INTRODUCTION - AN OVERVIEW OF BANKING INDUSTRY IN INDIA
EVOLUTION OF BANKING:

In ancient Babylon, Egypt and Greece, banking was carried on in fact, the temples usually served as the place to deposit money. In Rome in the year 210 B.C., an ordinance was issued that set aside a place for money changers. The word ‘bank’ comes to us from Italian. In the middle ages, the money changers of Italy did their business in the street on a bench, and the Italian word for bench, and the Italian word for bench is ‘Banco” from which the word bank has been derived. In Venice in 1587, Banco di Rialto was first set up. It accepted deposits and permitted the depositors to write cheques against their money. In 1619, Banco Del Giro took over this bank. The Bank of Amsterdam was set up in 1609.

The traditional Hindu scriptures refer to the money lending activities in the Vedic period. In India, during the Ramayana and the Mahabharata eras banking had become a full-fledged business activity. During the Smriti period which followed the Vedic period and the Epic age the business of banking was carried on by the members of the Vaishya community. Manu, the great lawgiver of the time, speaks of the earning of interest as the business of Vaishyas. The banker in the Smriti period performed most of those functions which commercial banks perform in modern times such as accepting deposits, granting secured and unsecured loans, acting as his customer’s bailey, granting loans to king in times of grave crises, acting as the treasurer and banker to the state and issuing and managing the currency of the country.¹
As a public enterprise, banking made its first beginning around the middle of the twelfth century in Italy. The Bank of Venice, founded in 1157, was the first public banking institution. Following its establishment, were established the Bank of Barcelona and the Bank of Genoa in 1401 and 1407 respectively. The Bank of Venice and the Bank of Genoa continued to operate successfully until the end of the eighteenth century.

Public banks like the famous Bank of Amsterdam, which was founded in 1609. The principal function of these banks was to help in the development of trade and commerce by receiving by weight the heterogeneous metallic money which was then current and creating in exchange for it deposits in their banks that were transferable through bank cheques.

Establishment of the Bank of England in 1694, the development of modern commercial banking institutions had to wait for another century and four decades until the passage of the Banking Act of 1833 which provided for the establishment of joint-stock banks.²

**BANKING:** The word 'Bank' is used in the sense of a commercial bank. It is of Germanic origin though some persons trace its origin to the French word 'Banqui' and the Italian word 'Banca'. It referred to a bench for keeping, lending, and exchanging of money or coins in the market place by moneylenders and moneychangers.
There was no such word as ‘banking’ before 1640, although the practise of safe-keeping and savings flourished in the temple of Babylon as early as 2000 B.C. Chanakya in his Arthashastra written in about 300 B.C. mentioned about the existence of powerful guilds of merchant bankers who received deposits, advanced loans and hundis (letters of transfer). The Jain scriptures mention the names of two bankers who built the famous Dilwara temples of Mount Abu during 1197 and 1247 A.D.

The first bank called the ‘Bank of Venice’ was established in Venice, Italy in 1157 to finance the monarch in his wars. The bankers of Lombardy were famous in England. But the modern banking began with the English goldsmiths only after 1640. The Bank of England started its business in 1694 with a view to finance the Government to carry on its war with France.³

BANKING INDUSTRY IN INDIA:

The first bank in India was ‘Bank of Hindustan’ started in 1770 by Alexander & Co., an English agency house in Calcutta, which failed in 1782 with the closure of the agency house.

The East India Company established three Banks namely Bank of Bengal in 1809, Bank of Bombay in 1840 and Bank of Madras in 1843. These Banks continued their smooth operations till 1920 when they were amalgamated to form Imperial Bank of India, which was formally established on January 27, 1921. Thirty four years
later after the passing of the State Bank of India Act, 1955, this Imperial Bank was
taken over by the State Bank of India.

DEFINITION OF BANKING:

Kent defines banking as "an organisation whose principal operations are
concerned with the accumulation of the temporarily idle money of the general public
for the purpose of advancing to others for expenditure."

Sayres defines banking as "Ordinary banking business consists of changing
cash for bank deposits and bank deposits for cash; transferring bank deposits from
one person or corporation (one 'depositor') to another; giving bank deposits in
exchange for bills of exchange, government bonds, the secured or unsecured
promises of businessmen to repay, etc."

The Banking Regulation Act, 1949, defines banking as accepting for the
purpose of lending or investment of deposits money from the public, repayable on
demand or otherwise and withdraw able by cheque, draft, order or otherwise.

DEFINITION OF BANKER:

According to Crowther, "The banker's business is to take the debts of other
people to offer his own in exchange, and thereby create money."
Prof. Hart says that a banker is one who in the ordinary course of his business, receives money which he pays by honouring the cheques of persons from whom or on whose account he receives it.

**DEFINITION OF BANK:**

Chambers Twentieth Century Dictionary defines a bank as an "institution for the keeping, lending and exchanging etc. of money."

Prof. Kinley defines a bank as an establishment which makes to individuals such advances of money as may be required and safely made and to which individuals entrust money, which it is not required by them for use.

The Indian Companies Act defines the term bank as "The accepting for the purpose of lending or investment of deposits of money from the public, repayable on-demand or otherwise and withdraw able by cheque, draft, order or otherwise."

Section 5 (b) of the Banking Companies Act, 1949 defines banking as "accepting for the purpose of lending or investment of deposits of money received from the public, repayable on demand and withdraw able by cheque, draft, order or otherwise".

From the above definition, it is clear that a bank after accepting deposits from the public lends or invests in various assets which bring revenue to the bank. Out of
such earnings, the bank will not only repay the deposits as and when demand by the public but will also pay interest on the deposits.

**The customers of a bank can withdraw money:**

a) By withdrawal slip provided by the bank or

b) By cheques provided by the bank to the account holder or

c) By cheques a draft is made by the bank on deposit of money. It can be made by any person for sending money from one place to another. A draft is an instruction by a branchy of a bank to another branch.

d) The money in the bank can also be withdrawn through pay order. A pay order is an instrument given by the bank which carries the signature of the bank manager on a cheque. In other words, it is banker’s cheque.

