BANKING INDUSTRY IN INDIA - THE OVERVIEW
EVOLUTION OF BANKING:

In modern times, commercial banking occupies quite an important place in the financial frame-work of every economy because of the continuing challenge it presents to those who are responsible for managing the affairs of the banks and to those who observe and study their performance. The character of banking has kept on meandering through time and the working of the commercial banks reflects the changing character of the credit mechanism which itself is the outcome of the economic changes taking place in the economic system. Consequently, commercial banks’ working must be flexible to enable them to face the new economic problems and policy issues in order to play their useful role in the economy.

In its naïve form, banking is as old as authentic history and the origins of modern commercial banking are traceable in ancient times. The New Testament mentions about the activities of moneychangers in the temples of Jerusalem. In ancient Greece, the famous temples of Delphi and Olympia were used, as depositories for people's surplus funds and these were the centres of money lending transactions. Traces of credit by compensation and by transfer order are found in Assyria, Phoenicia and Egypt before the system attained full development in Greece and Rome. The ancient 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.4

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.”5

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.6
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."
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 by way 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.9

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.10

<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.11

<table>
<thead>
<tr>
<th>S.No</th>
<th>Name of the Banks</th>
<th>Compensation(Rs.inLakhs)</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'.

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
To conclude, nationalization of banks in India did a wonderful job, particularly in the following areas and spheres of activities.

1. Taken banking service to rural and remote areas.
2. Awakened the rural masses about the need and usefulness of banking service.
3. Helped enormously speedy transfer of funds from one place to another.
4. Provided thousands of job opportunities to educate youth.
5. Made credit available to neglected people like agricultural labourer, small traders at reduced interest rate.
6. Helped to free the rural poor from the clutches of moneylenders.
7. Ensured adequate and timely credit for agricultural activities and farming operations.
8. Priority sector advances ensured adequate supply of credit to weaker sections of the society like village artisans, labourers, scheduled caste and tribes.
9. Helped export sector to obtain cheap credit.
10. Ensured even supply of credit to various industrial activities.
11. Avoided diversion of funds for harmful activities like speculation in shares, hoarding of essential commodities investment in real estates etc.,
12. Removed concentration of wealth in the hands of few industrialists.
13. Ensured use of public money (deposits of public) for social and desirable purposes.
15. Helped implementation of various welfare measures formulated by Government.
ARGUMENTS AGAINST NATIONALISATION:

Those oppose nationalisation of banks give the following arguments:

1. **Reduction in Efficiency.** The experience of other nationalised institutions indicates that the nationalisation of the commercial banks will reduce the efficiency of these banks. Moreover, political interference will also impair the smooth working of these institutions.

2. **No Control on Monopolies.** The root cause of the growth of monopolies and the concentration of wealth and power lies in the existing economic system. Therefore, the remedy requires the changing and reforming of the economic system and not the nationalisation of banks.

3. **Other Way to Remove Malpractices.** Malpractice of privately owned banks can be checked by adopting appropriate monetary and fiscal policies and through efficient supervision by the Reserve Bank of India. There is no need to take such drastic step of bank nationalisation of banks.

4. **Risky lending to Agriculturists.** Extending loans to agriculture and small-scale industries is risky and less remunerative. Such loans are against the sound banking rules and may weaken the economic viability of these institutions.

5. **No Need of Security to Deposits.** It is pointed out that there is no need to provide 100 per cent security to the depositors in India through nationalisation of banks. Institutions like Indian Deposit Insurance and credit Guarantee Corporation are functioning quite efficiently and providing enough relief to the depositors.

6. **Burden of Compensation.** Nationalisation involves huge amounts of money to be paid as compensation to the shareholders. This puts additional financial burden on the
government. Moreover, it is also argued that nationalisation will not bring much revenue to the state.

7. **Nationalisation is no Socialism.** It is argued that nationalisation may not lead to socialism. State capitalism is not socialism. Moreover, there is a general tendency to treat public property not as scared national property, but as no one's property. As such, it is misused and destroyed like anything.¹⁴

**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 tiding 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.\textsuperscript{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 credit in an effort to push the economy into 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.Narasimha 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 3. 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 tabled 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.

NARASIMHAM COMMITTEE RECOMMENDATIONS 1991

The following are the Recommendations of Narasimham Committee - I:

1. The Committee’s approach to the issue of financial sector reform is to ensure that the financial services industry operates on the basis of operational flexibility and functional autonomy with a view to enhancing efficiency, productivity and profitability. A vibrant and competitive financial system is also necessary to sustain the ongoing reform in the
structural aspects of the real economy. The Committee believe that ensuring the integrity and autonomy of operations of banks and Development Financial Institutions (DFIs) is by far the more relevant issue at present than the question of their ownership.

2. The Indian banking and financial system has made commendable progress in extending its geographical spread and functional reach. The spread of the banking system has been a major factor in promoting financial intermediation in the economy and in the growth of financial savings. The credit reach also has been extensive and the banking system now caters to several million borrowers especially in agriculture and small industry. The DFIs have established themselves as a major institutional support for investment in the private sector. The last decade has witnessed considerable diversification of the money and capital markets. New financial services and instruments have appeared on the scene.

3. Despite this fabulous progress serious problems have cropped leading to decline in productivity and efficiency, and erosion of the profitability of the banking sector. The major factors responsible for these are: (a) directed investments; and (b) directed credit programmes. In both these cases, rates of interest that were available to banks were less than the market related rates or what they could have secured from alternate deployment of funds. There has been a deterioration in the quality of the loan portfolio which in turn has come in the way of banks' income generation and enhancement of their capital funds. Inadequacy of capital has been accompanied by inadequacy of loan loss provisions. The accounting and disclosure practices also do not always reflect the true
state of affairs of banks and financial institutions. The erosion of profitability of banks has also emanated from the side of expenditure as a result of fast and massive expansion of branches, many of which are unremunerative especially in the rural areas, a considerable degree of over-manning especially in the urban and metropolitan centres and inadequate progress in updating work technology. Both management weaknesses and trade union pressures have contributed to this. There have also been weaknesses in the internal organizational structure of the banks, lack of sufficient delegation of authority and inadequate internal controls and deterioration in what is termed 'housekeeping' such as balancing of books and reconciliation of inter-branch and inter-bank entries. The DFIs also suffer from a degree of portfolio contamination. This more pronounced in the case of the States Financial Corporations (SFCs). Being smaller institutions the internal organizational problems of the DFIs have suffered from excessive administrative and political interference in individual credit decision making and internal management. The deterioration in the financial health of the system has reached a point where unless remedial measures are taken soon, it could further erode the real value of and return on the savings entrusted to them and even have an adverse impact on depositor and investor confidence. This diagnosis of the problems indicates the lines of solution which the committee proposes with a view as much to improving the health of the system as for making it an integral part of the ongoing process of economic reforms.

