the introduction of banking sector reforms, the following changes have taken place in Indian banking:

1. Weak public sector banks were recapitalized through budgetary support.
2. Some banks have strengthened their capital base through public issue of shares.
3. Private sector banks have been established.
4. Local Area Banks have been licensed to instill a greater element of competition in the financial system.
5. Interest rate both on deposit and lending side have deregulated, dismantling the administered interest rate structures.
6. The determination of foreign exchange rate is left in market conditions.
7. New debt instrument like capital index bonds were launched. A government debt is also left to market titers.
8. Prudential norms for income recognition, asset classification, and provisioning and capital adequacy have been strictly enforced to achieve international standards.
9. The tax deduction a sources on government securities has been removed.
10. The banks financial health has been vastly improved and their profitability is on the increasing trend.
2.5 Probable Challenges to Financial Sector

The Indian financial system as shown considerable widening and deepening since the initiation of the financial sector reforms in 1992-93. In future the financial sector would grow not only in size but also in complexity as the forces of reform gather momentum.

Risk management is as important area where improvements area needed. All major component of risk, viz. Credit risk, interest rate risk and foreign change risk will become much more critical than in the past. Future trends of banking development ill be,

1. Greater specialization by banks in different niches of the market such as retails, Agriculture, export, small-scale and corporate sector.
2. Greater reliance on non-fund business such as advisory and consultancy services, guarantee and custody services.
3. Greater overlap in product coverage between commercial banks and non-bank financial intermediaries.
4. Greater financial disinter mediation with large companies accessing securities debt dramatically and in the financial market abroad.
2.6 Rationale Behind Studying Reforms

Banks are in new dimension. The developed technology introduced many new features and innovations in banking services are made great changes in the banking sectors. Liberalization, over competition, innovation in their primary and secondary functions. Innovations are used to provide financial service instruments. Money demand for on supply of bank money changed. The velocity circulation of bank money increased. In this situation every customer expected to know innovative technology adopted by the bank. So the customer can take the advantage of financial services. The rationale behind studying this is to know whether the customer may aware of the technology and facilities and he/she does not want to take the advanced features.

2.7 Conclusion

There are various kinds of banks are there in the financial market to provide financial services to the customers such as Central bank, Commercial bank, Co-Operative bank, Scheduled bank, Non-Scheduled bank, Development bank, Regional Rural bank and EXIM bank.

The RBI is the apex for all the financial market to provide financial institutions. Financial reforms made dramatic changes in the financial market.
E Banking is performing basic banking transactions electronically to the customers round the clock globally. Telebanking is one of the service channel offered by banks.

To analyze the problems that the financial sector faced and to suggest remedial measures, various study groups and committees were setup such as, Dehejia Committee, Tandon committee, Chore committee, Marathe committee and Narashimham committee.

The reforms in the banking sector introduces new electronic policy and the innovative techniques in information. Technology due to this the Indian banks offer financial services to the customers in numerous ways.

The financial sector growths increase the number of services to the customers. The financial sector increases not only in terms of size and also in terms of complexity.