**SOCIAL CONTROL OVER BANKS:** The banks are the custodians of savings and powerful institutions to provide credit. They mobilise the resources from all the sections of the community byway of deposits and channelise them to industries and others by way of granting loans. In 1955 the Imperial Bank of India was not nationalized and SBI was constituted.

It was observed that the commercial banks were directed their advances to the large and medium scale industries and the priority sectors such as agriculture, small-scale industries and exports were neglected. The Chairman and directors of banks were mostly industrialists and many of them were interested in sanctioning
large amount of loans and advances to the industries with which they were connected. To overcome these deficiencies found in the working of the banks, the Banking Laws (Amendment) Act was passed in December 1968 and came into force on 1-2-1969. It is known as the scheme of ‘social control’ over the banks. The then Deputy Prime Minister, Mr. Morarji Desai made a statement in the parliament on the eve of introducing the bill to amend the banking laws Act. He explained that the aim of social control was, “to regulate our social and economic life so as to attain the optimum growth rate for our economy and to prevent at the same time monopolistic trend, concentration of economic power and misdirection of resources”.  

The following are the main provisions of this amendment,

1. Bigger banks had to be managed by whole time chairman possessing special knowledge and practical experience of the working of a banking company or of finance, economics or business administration.

2. The majority of directors had to be persons with special knowledge or practical experience in any of the areas such as accountancy, agriculture and rural economy, banking, co-operative, finance, law, small scale industries etc.

3. At least two directors had to possess special knowledge and practical experience in respect of agriculture, rural economy and co-operation.

4. The banks were also prohibited from making any loans or advances, secured or unsecured to their directors or to any companies in which they have substantial interest.
NATIONALIZATION OF BANKS IN INDIA: After Independence, India aimed at a socialistic pattern of society. This goal is expected to be achieved through the effective functioning of joint sector. As such, the two sectors, private and public, were allowed to function independently of each other. The public sector was wholly owned and controlled by the Government. The private sector was regulated through the system of licences, controls and legislative acts etc. The public sector was made to grow by nationalization of industries and institutions, particularly those which required huge capital outlay like steel and power supply or which provide public utility services like communication services.

The broad aim of nationalisation was “To control the heights of the economy and meet progressively and serve better the needs of development of the economy in conformity with national policy and objectives” (Preamble to the Banking Companies- Acquisition and transfer of undertakings Act, 1970.

The then Prime Minister Mrs. Indira Gandhi, indicated in her broadcast bank nationalisation on July 19, 1969 that “for the millions of small farmers, or artisans and other self-employed persons, a bank can be a source of credit, which is the very basis for any effort to improve their meagre economic lot.”

The social control measures outlined above were not considered adequate to achieve the desired social and economic objectives. Therefore, the Government of India, on 19th July 1969 i.e., after five months and eighteen days after the statutory imposition of social control, nationalized fourteen major Indian Banks each having
deposits of more than Rs. 50 crore - Rs. 2,741.75 crore in aggregate as on 31st December, 1968. No foreign bank was taken over. The names of fourteen banks taken over by the Government under the Banking companies Act of 1969 are given below.  

**TABLE-1**: DETAILS OF COMPENSATION PAID BY THE GOVT. DURING 1ST PHASE OF NATIONALISATION

<table>
<thead>
<tr>
<th>S.No</th>
<th>Name of the Bank</th>
<th>Amount of Compensation paid by Government (Rs. In lakhs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Central Bank of India Ltd</td>
<td>1750</td>
</tr>
<tr>
<td>2</td>
<td>Bank of India Ltd</td>
<td>1470</td>
</tr>
<tr>
<td>3</td>
<td>Punjab National Bank Ltd</td>
<td>1020</td>
</tr>
<tr>
<td>4</td>
<td>The Bank of Baroda Ltd.</td>
<td>840</td>
</tr>
<tr>
<td>5</td>
<td>The United Commercial Bank Ltd.</td>
<td>830</td>
</tr>
<tr>
<td>6</td>
<td>Canara Bank Ltd</td>
<td>360</td>
</tr>
<tr>
<td>7</td>
<td>United Bank of India Ltd</td>
<td>420</td>
</tr>
<tr>
<td>8</td>
<td>Dena Bank Ltd</td>
<td>360</td>
</tr>
<tr>
<td>9</td>
<td>Syndicate Bank Ltd</td>
<td>360</td>
</tr>
<tr>
<td>10</td>
<td>The Union Bank of India Ltd</td>
<td>310</td>
</tr>
<tr>
<td>11</td>
<td>Allahabad Bank Ltd.</td>
<td>310</td>
</tr>
<tr>
<td>12</td>
<td>The Indian Bank Ltd.</td>
<td>230</td>
</tr>
<tr>
<td>13</td>
<td>The Bank of Maharashtra Ltd.</td>
<td>230</td>
</tr>
<tr>
<td>14</td>
<td>The Indian Overseas Bank Ltd.</td>
<td>250</td>
</tr>
</tbody>
</table>


**NATIONALIZATION OF SIX MORE BANKS**: Public sector banking was enlarged on 15th April, 1980 with the nationalization of six more Indian Banks, whose demand and time liabilities exceed Rs. 200 crore on 14th March 1980. The six banks were acquired under the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980. The names of the banks are given below.
TABLE-1.2: DETAILS OF COMPENSATION PAID BY THE GOVT. DURING 2\textsuperscript{ND} PHASE OF NATIONALISATION

<table>
<thead>
<tr>
<th>S.No</th>
<th>Name of the Banks</th>
<th>Compensation (Rs. In Lakhs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>The Andhra Bank Ltd.</td>
<td>610</td>
</tr>
<tr>
<td>2</td>
<td>The Punjab &amp; Sind Bank Ltd.</td>
<td>180</td>
</tr>
<tr>
<td>3</td>
<td>The New Bank of India Ltd.</td>
<td>510</td>
</tr>
<tr>
<td>4</td>
<td>The Vijaya Bank Ltd.</td>
<td>100</td>
</tr>
<tr>
<td>5</td>
<td>The Corporation Bank Ltd.</td>
<td>210</td>
</tr>
<tr>
<td>6</td>
<td>The Oriental Bank of Commerce Ltd.</td>
<td>240</td>
</tr>
</tbody>
</table>


Even after nationalization, the names of the banks were retained. However, the term Ltd., was dropped from the names as Central Government has now become the only shareholder of each nationalized bank. The Government as a shareholder will not have 'limited liability' as in the case with shareholders of limited companies or institutions. Hence, the word ‘Limited’ was dropped. The nationalized banks are subsequently referred as ‘Public Sector Banks’.