4. The Committee is of the view that the Statutory Liquidity Ratio (SLR) instrument should be deployed in conformity with the original intention of regarding it as a prudential requirement and not be viewed as a major instrument for financing the public
sector. In line with Government’s decision to reduce the fiscal deficit to a level consistent with macro-economic stability, the Committee recommends that the SLR be brought down in a phased manner to 25 per cent over a period of about five years, starting with some reduction in the current year itself.

5. As regards the cash reserves ratio, the Reserve Bank should have the flexibility to operate this instrument to serve its monetary policy objectives. The Committee believes that given the Government’s resolve to reduce the fiscal deficit, the occasion for the use of cash reserve ratio to control the secondary expansion of credit should also be less. The Committee accordingly proposes that the Reserve Bank consider progressively reducing the cash reserve ratio from its present high level. With the deregulation of interest rates there would be more scope for the use of open market operations by the Reserve Bank with correspondingly less emphasis on variations in the cash reserve ratio.

6. The Committee proposes that the interest rate paid to banks on their SLR investments and on Cash Reserve Ratio (CRR) in respect of impounded deposits above the basic minimum should be increased. The rates on SLR investments should be progressively market related while that on cash reserve requirement above the basic minimum should be broadly related to banks’ average cost of deposits. However, during the present regime of administered interest rates, this rate may be fixed at the level of banks’ one year deposit rate.

7. With respect to directed credit programmes, the Committee is of the view that they
have played a useful purpose in extending the reach of the banking system to cover sectors which were neglected hitherto. Despite considerable unproductive lending, there is evidence that the contribution of bank credit to growth of agriculture and small industry has made an impact. This calls for some re-examination of the present relevance of directed credit programmes at least in respect of those who are able to stand on their own feet and to whom the direct credit programmes with the element of interest concessionality that has accompanied it has become a source of economic rent. The Committee recognizes that in the last two decades banking and credit policies have been deployed with a redistributive objective. However, the Committee believes that the pursuit of such objectives should use the instrumentality of the fiscal rather than the credit system. Accordingly, the Committee proposes that the direct credit programmes should be phased out. This process of phasing out would also recognize the need that for some time it would be necessary for a measure of special credit support through direction. The Committee therefore, proposes that the priority sector be redefined to comprise the small and marginal farmer, the tiny sector of industry small business and transport operators, village and cottage industries, rural artisans, and other weaker sections. The credit target for this redefined priority sector should hence-forth be fixed at 10 per cent of aggregate credit which would be broadly in line with the credit flows to these sectors at present. The Committee also proposes that a review may be undertaken at the end of three years to see if directed credit programmes need to be continued. As regards medium and large farmers, and the larger among small industries, including transport operators, etc., who would not now constitute part of the redefined priority sector, the Committee proposes that to further encourage banks to provide credit to these
erstwhile constituents of the priority sector, the Reserve Bank and other refinancing agencies institute a preferential refinance scheme in terms of which incremental credit to these sectors would be eligible for preferential refinance subject to normal eligibility criteria.

8. The Committee is of the view that the present structure of administered interest rates highly complex and rigid. This is so in spite of recent moves towards deregulation. The Committee proposes that interest rates be further deregulated so as to reflect emerging market conditions. At the same time, the Committee believes that a reasonable degree of macro economic balance through a reduction the fiscal deficit is necessary for successful deregulation of interest rates. Premature moves to market determined interest rates could, as experience abroad has shown, pose the danger of excessive bank lending at high nominal rates to borrowers of dubious credit-worthiness, eventually creating acute problems for both the bank as well as the borrowers. Accordingly, the Committee recommends that for the present, interest rates on bank deposits may continue to be regulated, the ceilings on such rates being raised as the SLR is reduced progressively as suggested by the Committee earlier. Similarly, the interest rate on Government borrowing may also be gradually brought in line with market-determined rates which would be facilitated by the reduction in SLR. Meanwhile, the Committee would recommend that concessional interest rates should be phased out. The structure of interest rates should bear a broad relationship to the Bank rate which should be used as an anchor to signal the Reserve Bank’s monetary policy stance. It would be desirable to provide for what may be called a prime rate, which would be the floor of the lending rates.
of banks and DFIs. The spreads between the Bank rate, the bank deposit rates, the Government borrowing rates and the prime rate may be determined by the RBI broadly in accordance with the criteria suggested by the Chakravarthy Committee so as to ensure that the real rates of interest remain positive.

9. The inadequacy of capital in the banking system is a cause for concern. While progress towards BIS norms is desirable, the Committee recognizes that this will have to be phased over time. The Committee suggests that the banks and financial institutions should achieve a minimum 4 per cent capital adequacy ratio in relation to risk weighted assets by March 1993, of which Tier 1 capital should be not less than 2 per cent. The BIS standards of 8 per cent should be achieved over the period of the following 3 years, that is, by March 1996. For those banks with an international presence it would be necessary to reach these figures even earlier.

10. The Committee believes that in respect of those banks whose operations have been profitable and which enjoy a good reputation in the markets, they could straight-away approach the capital market for enhancement of their capital. The Committee, therefore, recommends that in respect of such banks, issue of fresh capital to the public through the capital market should be permitted. Subscribers to such issues could include mutual funds, profitable public sector undertakings and employees of the institutions besides the general public. In respect of other banks, the Government could meet the shortfall in their capital requirements by direct subscription to capital or by providing a loan which could be treated as subordinate debt.
11. Before arriving at the capital adequacy ratio for each back, it is necessary that the assets of the banks be evaluated on the basis of their realizable values. The Committee proposes that the banks and financial institutions adopt uniform accounting practices particularly in regard to income recognition and provisioning against doubtful debts. There is need also for adopting sound practices in regard to valuation of investments on the lines suggested by the Ghosh Committee on Final Accounts.

12. In regard to income recognition the Committee recommends that in respect of banks and financial institutions which are following the accrual system of accounting, no income should be recognized in the accounts in respect of non-performing assets. An asset would be considered non-performing if interest on such assets remains past due for a period exceeding 180 days at the balance sheet date. The Committee further recommends that banks and financial institutions be given a period of three years to move towards the above norms in a phased manner beginning with the current year.

13. For the purpose of provisioning, the Committee recommends that, using the health code classification which is already in vogue in banks and financial institutions, the assets should be classified into four categories namely, Standard, Sub-standard, Doubtful and Loss Assets. In regard to Sub-standard Assets, a general provision should be created equal to 10 per cent of the total outstandings under this category. In respect of Doubtful Debts, provision should be created to the extent of 100 percent of the security shortfall. In respect of the secured portion of the some Doubtful Debts, further provision should be created, ranging from 20 per cent to 50 per cent, depending on the period for which such assets remain in the doubtful category. Loss Assets should either the fully written off or
provision be created to the extent of 100 per cent. The Committee is of the view that a period of 4 years should be given to the banks and financial institutions to confirm to these provisioning requirements. The movement towards these norms should be done in a phased manner beginning with the current year. However, it is necessary for banks and financial institutions to ensure that in respect of doubtful debts 100 per cent of the security shortfall provided for in the shortest possible time.

