CHAPTER NO.1

INTRODUCTION AND HISTORY OF BANKING

<table>
<thead>
<tr>
<th>CONTENT OF CHAPTER I</th>
<th>PAGE NO</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.1) INTRODUCTION</td>
<td>3</td>
</tr>
<tr>
<td>1.2) HISTORY OF BANKING IN THE WORD</td>
<td>3</td>
</tr>
<tr>
<td>1.3) HISTORY OF BANKING IN INDIA</td>
<td>13</td>
</tr>
<tr>
<td>1.4) HISTORY OF BANKING IN IRAN</td>
<td>20</td>
</tr>
<tr>
<td>1.5) WORD BANK</td>
<td>29</td>
</tr>
<tr>
<td>1.6) PRIVATE BANKS AND PRIVATE BANKING</td>
<td>32</td>
</tr>
<tr>
<td>1.7) IMPORTANCE OF BANKS</td>
<td>33</td>
</tr>
<tr>
<td>1.8) ROLE OF BANKS</td>
<td>34</td>
</tr>
<tr>
<td>1.9) CHAPTER SCHEME</td>
<td>37</td>
</tr>
</tbody>
</table>
1.1) INTRODUCTION:

One of essential per-requirements for developing economic activities in various sectors is to reach needed financial sources to active people in these sectors. This important duty is performed by different organization or which are active in financial market like bank. Commercial banks, financial organization or agents are dominating in financial market of most countries. The main trend of commercial banks- according to their nature-is to give short-term facilities, while accommodations development process need long-term financial sources, supplying long-term required financial sources encounters some restriction through this market because of lack of appropriate fund market so that professional-development bank have been created for responding this need and filling the vacancy from lack of organization fund market. Since Private Sector banks pay more facilities than other banks and they have also play more important role in Iranian money market and Indian money market, so the necessity and significance of study of this subject will be more noticeable.

1.2) HISTORY OF BANKING IN THE WORD:

The first banks were probably the religious temples of the ancient world, and were probably established sometime during the 3rd millennium B.C. Banks probably predated the invention of money. Deposits initially consisted of grain and later other goods including cattle, agricultural implements, and eventually precious metals such as gold, in the form of easy-to-carry compressed plates. Temples and places were the safest places to store gold as they were constantly attended and well built. As sacred places, temples presented an extra deterrent to would-be thieves. There are extant records of loans from the 18th century BC in Babylon that were made by temple priests to merchants. By the time of Hammurabi’s Code, banking
was well enough developed to justify the promulgation of laws governing banking operations.

Ancient Greece holds further evidence of banking. Greek temples, as well as private and civic entities, conducted financial transactions such as loans, deposits, currency exchange, and validation of coinage. There is evidence too of credit, whereby in return for a payment from a client, a money lender in one Greek port would write a credit note for the client who could “cash” the note in another city, saving the client the danger of carting coinage with him on his journey. Pythius, who operated as a merchant banker throughout Asia Minor at the beginning of the 5th Century B.C., is the first individual banker of whom we have records. Many of the early bankers in Greek city-states were “metics” or foreign residents. Around 371 B.C., passion, a slave, became the wealthiest and most famous Greek banker, gaining his freedom and Athenian citizenship in the process.

The fourth century B.C., saw increased use of credit-based banking in the Mediterranean world. In Egypt, from early times, grain had been used as a form of money in addition to precious metals, and state granaries functioned as banks. When Egypt fell under the rule of a Greek dynasty, the Ptolemies (330-323 B.C.), the numerous scattered government granaries were transformed into a network of grain banks, centralized in Alexandria where the main accounts from all the state granary banks were recorded. This banking network functioned as a trade credit system in which payments were effected by transfer from one account to another without money passing.