Later in September 1993, New Bank of India merged with Punjab National Bank resulting in 19 Nationalised banks.\textsuperscript{12}

**GAINS FROM BANK NATIONALISATION**

In the early phase after nationalisation, the state owned financial institutions promoted overall financial development in various ways. First, they not only mobilised but also promoted household financial savings by extending the financial services in all sector of the economy. Between 1969 (when major commercial banks were nationalised) and 1990, the household saving as a ratio to GDP doubled from
about 10 to 20 percent. During the same period the share of financial savings in household total savings also went up from 20 to 44 per cent. The structure of household savings however, did not remain stable during the post nationalisation period. Bhattacharya (1984) found that it is determined by several factors: relative interest rates and tax benefits, aggregate and sectoral growth of real income, and inflation rate.

Secondly, after nationalisation the share of bank credit to agriculture and other priority sectors in total bank credit increased from less than 10 per cent in the pre-nationalisation period to more than 20 per cent. It was done essentially through direct regulations: by setting a minimum share of credit to priority sectors. Thirdly, the nationalisation enabled the government to keep the real interest rates low. The long-term interest rate, nominal rate minus the inflation rate, was mostly negative during the 1960s and 1970s. This has induced both public and private investments, especially in agriculture and other rural developmental activities, infrastructure and small-scale industry. Finally bank nationalisation gave a big boost to the spread of banking habit, especially in the rural sector.13

Banking industry in India (Post nationalization period)

- The number of branches has increased to more than 60000. Of these branches, 1/3 were set up in rural areas.
- Prior to nationalization, the population/ branch ratio was 70,000; which has come down to 17000 1. But still it has to come down further.
- The deposit mobilization of banks has increased manifold.
- The employment opportunities generated by the banks directly as well as indirectly have increased considerably.
- Loans to priority sector have gone up, especially to agriculture and small scale industries.
- There has been a shift in the lending policy of the commercial banks from security-based to productivity based.
- More industries have been started in backward and rural areas.
- Banks have adopted villages and have provided infrastructure facilities
- In rural area, agricultural credit cards have been introduced by which the agricultural inputs were made available through credit cards.
- Banks have also undertaken modern activities such as merchant banking mutual fund, housing finance, consumer loan etc.,
- The incidence of bank failure has been reduced.
- The introduction of computers has modernized banking transactions.
- Factoring the leasing finances we are undertaken.
- More consumer loans are extended by banks for improving standard of living of consumers.
- More branches of commercial banks are opened in foreign countries.
The Government has decided to reduce its enquiry participation in Public sector banks from the existing 51 per cent to 33 percent. A bill is likely to be introduced in the Parliament during the Budget section, 2001.

Thus, we find nationalization of commercial banks in India has led to remarkable growth in agriculture, industry and territory sector14.

COMMERCIAL BANKS:

Functions of Commercial Banks

The commercial banks serve as the king pin of the financial system of the country. They render many valuable services. The important functions of the commercial banks can be mentioned as

- Accepting Deposits
  - Fixed deposit account
  - Current deposit account
  - Savings deposit account
  - Recurring deposit account
  - Home safe account
- Advancing of Loans
  - Money at call
  - Cash credit
  - Overdraft
  - Discounting of bills of exchange
  - Term loans
  - Credit Creation
- Promoting Cheque System
- Agency Functions
- Remittance of funds
- Collection and payment of credit instruments
- Execution of standing orders
- Purchasing and sale of securities
- Collection of dividends on shares
- Income tax consultancy
- Acting as trustee and executor
- Acting as representative and correspondent
- General Utility Function
- Locker facility
- Traveller's cheques
- Letter of credit
- Collection of statistics
- Underwriting securities
- Gift cheques
- Acting as referee
- Foreign exchange business

These banks are primarily classified into scheduled banks and non-scheduled banks. Scheduled Banks include nationalized banks, State Bank of India and its subsidiaries, Private sector banks and foreign banks. Non-scheduled banks are those, which are not included in the 2nd schedule to RBI Act.
(a) Scheduled Banks

The second schedule of the Reserve Bank of India Act contains a list of Banks, which are described as "Scheduled Banks". A bank in order to be designated as a Scheduled Bank should have a paid up capital and reserves as prescribed by the Act. In terms of Sec. 42(6) of RBI Act, 1934, the required amount is only Rs. 5.00 lakh. However, presently to start a Commercial Bank, the RBI prescribed a minimum capital of Rs. 100 crore and its business must be managed in a manner, which, in the opinion of Reserve Bank of India, is not detrimental to the interest of its depositors. The Scheduled Banks are also required to maintain with the Reserve Bank of India a deposit in the form of Cash Reserve Ratio, based on its demand and time liabilities at prescribed rate.
The Scheduled Banks enjoy several privileges. An account with a Scheduled Bank carries a greater assurance of safety and prestige value than an account with a Non-Scheduled Bank. It is entitled to receive refinance facility as applicable. It may also get currency chest facility. In times of urgent need, it may obtain finance from the Reserve Bank of India to help it tide over temporary financial difficulties. Furthermore, the settlement of accounts between scheduled banks is facilitated by the use of the "Bankers" clearing House procedure. On the other hand, scheduled banks have to submit several returns to the Reserve Bank of India and are obliged to comply with the directions received from the Reserve Bank. Some of these returns have to be submitted in each week usually on Friday. The affairs of Scheduled Banks are closely watched and largely controlled by the Reserve Bank of India, in order to safeguard the general health of the Banking Industry as a whole.