14. The Committee believes that the balance sheets of banks and financial institutions should be made transparent and full disclosures made in the balance sheets as recommended by the International Accounting Standards Committee. This should be done in a phased manner commencing with the current year. The Reserve Bank, however, may defer implementation of such parts of the standards as it considers appropriate during the transitional period until the norms regarding income recognition and provisioning are fully implemented.

15. The Committee suggests that the criteria recommended for non performing assets and provisioning requirements be given due recognition by the tax authorities. For this purpose, the Committee recommends that the guidelines to be issued by the Reserve Bank of India under Section 43D of the Income Tax Act should be in line without recommendations for determination of non-performing assets. Also, the specific provisions made by the banks and institutions in line with our recommendations should be made permissible deductions under the Income Tax Act. The Committee further suggests that in regard to general provisions, instead of deductions under Section 36 (1)
(vii-a) being restricted to 5 per cent of the total income and 2 per cent of the aggregate average advances by rural branches, it should be restricted to 0.5 per cent of the aggregate average non-agricultural advances and 2 per cent of the aggregate average advances by rural branches. This exemption should also be available to banks having operations outside India in respect of their Indian assets, in addition to the deductions available under Section 36 (1) (viii).

16. Banks, at present, experience considerable difficulties in recoveries of loans and enforcement of security charged to them. The delays, that characterize our legal system have resulted in the blocking of a significant portion of the funds of banks and DFIs in unproductive assets, the value of which deteriorate with the passage of time. The Committee, therefore, considers that there is urgent need to work out a suitable mechanism through which the dues to the credit institutions could be realized without delay and strongly recommends that Special Tribunals on the pattern recommended by the Tiwari Committee on the subject be set up to speed up the process of recovery. The introduction of legislation for this purpose is long overdue and should be preceded with immediately.

17. While the reform of accounting practices and the creation of Special Tribunals are essential, the Committee believes that an arrangement has to be worked out under which part at least of the bad and doubtful debts of the banks and financial institutions are taken off the balance sheet so that the banks could recycle the funds through this process into more productive assets. For this purpose, the committee proposes the establishment, if
necessary by special legislation, of an Assets Reconstruction Fund (ARF) which could take over from the banks and financial institutions a portion of the bad and doubtful debts at a discount, the level of discount being determined by independent auditors on the basis of clearly stipulated guidelines. The ARF should be provided with special powers for recovery somewhat broader than those contained in Sections 29-32 of the State Financial Corporation’s Act 1951. The capital of the ARF should be subscribed by the public sector banks and financial institutions.

18. It is necessary to ensure that the bad and doubtful debts of banks and financial institutions are transferred to the ARF in a phased manner to ensure smooth and effective functioning of the ARF. To begin with, all consortium accounts where more than one bank or institution is involved should be transferred to the ARF. The number of such accounts will not be large but the amounts involved are substantial to make a difference to the balance sheets of banks. Gradually, depending on the progress achieved by the ARF, other bad and doubtful debts could be transferred over time. Meanwhile, banks and institutions should pursue recovery through the Special Tribunals. Based on the valuation given in respect of each asset by a panel of at least two independent auditors, the ARF would issue bonds to the concerned institution carrying an interest rate equal to the Government bond rate and repayable over a period of 5 years. These bonds will need to be guaranteed by the Government of India and should be treated as qualifying for SLR purposes. The advantage to banks of this arrangement would be that their bad and doubtful debts would be off their books though at a price but they would have in substitution of these advances bonds up to the discounted value with a certainty of interest.
income which would be an obviously important aspect from the point of view of income recognition, and further by making these bond holding eligible for SLR purposes, banks’ fresh resources could become available for normal lending purposes. The Committee emphasizes that this proposal should be regarded as an emergency measure and not as a continuing source of relief to the banks to DFIs. It should be made clear to the banks and financial institutions that once their books are cleaned up through this process, they should take normal care and pay due commercial attention in loan appraisals and supervision and make adequate provisions for assets of doubtful realizable value.

19. Selling these assets to the Fund at a discount would obviously mean an obligation on the banks / DFIs to write off these losses which many of them are in no position to do now, given their weak capital position. The Committee proposes that to enable the banks to finance the write off represented by the extent of the discount, the Government of India would, where necessary, provide, as mentioned earlier, a subordinated loan counting for capital. As far as the Government of India itself is concerned, the Committee believes that the counterpart of any external assistance that would be available for financial sector reform could be used to provide this type of capital to the banks and DFIs.

20. The ARF would be expected to deal with those assets which are in the process of recovery. In respect of sick units which are under nursing or rehabilitation programmes, it is necessary to work out a similar arrangement to ensure smooth decision making and implementation in respect of such nursing programmes. The Committee recommends that in respect of all such consortium accounts which are under a nursing programme or
in respect of which rehabilitation programmes are in the process of being worked out, the concerned lead financial institution and/or lead commercial bank should take over the term loan and working capital dues respectively from under participating institutions and banks. Such acquisitions should be at a discount based on the realizable value of the assets assessed by a panel of at least two independent auditors as in the case of transfer of assets to ARF.

21. In regard to the structure of the banking system, the Committee is of the view that the system should evolve towards a broad pattern consisting of:

a) 3 or 4 large banks (including the State Bank of India) which could become international in character;

b) 8 to 10 national banks with a network of branches throughout the country engaged in ‘universal’ banking;

c) Local banks whose operations would be generally confined to a specific region; and

d) Rural banks (including RRBs) whose operations would be confined to the rural areas and whose business would be predominantly engaged in financing of agriculture and allied activities.

The Committee is of the view that the move towards this revised system should be market driven and based on profitability considerations and brought about through a process of mergers and acquisitions.