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

Ancient Rome perfected the administrative aspect of banking and saw greater regulation of financial institutions and financial practices. Charging interest on loans and paying interest on deposits became more highly developed and competitive. The development of Roman banks was limited, however, by the Roman preference for cash transactions. During the reign of the Roman emperor Gallienus (260-268 CE), there was a temporary breakdown of the Roman banking system after the banks rejected the flakes of copper produced by his mints. With the ascent of Christianity, banking became subject to additional restrictions, as the charging of interest was seen as immoral. After the fall of Rome, banking was abandoned in Western Europe and did not revive until the time of the crusades.

Most early religious systems in the ancient Near East, and the secular codes arising from them, did not forbid usury. These societies regarded inanimate matter as alive, like plants, animals and people and capable of reproducing itself. Hence if you lent ‘food money’, or monetary tokens of any kind, it was legitimate to change interest. Food money in the shape of olives, dates, seeds or animals was lent out as early as C.5000 BC, if not earlier. Among the Mesopotamians, Hittites, Phoenicians and Egyptians, interest was legal and often mixed by the state. But the Jews took a different view of the matter.

The Torah and later sections of the Hebrew Bible criticize interest-taking, but interpretations of the Biblica prohibition vary. One common
understanding is that Jews are forbidden to charge interest upon loans made to other Jews, but allowed to change interest on transactions with non-Jews, or Gentiles. However, the Hebrew Bible itself gives numerous examples where this provision was evaded.

However, the Hebrew Bible itself gives numerous examples where this provision was evaded. Johnson holds that the Hebrew Bible treats the lending as philanthropy in a poor community whose aim was collective survival, but which is not obliged to be charitable towards outsiders.

Jews were ostracized from most professions by local rulers, the Church and the guilds and so were pushed into marginal occupations considered socially inferior, such as tax and rent collecting and money lending, while the provision of financial services were increasingly demanded by the expansion of European trade and commerce. Medieval trade fairs, such as the one in Hamburg, contributed to the growth of banking in a curious way: moneychangers issued documents redeemable at other fairs, in exchange for hard currency. These documents could be cashed at another fair in a different country or at a future fair in the same location. If redeemable at a future date, they would often be discounted by an amount comparable to a rate of interest. Eventually, these documents evolved into bills of exchange, which could be redeemed at any office of the issuing banker. These bills made it possible to transfer large sums of money without the complications of hauling large chests of gold and hiring armed guards to protect the gold from thieves.

Beginning around 1100, the need to transfer large of money to finance the Crusades stimulated the reemergence of banking in western Europe. In 1156, in Genoa, occurred the earliest known foreign exchange contract. Two brothers borrowed 115 Genoese pounds and agreed to reimburse the bank’s
agents in Constantinople the sum of 460 bezants on month after their arrival in that city. In the following century the use of such contracts grew rapidly, particularly since profits form time differences were seen as not infringing canon laws against usury. In 11672, Henry II levied a tax to support the crusades – the first of a series of taxes levied by Henry over the years with the same objective. The Templars and hospitalers acted as Henry’s bankers in the Holy Land. The Templars’ wide flung, large land holdings across Europe also emerged in the 1100-1300 time frame as the beginning of Europe-wide banking, as their practice was to take in local currency, for which a demand note would be given that would be good at any of their castles across Europe, allowing movement of money without the usual risk of robbery while traveling.

By 1200 there was a large and growing volume of long-distance and international trade in a number of agricultural commodities and manufactured goods in Western Europe, including corn, wool, finished cloth, wine, salt, wax and tallow, leather and leather goods, and weapons and armour. Individual trading concerns and combines often specialized in one or more of these, as did individual procedures; because a large amount of capital was required to establish, e.g., a cloth manufacturing business, only the largest firms could diversify. As a result, businesses and clusters of businesses tended to market fairly narrow product lines. Big firms like the Medici bank could and did specialize; the Medici’s manufacturing division had a number of manufacturing facilities producing many different types of cloth. Perhaps the best example of product policy comes from the Cistercian monastic order, where individual monasteries and granges tended to specialize in particular agricultural products or types of industrial production, usually with an eye to meeting particular local or regional market needs.
Ironically, the Papal bankers were the most successful of the Western world. When Pope John XXII (born Jacques d’Euse (1249-1334) was crowned in Lyon in 1316, he set up residency in Avignon. Civil war in Florence between the rival Guelph and Ghibelline factions resulted in victory for a group of Guelph merchant facilities in the city. They took over papal banking monopolies from rivals in nearby Siena and became tax collectors for the Pope throughout Europe. In 1306, Philip IV expelled Jews from France. In 1311 he expelled Italian bankers and collected their outstanding credit. In 1327, Avignon had 43 branches of Italian banking houses. In 1347, Edward III of England defaulted on loans. Later there was the bankruptcy of the Peruzzi (1374) and Bardi (1353).