(b) Nationalised Banks

The Government, on the recommendations of the banking commission, nationalised 14 major commercial banks on July 19, 1969, and six more banks on April 15, 1980, with a view to restricting the malpractices indulged in by private banks, preventing misuse of banking resources to improve banking facilities to customers in remote and less developed areas. However, even after decades, the banks have not fully served the purpose for which they were nationalised, in terms of branch expansion, mobilisation of deposits, extending credit, customer satisfaction etc.¹⁵.
(c) Non-Scheduled Banks

The commercial banks, not included in the Second Schedule of the RBI Act are known as Non-Scheduled Banks. They are not entitled to get facilities like refinance and rediscounting of bills, etc from RBI. They do not get the prestige like Scheduled Banks. They are mainly engaged in lending money, discounting and collecting bills and various agency services. They insist higher security for loans.

As on December 1999, there was only one non-scheduled bank viz., Sikkim Bank Ltd is in operation. RBI currently does not encourage the opening of non-scheduled banks. Efforts are on to merge the only non-scheduled bank viz., Sikkim Bank Ltd with Union Bank of India.

POST NATIONALISATION ERA:

In the first decade of nationalisation, the accent was on branch expansion. Bank branches till then a privilege of metropolitan and urban areas, spread quickly to every semi-urban and rural area across the country. The average population served by a bank branch fell dramatically in the first decade from about 63,000 in 1969 to about 20,000 in 1980.

In the next decade the accent shifted to resource mobilisation. Deposit hunting became the paramount task, the performance of which decided the fate of the bank manager.

The third decade was a period of reforms. Prudential banking norms governing capital adequacy, income recognition and asset quality, which had got
diluted in the first two decades of hectic expansion were sought to be re-established and brought on par with international standards. The rigidities of a government owned institution, the adoption of new norms by the banks was surprisingly swift and smooth.

Now in the fourth decade, the banks have embarked on a massive expansion of a credit in an effort to push the economy in to a higher growth trajectory. Per capita bank credit in the country was just Rs.69 on the eve of nationalisation. Thirty years on, in March 2000 it has risen closed to Rs.4,000, by 2003 it now stands at over Rs.7,000.16

PSBs AND COMPETITION IN INDIA:

In the Indian context as is well known, it is through well designed policy reform that the PSBs have been exposed to increasing competitive environment through (a) entry of new private banks (b) relaxations on the entry of foreign bank branches (c) near total deregulation of interest rates structure and (d) increased functional autonomy and operational flexibility in a large number of areas for PSBs. As a measure of impact of this increased competitiveness since 1994-95 it can be seen from a bank group wise review that nationalised banks have faced a reduced share in assets, deposits and advances and at the same time increased their share in net profit in the banking segment. Thus, it may not be correct to say that the banking segment is either non competitive or it is only through privatisation that advantages of competitiveness can be increased. Even so the issue of relative low
efficiency of public sector banks may remain due mainly to several other inter related factors.\textsuperscript{17}

The other major weakness has been that Indian banks and, to some extent, financial institutions, suffer from inadequate operational flexibility. Banks in particular have been subject to so many regulations and controls, not only through statutory requirements but operational directives, guidelines and so forth, that there is hardly any aspect of banking which is not subject to some administrative directive from the government and/or the Reserve Bank. These apply not only to major aspects of operations but also to administrative matters regarding what should normally be aspects of internal management.\textsuperscript{18}

The first attempt at reforming the financial sector was visible from the recommendations of the Committee to Review the Working of the Monetary System 1985 referred to as the Chakravarty Committee Report. The Committee advocated the necessity of moving away from quantitative controls, which, it felt, led to distortions in the credit market and resulted in curbing the growth of the economy. As regards administered interest rates, the Committee felt that they had become unduly complex and the concessional interest rates allowed projects of doubtful viability to be undertaken. The Committee recommended a more liberal approach to interest rates, which included a selective approach to concessional interest rates and a hike in coupon rates on government borrowing\textsuperscript{19}. 
REFORMS:

Through the late 1980s the overwhelming majority of India's entire financial sector, from commercial banking to long-term industrial credit to the insurance industry, was owned and run by the Central Government. After years of prodding and scolding by scholars and some members of the business community, the then Government of Prime Minister P.V.Narasinha Rao, decided to get serious about banking reform by setting up an expert commission, composed primarily of the heads of India's major banks and financial institutions, all in the public sector, to issue recommendations. Its principal recommendations included, first, privatisation of the banking sector by liberalising entry and, second, deregulation, particularly in the areas of interest rate controls, high requirements for banks to invest in low-yielding government securities and high requirements for banks to make loans, frequently subsidised, to targeted groups such as farmers or small businesses 'priority sector credit'.

REFORM PROCESS:

If the financial sector reforms are reviewed in a broad perspective, it would be evident that the first phase of reforms focused on modification of the policy framework, improvement in financial health of the entities and creation of a competitive environment. The second phase of reforms target the three inter related issues viz., 1. Strengthening the foundation of banking system 2. Streamlining procedures, upgrading technology and human resource development, and
Structural changes in the system. These would cover aspects of banking policy, and focus on institutional, supervisory and legislative dimensions.  

The Government of India set up a nine-member committee under the chairmanship of Narasimham, former Governor of Reserve Bank of India, to examine the structure and functioning of the existing financial system of India and suggest financial sector reforms. The report of the committee was tables in the Parliament on December 17, 1991.