22. The Committee is of the view that the structure of rural credit will have to combine the local character of the RRBs and the resources, skills and organizational / managerial
abilities of the commercial banks. With this end in view the Committee recommends that each public sector bank should set up one or more rural banking subsidiaries, depending on the size and administrative convenience of each sponsor bank, to take over all its rural branches and, where appropriate, swap its rural branches with those of other banks. Such rural banking subsidiaries should be treated on par with RRBs in regard to CRR/SLR requirements and refinance facilities from NABARD and sponsor banks. The 10 per cent target for directed credit which we have recommended as a transitional measure should be calculated on the basis of the combined totals of the present banks and their subsidiaries. The Committee proposes, that while RRBs should be allowed to engage in all types of banking business, their focus should continue to be lend to the target groups to maintain at a minimum the present level of their lending to these groups. With a view to improving the viability of their operations, the Committee proposes that the interest rate structure of the RRBs should be in line with those of the commercial banks. The Committee would leave the option open to the RRBs and their sponsor banks as to whether the RRBs should retain their identity so that their focus on lending to the target groups is not diffused or where both the RRBs and the sponsor banks wish to do so they could be merged with the sponsor banks and the sponsor banks in such cases should take them over as 100 per cent subsidiaries by buying out the shares from other agencies at a token price, and eventually merge them with the rural banking subsidiaries which we have proposed. For those RRBs that retain their identity and whose viability would need to be improved, we propose that instead of investing in Government bonds as part of their SLR requirements, they could place the amounts stipulated under SLR as deposits with NABARD or some special federal type of agency that might be set up for this purpose.
This would also be consistent with the statutory requirements in this regard and NABARD or this agency could pay interest on such balances by investing or deploying these funds to the best advantage on their behalf and thus help to augment the income of the RRBs.

23. The Committee proposes that Government should indicate that there would be no further nationalization of banks. Such an assurance will remove the existing disincentive for the more dynamic among the private banks to grow. The Committee also recommends that there should not be any difference in treatment between the public sector and the private sector banks. The Committee would propose that there be no bar to new banks in the private sector being set up provided they conform to the start-up capital and other requirements as may be prescribed by the Reserve Bank and the maintenance of prudential norms with regard to accounting, provisioning and other aspects of operations. This is in conjunction with the relevant statutory requirements governing their operations would provide adequate safeguards against misuse of banks’ resources to the determinant of the depositors interests.

24. The Committee recommends that branch licensing be abolished and the matter of opening branches or closing of branches (other than rural branches for the present) be left to the commercial judgment of the individual banks.

25. The Committee also believes that, consistent with other aspects of Government policy dealing with foreign investment, the policy with regard to allowing foreign banks to open
offices in India either as branches or, where the Reserve Bank considers it appropriate, as subsidiaries, should be more liberal, subject to the maintenance of minimum assigned capital as may be prescribed by the Reserve Bank and the statutory requirement of reciprocity. Joint ventures between foreign banks and Indian banks could also be permitted, particularly in regard to merchant and investment banking, leasing and other newer forms of financial services.

26. Foreign banks when permitted to operate in India should be subjected to the same requirements as are applicable to domestic banks. If, in view of certain constraints such as absence of branch network, the foreign banks are unable to fulfill certain requirements such as directed credit (of 10 per cent of aggregated credit) the Reserve Bank should work out alternative methods with a view to ensuring a level playing field.

27. The Committee is of the view that the foreign operations of Indian banks need to be rationalized. In line with the structure of the banking system visualized above, there would seem to be scope for one or more of the large banks, in addition to the SBI, to have operations abroad in major international financial centres and in regions with strong Indian ethnic presence. Pending the evolution of a few Indian banks with an International character, the Committee recommends as an interim measure that those Indian banks with the largest presence abroad and strong financial position could jointly set up one or more subsidiaries to take over their existing branches abroad. The SBI operations abroad can continue and indeed be strengthened in the course of time. The Government may also consider the larger banks increasing their presence abroad by
taking over existing small banks incorporated abroad as a means of expanding their international operations.

28. The Committee believes that the internal organization of banks is best left to the judgment of the managements of individual banks, depending upon the size of the bank, its branch spread and range of functions. However, for the medium and large national banks the Committee proposes a three-tier structure in terms of head office, a zonal office and branches. In the case of very large banks, a four-tier organization, as is the case with the State Bank, with head office, zonal office, regional office and branch may be appropriate. Local banks may not need an intermediate tier between the branch and the central office.

29. The Committee endorses the view of the Rangarajan Committee on Computerisation that there is urgent need for a greater use of computerized systems than at present. Computerisation has to be recognized as an indispensable tool for improvement in customer service, the institution and operation of better control systems, greater efficiency in information technology and the betterment of the work environment for employees. These are essential requirements for banks to function effectively and profitably in the increasingly complex and competitive environment which is fast developing in the financial services segment of the economy.

30. Consistent with the Committee’s view that the integrity and internal autonomy of banks and DFIs is far more important than the question of ownership, the Committee
makes the following recommendations regarding recruitment of officers & staff and appointments of chief executives and constitution of the boards of institutions:

31. The Committee recommends that instead of having a common recruitment system for officer's individual banks should be free to make their own recruitment. Thus there is no need for setting up a Banking Service Commission for centralized recruitment of officers nor for their recruitment, as at present, through Banking Service Recruitment Boards (BSRBs). This will provide scope for the banks to scout for talent and impart new skills to their personnel. The Committee, however, makes this recommendation on the assumption that the banks will set up objective, fair and impartial recruitment procedures and, wherever appropriate, they could voluntarily come together to have a joint recruitment system. As regards clerical grades, the present system of recruitment through BSRBs may continue but Committee would urge that the appointment of the Chairman of these Boards should be totally left to the coordinating banks.

32. The Committee believes that there has to be a recognition on the part of managements and trade unions that the system cannot hope to be competitive internally and be in step with the wide-ranging innovations taking place abroad without a radical change in work technology and culture and greater flexibility in personnel policies. The committee has been reassured to know that organized labour is as much convinced of the importance of enhancing the viability and profitability of the banking industry and providing efficient customer service. It is equally incumbent on management of banks to adapt forward looking personnel policies which would help to create a satisfying work environment.
33. The Committee recommends that the various guidelines and directives issued by the Government or the Reserve Bank in regard to internal administration of the banks should be reviewed to examine their continuing relevance in the context of the need to ensure the independence and autonomy of banks. Such guidelines which relate to matters of internal administration such as creation and categorization of posts, promotion procedures and similar matters should be rescinded.

34. The Committee believes that the Indian banking system, at present, is over-regulated and over-administered. Supervision should be based on evolving prudential norms and regulations which should be adhered to rather than excessive control over administrative and other aspects of bank organization and functioning. The Committee would also like to place greater emphasis on internal audit and internal inspection systems of banks. The inspection by the supervisory authorities should be based essentially on the internal audit and inspection reports. Their main concern should be to ensure that audit and inspection machinery (which will cover the credit appraisal system and its observance) is adequate and conforms to well laid down norms.