Objectives. Main objectives of the committee were:

(i) To examine the existing structure of the financial system and its various components;

(ii) To make recommendations for improving the efficiency and effectiveness of the system, with particular reference to economy of operations, accountability and profitability, and for infusing greater competitive vitality into the system so as to make the banks and other financial institutions to respond more effectively to the emerging needs of the economy;

(iii) To review the existing supervisory arrangement relating to the various entities in the financial sector and make recommendations for ensuring appropriate and effective supervision; and

(iv) To review the existing legislative framework and to suggest necessary amendments for implementing the recommendations.
REFORMS IN THE BANKING SECTOR:

With the introduction of new economic policy, during the 1990s the government resorted to reforms in the banking sector also as a follow up measure. The Recommendations of Narasimham Committee were responsible for undertaking banking reforms. The reforms are as follows.

1. Privatisation of shares of some of the leading public sector banks: some of the public sector banks shares were made available to the public. For example, State Bank of India sold a part of its shareholding to the public. Other public sector banks also followed the same.

2. Increase in the capital structure: The capital structure of commercial banks has to fall in line with the international convention of banking industry as adopted by the Basle Convention of International Banking Conference. The capital structure of banks has been divided into two parts namely, (i) Core capital and ii) Risk-weighed asset capital structure.

3. Cost Structure: The banking services have been made more cost-oriented and most of the services which were free earlier are now charged according to their costs to make banking industry more vibrant.

4. Change in the branch expansion policy: New branches of banks will not be allowed to open indiscriminately and existing branches which are non viable will be made to merge with other branches. Unprofitable Rural branches will be closed.
5. Extension of banking activities: Banks will be undertaking apart from traditional functions, other activities such as credit card, mutual fund, leasing, factoring, portfolio investment, housing finance, etc.,

6. Reducing Administrative Expenses: By introducing voluntary retirement scheme, the excess staff in the banking industry has been pruned by which banking business is made more profit oriented

7. Allowing of more new banks: Unit Trust of India, Global Trust Bank, IDBI, ICICI is some of the new commercial banks allowed to commence banking operations.

8. More foreign banks and branches: Foreign banks were allowed to open their branches and there is also a move on the part of the government to amend the Banking companies Act so that some of the existing private sector banks may be taken over by foreign banks or shares in these banks may be purchased by foreign banks. In the light of change of government in 2004 in New Delhi, this policy may be reviewed.

9. Foreign Exchange Operations: The Amendment to FERA and renaming of it as FEMA has provided more powers to commercial banks as Authorised Dealers to borrow in terms of foreign exchange from foreign markets. They can also undertake Swap Transactions so that they can earn more profits in foreign exchange transactions. This will also reduce their loss if there is a decline in the value of any foreign currency.

10. Capital market: To enable commercial banks to take part in capital market, they were permitted to operate mutual funds which are subject to regulations by SEBI.
Some of the commercial banks have even promoted subsidiary companies to operate in the capital market as brokers. Example: SBI Capital Market.

11. Housing Finance: Long term loans are given for housing, based on the earning capacity of customers and these are available at a concessional rate of interest.

12. Interest rate Deregulation: All along the interest rate of commercial banks was controlled by RBI. With the advent of reforms in banking operations, the commercial banks were given the option to adopt their own interest rate, according to the market conditions. Every bank announces its prime lending rate. This is the rate which a bank charges while lending against government securities. Keeping this interest rate as the base, there is interest spread, which is different interest rate for different types of loans. Floating interest rate is adopted by banks, based on market conditions and they even extend this to customers for swapping their interest rates with other banks which are charging higher interest rates.

13. Stock invests: In order to enable customers to take part in primary market, banks have been allowed to open stock invest account from which the customers can apply to different companies shares. The customer can mention the stock invest account in the share application form and when the allotment is made, the stock invest account will be debited to the extent of the shares allotted.

14. Bank Balance, Sheet Format: After 1993, there has been change in the format of banks, balance sheet. It is more on the basis of schedules that the banks will have to prepare their balance sheets. The contra entries have been deleted.
15. Asset Classification: The assets of banks have been classified as (a) standard assets, (b) Substandard assets (c) doubtful assets and (d) bad assets. These assets have been classified on the basis of their profitability and realization.

Standard asset: An asset which provides good income and which could be realized easily is a standard asset.

Sub-standard asset: When there is a delay in earning and realization, it becomes a substandard asset.

Doubtful asset: When there is a default in the payment, it is doubtful asset

Bad asset: Bad asset is one which is to be written off.

RBI has instructed the banks to make provisions for sub-standard, doubtful and bad assets out of profits and when a bank fails to earn profits, due to increasing non-performing assets, it will lead to erosion of its Reserve Fund and capital. The bank managers have been made accountable wherever there is an increase in non performing assets.

16. Service Area Scheme: With the failure of Lead Bank Scheme, RBI introduced Service Area Approach scheme by which the banks were allotted fixed areas around their locations. The bank will be the sole authority to extend credit facilities. The service is earmarked for one branch cannot be interfered by other branches. The areas for which loans could be extend have been broadly classified as (a) agriculture and allied, (b) small industry, (c) cottage industry and (d) investment and small business known as ISB which consists of mostly self employment schemes.
17. IDBI: IDBI has been a subsidiary of RBI still 1978. It was an apex bank for industrial finance while NABARD was its counterpart for agriculture. Now IDBI has been made as an independent Apex bank for industrial finance.

18. Consumer Loan: Every bank has been directed to open up a separate division for consumer loans under which credit will be extended for the purchase of consumer articles such as vehicles, refrigerator, and washing machines. TV etc.

19. Consumer Grievance Cell: Every bank must have a consumer grievance cell and it should meet once in 15 days. The consumers in each branch can represent their grievances.

20. Bank Ombudsman: In order to improve the quality of service and to provide legal protection to the Customers, Banks “Ombudsman has been created which is an organization to investigate any justice done to customers due to the deficiency in banking services. This is set up at every regional level (The word Ombudsman has its origin in Denmark and Sweden and the dictionary meaning is a ‘grievance man’ or ‘an official appointed to investigate complaints against the administration.’)

21. SIDBI: By way of promoting small scale industries, a separate apex bank has been created known as Small Industries Development Bank of India. This provides refinancing facilities to commercial banks for promoting small scale industry.

22. Promotion of exports, tiny sector and entrepreneurial talents: Banks have been asked to open separate schemes for promoting export finance, entrepreneurial
development programmes and also promotion of tiny sector in areas with a population of less than 1 lakh and investment of rupees more than 2 lakhs.

23. One time settlement: Loans which have been outstanding for a long time, and where the borrowers are reeling under the debt burden, they have been asked to make payment at a confessional rate of interest before resorting to any legal action. Such a scheme is known as One-time settlement.

24. Use of modern technology: There has been a remarkable change in the functioning of banks with the introduction of computers. Banks have introduced Teller System and entries in the pass books are done by the computers. Even transfer of funds is electronically done, which is called electronic clearing system. Cheques facilitating such transfer are called MICR (Magnetic Ink Character Recognition) which enables quick clearance of cheques.

25. Securitisation Act: In 2002, securitization and Reconstruction of Financial Assets and Enforcement of Securities interest Act was passed by which banks can approach the Debt Recovery Tribunal for attaching the property of the defaulting customers immediately. This will enable the bank to recover the loan either by liquidating the assets or by transferring the assets to another party so that the loan can be recovered by the management of the assets in a profitable way.

26. Introduction of Green Card: By way of extending credit card to rural areas, Green Card has been introduced to agriculturists who will enable them to buy agricultural inputs on credit and they can repay the loan after harvest.
Thus, it is found that the reforms undertaken by the banking sector have covered all the sectors of the economy and have made the banking industry more dynamic. This is evident from the fact that more foreign banks are showing keen interests to come to India and open branches. State Bank of India issued two bonds in the overseas market known as (a) India Resurgent Bonds and (b) Millennium Bonds and could raise more than 4 billion dollars. This clearly reveals the confidence reposed by the overseas investors on the Indian banking sectors.23

RECENT TRENDS IN INDIAN BANKING:

Indian Banking system developed enormously after independence. Particularly after nationalization of banks there has been a multi-dimensional development. Nationalization of banks provided an impetus to the banking development and the banks started functioning with social responsibility.

VENTURE CAPITAL

A ‘Venture’ is a new risky business. ‘Venture Capital’ therefore, refers to providing start-up capital to new and risky business operations.

Every new business operation is risky. Then what distinguishes venture capital business operations from other business operations? In Venture Capital business:
(a) the promoters may be new technocrats, who have not proved their business acumen or expertise so far; and
(b) the idea of new product is yet to be tested in the market.
Hence, the venture capitalist (one who provides finance for venture capital business) takes a bigger risk in financing the production of a new product by persons who have not proven their business capabilities so far. It can be said that venture capital is the Equity investment in young private companies. The Venture capitalist may be financial institutions, banks, investment companies or even wealthy individuals. The venture capitalist is prepared to back an untried business operation in exchange for a share of future expected profits. The venture capitalist usually provides capital in stages depending upon growth of business operations and not at one stroke. If the business succeeds the venture capitalist makes big profit from a share in profit and form value appreciation of investment in Equity Shares.

In USA it started in a big way in 1980s. Even the US Government provided cheap loans to investment companies to encourage them to relend the money to deserving new entrepreneurs. There are many success stories of venture capital assisted business operations. However, failures of Venture Capital business are more than success stories.

In India Venture Capital business idea caught the minds of financial institutions only in 1990s. The Government allows banks tax concession for venture capital business operations. However, this business started only in a small scale in India so far. The reason mainly is the reluctance of banks to provide funds for untested and doubtful business operations. However, new software engineers have
started in a big way with venture capital assistance. In India, SEBI has laid down rules and regulations for venture capital business.

As per RBI guidelines banks providing finance to venture capital business can treat such advances as priority sector loans. The Technology Development and Information Company of India Ltd., Risk Capital and Technology Finance Corporation, SBI Capital Market, Canbank Financial Services and Credit Capital Finance Corporation are already financing high risk, new ventures under Venture Capital Financing Schemes.

As per “Venture Activity Report 1998” published by Indian Venture Capital Association, Bangalore total venture capital investment in India during the year 1998 amounted to Rs. 1256 crore. Information Technology (IT) sector has attracted the largest share of Rs. 324 crore followed by computer software sector which received investment totalling at Rs. 251 crore.

**FACTORING SERVICES**

Factoring services originated from the recommendations of Kalyanasundaram Committee. SBI was the first to start factoring services and Canara Bank has floated Canbank Factors Ltd., which was incorporated on 10th May 1991. Factoring is a portfolio of complementary financial services relating to receivables of a company. The basic components of factoring services are finance up to 80% of the invoice value, sales ledger administration, debt collection services and credit.
insurance. Current Guidelines on Factoring says that, Banks can form subsidiaries for Factoring Services subject to the following guidelines:

(a) Banks can conduct its business by setting up subsidiaries and invest in factoring companies jointly with other banks.

(b) Such concerns should not engage themselves in financing of other companies and concerns engaged in factoring.

(c) Investment of a bank in the business should not exceed 10% of the paid up capital and reserves of the bank.

(d) Setting up such ventures require prior clearance from RBI.

(e) The bank should furnish information as required by RBI from time to time.

SINGLE WINDOW BANKING

The universal teller pact will ensure that customers can meet all their banking needs from a single window instead of going to different counters in a branch for different transactions.

Bank of Baroda seems to be the fast-nationalised bank to have struck such an agreement with trade unions. The State Bank of India recently introduced the single window concept in select branches. However it is not known whether it has entered into any agreement with its unions on this.24
BANKNET

The collecting, processing and distribution of information is vital to business growth of banks. Computerization takes care of only the processing. The gathering and distribution on use of telephone, mail, telegraph and telex which leads to delay and high cost due to handling at several stages. Hence, a common communications network called 'Banknet' operated by banks and financial institutions on a co-operative basis within the county is being setup. The Banknet can be put to several uses. Some of the illustrative areas are given hereunder:

(i) Transfer of funds from one place to another distant place or bank.
(ii) Exchange of statistical information among banks.
(iii) Foreign Exchange business operations.
(iv) Inter-Bank applications, like settlement of funds between banks.
(v) Others.