35. The Committee is firmly of the opinion that the duality of control over the banking system between the Reserve Bank and the Banking Division of the Ministry of Finance should end and that the Reserve Bank should be the primary agency for the regulation of the banking system. The supervisory function over the banks and other financial institutions, the Committee believes, should be hived off to a separate authority to operate as a quasi-autonomous body under the aegis of the Reserve Bank but which would be
The Committee believes that consortium lending should be dispensed with and, in its place, a system of syndication or participation in lending, at the instance not only, as now, of the lenders but also of the borrowers, should be introduced. The Committee also believes that commercial banks should be encouraged to provide term finance to industry, while at the same time, the DFIs should increasingly engage in providing core working capital. This will help to enhance healthy competition between banks and DFIs. The Committee proposes that the present system of cross holding of equity and cross representation on the boards of the DFIs should be done away with. The Committee welcomes the removal of the tax concession enjoyed by IDBI as an important step in ensuring equality of treatment between various DFIs. As a further measure of enhancing competition and ensuring a level playing field, the Committee proposes that the IDBI should retain only its apex and refinancing role and that its direct lending function by transferred to a separate institution which could be incorporated as a company. The infected portion of the DFI's portfolio should be handed over to the ARF on the same terms and conditions as would apply to commercial banks.

In the case of state level institutions, it is necessary to distance them from the State Governments and ensure that they function on business principles on prudential norms and have a management set-up suited for this purpose. The Committee proposes that an action plan on these lines be worked out and implemented over the next 3 years.

As regards the role of DFIs in corporate takeovers, the Committees believe that DFIs should lend support to existing managements who have a record of conducting the affairs.
of the company in a manner beneficial to all concerned, including the shareholders, unless in their opinion the prospective new management is likely to promote the interests of the company better. In doing so Committee would expect the institution to exercise their individual professional judgement.

40. The DFIs should seek to obtain their resources from the market on competitive terms and their privileged access to concessional finance through the SLR and other arrangements should gradually be phased out over a period of three years.

41. The last decade has witnessed a considerable growth in capital market operations with the emergence of new instruments and new institutions. The capital market, however, is tightly controlled by the Government whose prior approval is invariably required for a new issue in the market, the terms of the issue and its pricing. The process of setting up Securities and Exchange Board of India (SEBI) for overseeing the operations of the market is still not complete with the legislation for this purpose yet to be enacted. The Committee believes the present restrictive environment is neither in tune with the new economic reforms nor conducive to the growth of the capital market itself.

42. The Committee strongly favours substantial and speedy liberalization of the capital market. Prior approval of agency—either Government or SEBI – for any issuer in the market should be dispensed with. The issue should be free to decide on the nature of the instrument, its terms and its pricing. The Committee would recommend, in this context, that the SEBI formulate a set of prudential guidelines designed to protect the interests of
investor, to replace the extent restrictive guidelines issued by the Controller of Capital
Issues (CCI). In view of the above, the office of the CCI will cease to have relevance. In
the Committee’s view, SEBI should not become a controlling authority substituting the
CCI, but should function more as a market regulator to see that the market is operated on
the basis of well laid down principles and conventions. The capital market should be
gradually opened up to foreign portfolio investments and simultaneously efforts should
be initiated to improve the depth of the market by facilitating issue of new types of
equities and innovative debt instruments. Towards facilitating securitization of debt,
which could increase the flow of instruments, appropriate amendments will need to be
carried out in the Stamp Act.

43. In the last decade several new institutions have appeared on the financial scene.
Merchant banks, mutual funds, leasing companies, venture capital companies and
factoring companies have now joined hire purchase companies in expanding the range of
financial services available. However, the regulatory framework for these new set of
institutions has still to be developed.

44. The Committee recommends that the supervision of these institutions which form an
integral part of the financial system should come within the preview of the new agency to
be set up for this purpose under the aegis of the RBI. The control of these institutions
should be principally confined to off-site supervision with the on-site supervision being
resorted to cases which call for active intervention. The SEBI which is charged with the
responsibility of ensuring orderly functioning of the market should have jurisdiction over
these institutions to the extent their activities impinge on market operations. In regard to mutual funds there is a good case for enacting new legislation on the lines obtaining in several countries with a view to providing an appropriate legal framework for their constitution and functioning. The present guidelines with regard to venture capital companies are unduly restrictive, and affecting the growth of this business and need to be reviewed and amended.

45. As in the case of banks and financial institutions there is need to lay down prudential norms and guidelines governing the functioning of these institutions. These prudential guidelines should relate, among other things, to capital adequacy, adherence to sound accounting and financial policies, disclosure requirements and valuations of assets. The eligibility criteria for entry, growth and exit should also be clearly stipulated so that the growth of these institutions takes place on proper lines.

46. The Committee would like to emphasise that a proper sequencing of reforms is essential. Deregulation of interest rates can only follow success in controlling fiscal deficits. Asset reconstruction, institution of capital adequacy and establishment of prudential norms with a good supervisory machinery have to be proceeded with in a phased manner over the next 3 to 5 years but, Committee believes, it is important that the process must begin in the current year itself.

47. The above set of proposals would necessitate certain amendments in existing laws which the Government should undertake expeditiously.
The Committee's approach thus seeks to consolidate the gains made in the Indian financial sector while improving the quality of the portfolio, providing greater operational flexibility and most importantly greater autonomy in the internal operations of the banks and financial institutions so as to nurture a healthy, competitive and vibrant financial sector. This will, above all else, require de-politicisation of appointments, implying at the same time a self-denial by Government and the perception that it has distanced itself from the internal decision making of the banks and the financial institutions. The proposed deregulation of the financial sector and the measures aimed at improving its health and competitive vitality would, in the Committee's view, be consistent with the steps being taken to open up the Indian economy, enable the Indian financial sector to forge closer links with the global financial markets, and enhance India's ability to take competitive advantage of the increasing international opportunities for Indian trade, industry and finance.  

BANKING SECTOR REFORMS COMMITTEE (1998):

The Finance Ministry of Govt. of India appointed once again a committee under the chairmanship of Sri M. Narasimhan to recommend reforms of the Indian banking sector. Reviewing the developments that have taken place during the period 1991-98, the committee made recommendations for reforming the banking sector. The Report was submitted in April 1998.

NARASIMHAM COMMITTEE (II)

The following are the recommendations of Narasimham Committee –II on Banking Sector:
1. The Committee suggests that pending the emergence of markets in India where market risks can be covered, it would be desirable that capital adequacy requirements take into account market risks in addition to the credit risks.

2. In the next three years, the entire portfolio of Government securities should be marked to market and this schedule of adjustment should be announced at the earliest. It would be appropriate that there should be a 5% weight for market risk for Government and approved securities.

3. The risk weight for a Government guaranteed advance should be the same as for other advances. To ensure that banks do not suddenly face difficulties in meeting the capital adequacy requirement, the new prescription on risk weight for Government guaranteed advances should be made prospective from the time the new prescription is put in place.