The transfer of funds includes that customer can draw cash against their deposit at any branch of the bank as envisaged under 'on-line banking' and can also deposit cash at any branch for credit to an account at some other branch. Advance can be allowed at one branch against deposit at some other branch. This concept is known as 'Banking Anywhere'.
AUTOMATED TELLER MACHINES (ATM)

The evolutionary trend from cash economy to cheque economy and onwards to plastic card economy is witnessed in the introduction of ATMs. ATM or Automated Teller Machine outwardly appears like a human weighing Machine kept in Railway Platforms. These days, ATMs are securely placed inside the walls of bank's premises. While a weighing machine measure the weight of a person in kilograms, the ATM measures the bank balance of a person in rupees. In the weighing machine you insert a coin and you get a card telling your weight and fortune. In ATM you insert a plastic card and you get brand new currency notes and your bank balance.

HSBC bank is the first bank in India to offer ATM facility in 1987. August, 1988-Bank of India installs an ATM, The first public sector bank to offer the facility. Presently, a number of Indian and Foreign banks are offering ATM facility but mostly in cities. There is ease and privacy of operation through self-service.

ATMs have many advantages, some of which are given below:

(i) In ATM one can draw cash round the clock (for 24 hours a day) and no employé interface is required.

(ii) ATM provide customer not having credit card facilities an alternative for obtaining cash when required.

(iii) It eliminates the need for the customers to travel to the branch at which his accounts are maintained if the machines are conveniently located and networked.
(iv) Automatic and instantaneous accounting is possible.
(v) When labour cost is high the technology provides a cost effective solution.
(vi) Customers can deposit cash / instruments and leave instructions for the requirements of statement of accounts, transfer etc.,
(vii) As transactions are handled through software, without cash or instruments scope for frauds, robberies and misappropriation is reduced.

ATMs are used to far more extensively in countries such as the US and Japan. China for instance already have 65000 machines installed. In India it’s around 20000, out of which half of 50 percent have been supplied by the NCR (National Cash Register) corporation which has been in India since 1996.26

It may cost Rs.20 lakhs to Rs.30 lakhs to establish an ATM. The cost of maintaining an ATM is around Rs.6 to 9 lakhs per annum or Rs.2000-3000 per day per ATM. Work is under progress to bring down these costs.27

The minimum charge on a no profit and no loss basis is around Rs.20 per a transaction in ATM. Because of which bank started pooling in to networks for ATM usage. Punjab national bank, Oriental Bank of Commerce, Indian Bank, UTI Bank and Global Trust Bank are sharing their ATM’s spread across the country. The network has got 1700 ATM’s.28
Another consortium lead by Bank of India includes Indian Bank, Syndicate Bank, United Bank of India and Union Bank of India. Bank of India is charging Rs.10 per transaction from the others in a network of 3000 ATMs.29

Cash dispensed through ATMs in the country have more than doubled to around Rs.55000 crores in fiscal 2003 as against around Rs.27000 crores in the previous fiscal.30

PHONE BANKING

Phone Banking is yet another banking service offered by banks. Under this system, like in ATM card, a secret code number is provided to each account holder. A customer wanting to know his bank balance or any other information relating to his bank account should dial up a particular phone number indicating by the Bank. When the number is dialled, a recorded voice will ask a person to identify himself with his account number and code number. If the numbers are tallied, one will get all the information one want to know about one's account. Presently many foreign banks provide this service. One cannot draw cash or deposit cash through phone banking. It is basically an information service.

OFFSHORE BANKING UNITS:

The Indian Banking industry is witnessing some obvious consequences of globalisation. After having gone through momentous changes domestically-with
foreign direct investment and growing competition-Indian banks have now focused attention in a big way on their overseas operations.

The Key modes by which Indian banks are present overseas are branches, representative officers, subsidiaries, joint ventures and alliances. And the new trend in the block is Off-shore banking units (OBUs). The Reserve Bank of India in November 2002 came up with the concept of OBUs which would essentially be on-shore operations of Indian banks catering solely to off-shore business. An OBU would have to locate in an export oriented zone.

Currently four PSBs namely, State Bank of India, Bank of Baroda, Punjab National Bank and Union Bank of India have setup OBUs in SEEPZ, in Mumbai.\textsuperscript{31}

The Government of India introduced Special Economic Zones (SEZs) with a view to providing an internationally competitive and a hassle-free environment for export production. For the first time, Offshore Banking Units (OBUs) were permitted to be set up in SEZs. These units would be virtually foreign branches of Indian banks but located in India. These OBUs, inter alia, would be exempted from cash reserve requirements and would be able to provide finance to SEZ units and SEZ developers at international rates of interest. RBI has granted exemption from CRR requirements to the parent bank with reference to its OBU branch.\textsuperscript{32}
Offshore banking units are branches of international banks or other subsidiaries or affiliates. They do not carry retail business, but generally provide wholesale banking services – project financing, syndicated loans, issue of short-term and medium-term instruments, such as negotiable certificates of deposits and capital notes – as well as merchant banking activities in foreign currency denominated bonds and equity shares.

**Participation of the Indian Banks:**

Few Indian Banks, such as State Bank of India, Indian Overseas Bank, Bank of India and Bank of Baroda, have set-up offshore banking units for deposit taking and final lending at Behrain, Hong Kong, Colombo, Cayman Islands, and so on. Indian Bank, Bank of Baroda and Union Bank of India jointly floated a deposit taking company, IBU International Finance, in Hong Kong for both offshore and onshore banking.

The benefits for the Indian banks from these ventures are:

Sizeable profits - as these ventures involve relatively low operating costs. With multi-currency deposit bases, the banks would be able to serve better the needs of their customers who have set-up joint ventures abroad in the form of foreign currency finance. The banks would strengthen the country's balance of payments through repatriation of profits from the venture.
Offshore Banking Centre in India:

Financial experts have been pleading to establish an offshore banking center in India. Geographically, India provides distinct advantages in attracting offshore banking units, because it has a stable economic and political performance, a vast market, technical manpower that could find employment in these centres. Another advantage is that the Indian market would open a little before the Tokyo market closes, and close before New York opens, thus providing a vital time link for international money market dealers.