4. There is an additional capital requirement of 5% of the foreign exchange open position limit. Such risks should be integrated into the calculation of risk weighted assets. The Committee recommends that the foreign exchange open position limits should carry a 100% risk weight.

5. The Committee accordingly recommends that the minimum capital to risk assets ratio be increased to 10% from its present level of 8%.

6. In respect of PSBs, the additional capital requirement will have to come from either the
Government, or the market. With the many demands on the budget and the continuing imperative need for fiscal consolidation, subscription to bank capital funds cannot be regarded as a priority claim on budgetary resources. Those banks which are in a position to access the capital market at home or abroad should, therefore, be encouraged to do so.

7. The Committee recommends that an asset be classified as doubtful if it is in the substandard category for 18 months in the first instance and eventually for 12 months and loss if it has been so identified but not written off. These norms, which should be regarded as the minimum, may be brought into force in a phased manner.

8. The Committee has noted that NPA figures do not include advances covered by Government guarantees which have turned sticky and which in the absence of such guarantees would have been classified as NPAs. The Committee is of the view that for the purposes of evaluating the quality of asset portfolio such advances should be treated as NPAs. If, however, for reason of the sovereign guarantee argument such advances are excluded from computation, the Committee would recommend that Government guaranteed advances which otherwise would have been classified as NPAs should be separately shown as an aspect of fuller disclosure and greater transparency of operations.

9. Banks and financial institutions should avoid the practice of "ever greening" by making fresh advances to their troubled constituents only with a view to settling interest dues and avoiding classification of the loans in question as NPAs.
10. The Committee believes that the objective should be to reduce the average level of net NPAs for all banks to below 5% by the year 2000 and to 3% by 2002.

11. For banks with a high NPA portfolio, the Committee suggests consideration of two alternative approaches to the problem as an alternative to the ARF proposal made by the earlier CFS.

12. Directed credit has a proportionately higher share in NPA portfolio of banks and has been one of the factors in erosion in the quality of bank assets. There is continuing need for banks to extend credit to agriculture and small scale sector which are important segments of the national economy, on commercial considerations and on the basis of creditworthiness. In this process, there is scope for correcting the distortions arising out of directed credit and its impact on banks' assets quality.

13. The Committee has noted the reasons why the Government could not accept the Recommendation for reducing the scope of directed credit under priority sector from 40% to 10%.

14. With regard to income recognition, in India, income stops accruing when interest or instalment of principal is not paid within 180 days. The Committee believes that we should move towards international practices in this regard and recommends the introduction of the norm of 90 days in a phased manner by the year 2002.
15. At present, there is no requirement in India for a general provision on standard assets. In the Committee’s view a general provision, say, of 1% would be appropriate and RBI should consider its introduction in a phased manner.

16. Banks should also pay greater attention to asset liability management to avoid mismatches and to cover, among others, liquidity and interest rate risks.

17. Banks should be encouraged to adopt statistical risk management techniques like Value-at-Risk in respect of balance sheet items which are susceptible to market price fluctuations, forex rate volatility and interest rate changes. While the Reserve Bank may initially, prescribe certain normative models for market risk management, the ultimate objective should be that of banks building up their own models and RBI backtesting them for their validity on a periodical basis.

18. Banks should bring out revised Operational Manuals and update them regularly, keeping in view the emerging needs and ensure adherence to the instructions so that these operations are conducted in the best interest of a bank and with a view to promoting good customer service. These should form the basic objective of internal control systems, the major components of which are: (1) Internal Inspection and Audit, including concurrent audit, (2) Submission of Control Returns by branches/controlling offices to higher level offices (3) Visits by controlling officials to the field level offices (4) Risk management systems (5) Simplification of documentation, procedure and of inter office communication channels.
19. An area requiring close scrutiny in the coming years would be computer audit, in view of large scale usage and reliance on information technology.

20. There is enough international experience to show the dangers to an institution arising out of inadequate reporting to and checking by the back offices of trading transactions and positions taken. Banks should pay special attention to this aspect.

21. There is need to institute an independent loan review mechanism especially for large borrowal accounts and systems to identify potential NPAs. It would be desirable that banks evolve a filtering mechanism by stipulating in-house prudential limits beyond which exposures on single/group borrowers are taken keeping in view their risk profile as revealed through credit rating and other relevant factors. Further, in-house limits could be thought of to limit the concentration of large exposures and industry/sector/geographical exposures within the Board approved exposure limits and proper overseeing of these by the senior management/boards.

22. The Committee feels that the present practice of RBI selection of statutory auditors for banks with Board of Directors having no role in the appointment process, is not conducive to sound corporate governance. We would recommend that the RBI may review the existing practice in this regard. It may also reassess the role and function of the Standing Advisory Committee on Bank Audit in the light of the setting up of the Audit Committee under the aegis of the Board for Financial Supervision.
23. The Committee notes that public sector banks and financial institutions have yet to introduce a system of recruiting skilled manpower from the open market.

24. It seems apparent that there are varying levels of over manning in public sector banks. The managements of individual banks must initiate steps to measure what adjustments in the size of their work force is necessary for the banks to remain efficient, competitive and viable. Surplus staff, where identified, would need to be redeployed on new business and activities, where necessary after suitable retraining. It is possible that even after this some of the excess staff may not be suitable for redeployment on grounds of aptitude and mobility. It will, therefore, be necessary to introduce an appropriate Voluntary Retirement Scheme with incentives. The managements of banks would need to initiate dialogue in this area with representatives of labour.

25. The Committee would urge the managements of Indian banks to review the changing training needs in individual banks keeping in mind their own business environment and to address these urgently.

26. The Committee has tried to list out series of implementation steps for achieving rapid induction of information technology in the banking system. Further, information and control systems need to be developed in several areas like Better tracking of spreads, costs and NPAs for higher profitability. Accurate and timely information for strategic decisions to identify and promote profitable products and customers. Risk and Asset-Liability management; and Efficient Treasury management.
27. Mergers between banks and between banks and DFIs and NBFCs need to be based on synergies and locational and business specific complimentarities of the concerned institutions and must obviously make sound commercial sense.

28. A ‘weak bank’ should be one whose accumulated losses and net NPAs exceed its net worth or one whose operating profits less its income on recapitalisation bonds is negative for three consecutive years.

29. The policy of licensing new private banks (other than local area banks) may continue. The start up capital requirements of Rs.100 crore were set in 1993 and these may be reviewed.

30. The Committee is of the view that foreign banks may be allowed to set up subsidiaries or joint ventures in India. Such subsidiaries or joint ventures should be treated on par with other private banks and subject to the same conditions with regard to branches and directed credit as these banks.

31. There must be clearly defined prudent limits beyond which banks should not be allowed to rely on the call money market. This would reduce the problem of vulnerability of chronic borrowers. Access to the call market should be essentially for meeting unforeseen swings and not as a regular means of financing banks’ lending operations.