In an era where many Indian corporations are functioning abroad, and many corporations are granted permission to seek overseas finance, establishing an offshore unit will help tap the resources.\textsuperscript{33}

CORE BANKING

It is the buzz word today and every bank is trying to adopt it. It is a centralized banking platform through which a bank can control its entire operation. The adoption of CBS will help banks to roll out new products and services. This software provides in-depth knowledge about customers, which is essential in the present competitive scenario. It will also increase competition and put pressure on margins besides which greater focus on risk management is needed. PNB which has a CBS says that a CBS was chosen as it would enable the bank to provide value-added services to its customers and to meet all future requirements in terms of MIS and enable launch of new products and services.\textsuperscript{34}
UNIVERSAL BANKING

In Universal banking, large banks operate extensive networks of branches, provide many different services, hold several claims on firms (including equity and debt), and participate directly in the corporate governance of firms that rely on the banks for funding or as insurance underwriters.

The concept has been prevalent in developed countries like France, Germany, US, but it is uncommon in UK. It is yet to take off, officially, in India. During the pre-economic reforms period, commercial banks and development financial institutions were functioning distinctly, the former specializing in short and medium-term financing, while the latter on long-term lending and project financing. Commercial banks were accessing short-term low cost funds through savings investments like current accounts, savings bank accounts and short duration fixed deposits, besides collection float. Development Financial institutions (DFIs) on the other hand, were essentially depending on budget allocations for long-term lending at a concessionary rate of interest.

The scenario has radically changed during the post-reforms period, with the resolve of the government not to fund DFIs through budget allocations. DFIs' therefore have been accessing long-term funds from the markets in the form of bonds, which are not all that inexpensive, resulting in hike in lending rates. Further, globalisation and liberalization of economy has resulted in massive pile-up of NPAs,
as many Indian industrial borrowers could not simply become competitive in a global market for a variety of reasons.

What about commercial banks trying to enter in a big way long-term lending, either through project finance route or term loan route? As some of these banks have been acquiring the needed skills, perhaps they are justified to be in competition to the DFIs in this regard. The vital question is maturity mismatch and acquisition of the right banking skills to be a term lender/investor.

India is a vast nation with a population of over 1 billion and is a growing economy. There is always a room for term lending institutions like ICICI, IDBI, Exim bank, IFCI and IIBI to co-exist and prosper along with commercial banks without really embracing universal banking. Having said this, one need not criticise commercial banks for their foray into long-term lending activities and investment activity and term lending institutions resorting to working capital finance, without explicitly and comprehensively embracing universal banking. It is more a question of Assent liability Management, skills and competitive spirit rather than identification with the various facets of universal banking.36

NET BANKING OR INTERNET BANKING

Banking is practically a service-oriented activity. One of the methods of providing service is through the medium of computer network. Net or Internet Banking refers to extension of banking services through the network of computers.
'Internet' is a worldwide network of computers located at banks, offices, hospitals, educational institutions, commercial establishments at different countries are connecting through one another. If you have a Personal Computer (PC) telephone connection and an instrument called 'modem', with the internet facility you can have access to various colleges and universities and offices and obtain important information, send and receive messages, etc. Similarly, banking messages can be exchanged between the bank and its customers through the net banking system. Hence, in the internet banking a customers can ask for his/ her bank balance, give other instructions pertaining to his account, call for his/ her statement of account, transfer money from his / her account, pay college fees, call for cheque book and a number of similar functions through net banking without visiting the bank. This system of conducting banking business is known as net or internet banking. ICICI Bank is presently conducting net banking. Others banks are slowly introducing this system in their organizations.

DEPOSIT INSURANCE SCHEME

To protect the interests of the depositors, the Deposit Insurance Corporation of India was established by an Act of Parliament in 1962. It provides insurance cover on deposits held with the commercial, and co-operative banks and the scheme of the deposit insurance corporation and the corporation has been renamed as 'Deposit Insurance and Credit Guarantee Corporation' with effect from 15th July 1978. The corporation provides protection to small depositors by insurance and provides guarantee to the banks for loans extended to small borrowers. Presently
deposits with banks up to Rs. 1,00,000 per account is guaranteed for repayment by the Corporation.

GOLD DEPOSIT SCHEME

The Government of India has proposed a new Gold Deposit Scheme in its Budget for 1999-2000. The purpose of the Scheme was to mobilize idle gold lying with people/institutions like temple in India and utilize the same for the productive purposes through the banking system. As per the scheme announced in September / October 1999 selected commercial banks are permitted to accept gold deposits from individuals, trusts and companies in the form of gold coin, jewellery, ornaments, gold bars etc. The banks after ascertaining their gold or its equivalent value in rupees. Interest amount will be paid separately and it is exempted from Income Tax. Gold value is exempted from wealth tax. One of the purposes of the scheme is to reduce the import of gold from abroad. In 1998-99 India imported 540 tonnes of gold through official channels. Non-Resident Indians are also permitted to bring with them 10 Kgs of gold subject to certain conditions when they come to India.

The scheme is beneficial to holders of gold as it does provide safety and security to their gold holdings besides a regular interest income thereon. The deposit will be for a period between 3 and 7 years. The Gold deposit Bond is transferable by endorsement and delivery as in the case with Negotiable instruments.
REFERENCES:


17. K.B.L. Mathur, “PSBs in India - should they be privatised?”, Economical and Political Weekly, Mumbai, June 8, 2002.


22. Dr. Mrs. S. Murty, “Financial Sector Reforms and Economic Growth in India”, UBSPD, New Delhi, p. 150, 184.


32. RBI annual report 2002-2003, RBI, New Delhi, p171.


34. Professional Banker, ICFAI Publications, October 2003, p35.