32. The minimum period of FD be reduced to 15 days and all money market instruments should likewise have a similar reduced minimum duration.
33. Foreign institutional investors should be given access to the Treasury Bill market. Broadening the market by increasing the participants would provide depth to the market.

34. The Committee also recommends that a distinction be made between NPAs arising out of client specific and institution specific reasons and general (agro-climatic and environmental issues) factors. While there should be no concession in treatment of NPAs arising from client specific reasons, any decision to declare a particular crop or product or a particular region to be distress hit should be taken purely on techno-economic consideration by a technical body like NABARD.

35. As a measure of improving the efficiency and imparting a measure of flexibility the committee recommends consideration of the debt securitisation concept within the priority sector. This could enable banks, which are not able to reach the priority sector target to purchase the debt from the institutions, which are able to lend beyond their mandated percentage.

36. Banks should devise appropriate criteria suited to the small industrial sector and be responsive to its genuine credit needs but this should not be by sacrificing cannons of sound banking. Borrowers also need to accept credit discipline. There is also need to review the present institutional set up of state level financial/industrial development institutions.
37. There is a need for all market participants to take note of the core principles and to formally announce full accession to these principles and their full and effective implementation.

38. Proprietorial concerns in the case of public sector banks impact on the regulatory function leading to a situation of ‘regulatory capture’ affecting the quality of regulation.

39. The Committee recommends that the regulatory and supervisory authorities should take note of the developments taking place elsewhere in the area of devising effective regulatory norms and to apply them in India taking into account the special characteristics but not in any way diluting the rigour of the norms so that the prescriptions match the best practices abroad.

40. An important aspect of regulatory concern should be ensuring transparency and credibility particularly as we move into a more market driven system where the market should be enabled to form its judgement about the soundness of an institution. There should be punitive penalties both for the inaccurate reporting to the supervisor or inaccurate disclosures to the public and transgressions in spirit of the regulations.

41. With the advent of computerisation there is need for clarity in the law regarding the evidentiary value of computer generated documents. The Shere Committee had made some Recommendations in this regard and the Committee notes that the Government is having consultations with public sector banks in this matter. With electronic funds
transfer several issues regarding authentication of payment instruments, etc. require to be clarified. The Committee recommends that a group be constituted by the Reserve Bank to work out the detailed proposals in this regard and implement them in a time bound manner.

42. The Committee recommends that the RBI should totally withdraw from the primary market in 91 days Treasury Bills; the RBI could, of course, have a presence in the secondary market for 91 days Treasury Bills. If the 91 days Treasury Bill rate reflects money market conditions, the money and securities market would develop an integral link. ...The Committee also recommends that foreign institutional investors should be given access to the Treasury Bill market.

After Narasimham Committee (II), the reforms in the banking industry was studied by various committees constituted by RBI.

<table>
<thead>
<tr>
<th>TITLE OF THE REPORT</th>
<th>DATE OF SUBMISSION</th>
<th>CHAIRMAN</th>
</tr>
</thead>
<tbody>
<tr>
<td>Report of the Committee on Technology Upgradation in the Banking Sector</td>
<td>July 17, 1999</td>
<td>Dr A. Vasudevan</td>
</tr>
<tr>
<td>Report of the Working Group on Restructuring Weak Public Sector Banks</td>
<td>Oct. 4, 1999</td>
<td>Shri M.S. Verma</td>
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</table>
Report of Informal Group on Valuation of Banks’ Investments Portfolio Nov. 3, 1999 Dr.T.C. Nair

Report of The In-house Working Group On Asset Securitisation Dec.29, 1999 Shri V.S.N. Murthy


Report of The Core Group on Voluntary Disclosure Norms for State Governments Jan. 12, 2001 Dr.Y.V.Reddy


Report of the Inter-Departmental Group to study the Rationalisation of Current account Facility with Reserve Bank of India May 2001 Shri K.W. Korgaonkar

Report on Internet Banking June 22, 2001 Shri S.R.Mittal

Report of the Expert Committee on Legal Aspects of Bank Frauds Aug 31, 2001 Dr.N.L. Mitra


Committee on Banking Sector Reforms (Narasimham Committee II) - Action taken on the recommendations Oct 31, 2001 CGM-in-Charge DBOD

Information systems audit policy for the banking and financial sector October 2001 Dr. R.B.Burman

Report of the Consultative Group of Directors of Banks / Financial Institutions April 2002 Dr. A.S. Ganguly


Committee on Payment Systems October 2002 Dr. R.H. Patil

Report of the Working Group on Rupee Derivatives Nov 7, 2002 Shri Jaspal Bindra

Report on Trend and Progress of Banking in India 2001-02 Nov 15, 2002 RBI

Report of the Committee on Computer Audit December 2002 Shri A.L. Narasimhan

Working Group on Cheque Truncation and E-cheques July 2003 Dr. Barman

Micro finance Aug, 2003 Shri Vepa Kamesam

Report on Trend and Progress of Banking in India, 2002-03 Nov 17, 2003 RBI


Rupee Interest Rate Derivatives Dec, 2003 Shri G. Padmanabhan


The Standing Committee on International Financial Standards and Codes

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 a 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 operations in exchange for a share of future expected profits. The venture capitalists 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 say 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 securedly placed inside the walls of bank's premises. While a weighing machine measures 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 employee 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 10000, 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
TABLE 1.3 DETAILS OF ATM'S IN PSB'S

<table>
<thead>
<tr>
<th>Name of the Bank</th>
<th>No. of ATM's</th>
</tr>
</thead>
<tbody>
<tr>
<td>Allahabad Bank</td>
<td>47</td>
</tr>
<tr>
<td>Andhra Bank</td>
<td>220</td>
</tr>
<tr>
<td>Bank of Baroda</td>
<td>50</td>
</tr>
<tr>
<td>Bank of India</td>
<td>150</td>
</tr>
<tr>
<td>Canara Bank</td>
<td>251</td>
</tr>
<tr>
<td>Corporation Bank</td>
<td>475</td>
</tr>
<tr>
<td>Indian Overseas Bank</td>
<td>130</td>
</tr>
<tr>
<td>Oriental Bank of Commerce</td>
<td>58</td>
</tr>
<tr>
<td>Punjab National Bank</td>
<td>242</td>
</tr>
<tr>
<td>Syndicate Bank</td>
<td>50</td>
</tr>
<tr>
<td>Union Bank</td>
<td>33</td>
</tr>
<tr>
<td>Vijaya Bank</td>
<td>18</td>
</tr>
<tr>
<td>SBI Associates</td>
<td>1360</td>
</tr>
</tbody>
</table>


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 located 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.32
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.33

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 Center 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.  

**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{35}

\textbf{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.\textsuperscript{36}

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.\textsuperscript{37}

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’s 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.

**SWOT ANALYSIS OF PSBs**:38

In the wake of Globalisation and Cut Throat competition, it is imperative to know the Strengths and Weaknesses of Public Sector Banks. The sweeping economic reforms may pose Threats and offer Opportunities.

An attempt is made to know the SWOT analysis of PSBs

**Strengths**

The following are the Strengths:

❖ An extensive branch network
❖ Large clientele
❖ Diversified credit pattern
❖ Skilled labour force and expertise

**Weaknesses**

The following are the Weaknesses of PSBs:

❖ Alarming level of NPAs
❖ Poor capital base
❖ Un-remunerative business and branches
❖ Lack of Autonomy

**Opportunities:**

Public Sector Banks have immense opportunities which are given as under
Liberalisation of the economy
Infrastructure development
Existence untapped potential
Adoption of modern technology

Threats:

Public Sector Banks are surrounded by Threats which are given as under

- Competition from new banks
- Increasing cost of operations
- Financial disintermediation
- Implication of globalisation
Table 1.4 – Showing the Profile of Public Sector Banks

<table>
<thead>
<tr>
<th>S.No</th>
<th>Name of the PSB</th>
<th>Year of Establishment</th>
<th>Head Office</th>
<th>Chairman &amp; Managing Director</th>
<th>No. of Branches in India</th>
<th>No. of Rural Branches in Kurnool Dt.</th>
<th>No. of Urban Branches in Kurnool Dt.</th>
<th>Total No of Branches in Kurnool Dt.</th>
</tr>
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<tbody>
<tr>
<td>1</td>
<td>Andhra Bank</td>
<td>1923</td>
<td>Hyderabad</td>
<td>B.Vasanthan</td>
<td>1128</td>
<td>6</td>
<td>19</td>
<td>25</td>
</tr>
<tr>
<td>2</td>
<td>Allahabad Bank</td>
<td>1865</td>
<td>Kolkata</td>
<td>B.Samal</td>
<td>1935</td>
<td>Nil</td>
<td>Nil</td>
<td>Nil</td>
</tr>
<tr>
<td>3</td>
<td>Bank of Baroda</td>
<td>1908</td>
<td>Mumbai</td>
<td>P.S.Shenoy</td>
<td>2692</td>
<td>Nil</td>
<td>1</td>
<td>1</td>
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<tr>
<td>4</td>
<td>Bank of India</td>
<td>1906</td>
<td>Mumbai</td>
<td>M.Venugopalan</td>
<td>2562</td>
<td>Nil</td>
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<td>1</td>
</tr>
<tr>
<td>5</td>
<td>Bank of Maharashtra</td>
<td>1935</td>
<td>Mumbai</td>
<td>S.C.Basu</td>
<td>1276</td>
<td>Nil</td>
<td>Nil</td>
<td>Nil</td>
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<tr>
<td>6</td>
<td>Canara Bank</td>
<td>1906</td>
<td>Mumbai</td>
<td>R.V.Shastri</td>
<td>2469</td>
<td>4</td>
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<td>7</td>
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<td>7</td>
<td>Central Bank of India</td>
<td>1911</td>
<td>Mumbai</td>
<td>Dr. Dalbir Singh</td>
<td>3130</td>
<td>1</td>
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<td>3</td>
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<tr>
<td>8</td>
<td>Corporation Bank</td>
<td>1906</td>
<td>Mumbai</td>
<td>K.Cherian Varghese</td>
<td>722</td>
<td>Nil</td>
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<td>9</td>
<td>Dena Bank</td>
<td>1938</td>
<td></td>
<td>A.G.Joshi</td>
<td>1135</td>
<td>Nil</td>
<td>Nil</td>
<td>Nil</td>
</tr>
<tr>
<td>S.No</td>
<td>Name of the PSB</td>
<td>Year of Establishment</td>
<td>Head Office</td>
<td>Chairman &amp; Managing Director</td>
<td>No. of Branches in India</td>
<td>No. of Rural Branches in Kurnool Dt.</td>
<td>No. of Urban Branches in Kurnool Dt.</td>
<td>Total No. of Branches in Kurnool Dt.</td>
</tr>
<tr>
<td>------</td>
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<td>10</td>
<td>Indian Bank</td>
<td>1907</td>
<td>Chennai</td>
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<td>1376</td>
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<td>11</td>
<td>Indian Overseas Bank</td>
<td>1936</td>
<td>S.S.Guptha</td>
<td>1462</td>
<td>Nil</td>
<td>3</td>
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<td>12</td>
<td>Oriental Bank of Commerce</td>
<td>1943</td>
<td>Delhi</td>
<td>B.D.Narang</td>
<td>1013</td>
<td>Nil</td>
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<td>13</td>
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<td>1895</td>
<td>Delhi</td>
<td>S.S. Kohli</td>
<td>4022</td>
<td>Nil</td>
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<tr>
<td>14</td>
<td>Punjab and Sindh Bank</td>
<td>1908</td>
<td>Delhi</td>
<td>N.S.Gujral</td>
<td>760</td>
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<tr>
<td>15</td>
<td>Syndicate Bank</td>
<td>1925</td>
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<td>Michael Bastian</td>
<td>1767</td>
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<td>16</td>
<td>Union Bank of India</td>
<td>1919</td>
<td>Mumbai</td>
<td>V.Leeladhar</td>
<td>2020</td>
<td>Nil</td>
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<td>17</td>
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<td>1980</td>
<td>Bangalore</td>
<td>M.S.Kapur</td>
<td>866</td>
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<tr>
<td>S. No.</td>
<td>Name of the PSB</td>
<td>Year of Establishment</td>
<td>Head Office</td>
<td>Chairman</td>
<td>Managing Director</td>
<td>Total No. of Branches in Kurnool Dt.</td>
<td>No. of Urban Branches in Kurnool</td>
<td>No. of Rural Branches in Kurnool</td>
</tr>
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<tr>
<td>20</td>
<td>State Bank of India</td>
<td>1955</td>
<td>Mumbai</td>
<td>A.K. Purwar</td>
<td>P.N. Venkatachalram</td>
<td>9039</td>
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<td>State Bank of Indore</td>
<td>1960</td>
<td>Indore</td>
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<td>M. Sin Rama Murthy</td>
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<td>Mysore</td>
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<td>A.K. Das</td>
<td>621</td>
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<td>State Bank of Patiala</td>
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<td>Patiala</td>
<td>Janaki Balliah</td>
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<td>1945</td>
<td>Travancore</td>
<td>Janaki Balliah</td>
<td>Amitabha Guha</td>
<td>668</td>
<td>Nil</td>
<td>Nil</td>
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</table>
REFERENCES:


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