The accompanying growth of Italian banking in France was the start of Lombard moneychanger in Europe, who moved from city to city along the busy pilgrim routes important for trade. Key cities in this period were Cahors, the birthplace of People John XXII, and Figeac. Perhaps it was because of these origins that the term Limbard is synonymous with Cahorsin in medieval Europe, and means ‘pawnbroker’. Banca Monte dei Paschi di Siena SPA (MPS) Italy is the oldest surviving bank in the world.

After 1400, political forces turned against the methods of the Italian free enterprise bankers. In 1401, King Martin I of Aragon expelled them. In 1403, Henry IV of England prohibited them from taking profits in any way in his kingdom. In 1409, Flanders imprisoned and then expelled Genoese bankers. In 1410, all Italian merchants were expelled from Paris. In 1401, the Bank of Barcelona was founded. In 1407, the Bank of St. George was founded in Genoa. This bank dominated business in the Mediterranean. In 1403 charging interest on loans was ruled legal in Florence despite the traditional Christian prohibition of usury. Italian banks such as the Lombard’s, who had agents in the main economic centers of Europe, had
been making charges for loans. The lawyer and theologian Lorenzo di
Antonio Ridolfi won a case which legalized interest payments by the
Florentine government. In 1413, Giovanni di Bicci de’Medici appointed
bankers to the pope. In 1440, Gutenberg invests the modern printing press
although Europe already knew of the use of paper money in China. The
printing press design was subsequently modified, by Leonardo da Vinci
among others, for use in minting coins nearly two centuries before printed
banknotes were produced in the West.

By the 1390s silver was short all over Europe, except in Venice. The silver
mines at Kutna Hora had begun to decline in the 1370s, and finally closed
down after being sacked by King Sigismund in 1422. By 1450 almost all of
the mints of northwest Europe had closed down for lack of silver. The last
money-changer in the major French port of Dieppe went out of business in
1446. In 1455 the Turks overran the Serbian silver mines, and in 1460
captured the last Bosnian mine. The last Venetian silver grosso was minted
in 1462. Several Venetian banks failed, and so did the Strozzi bank of
Florence, the second largest in the city. Even the smallest of small change
became scarce.

Modern Western economic and financial history is usually traced back to
the coffee houses of London. The London Royal Exchange was established
in 1565. At that time moneychangers were already called bankers, through
the term “bank” usually referred to their offices, and did not carry the
meaning it does today. There was also a hierarchical order among
professionals; at the top were the bankers who did business with heads of
the state, next were the city exchanges, and at the bottom were the pawn
shops or “Lombard’s”. Some European cities today have a Lombard street
where the pawn shop was located. After the siege of Antwerp trade moved
to Amsterdam. In 1609 the Amsterdamsche Wisselbank (Amsterdam
Exchange Bank) was founded which made Amsterdam the financial centre of the world until the Industrial Revolution.

Banking offices were usually located near centers of trade, and in the late 17th century, the largest centers for commerce were the ports of Amsterdam, London, and Hamburg. Individuals could participate in the lucrative East India trade by purchasing bills of credit from these banks, but the price they received for commodities was dependent on the ships returning (which often didn’t happen on time) and on the cargo they carried, which often won’t according to plan. The commodities market was very volatile for this reason, and also because of the money wars that led to cargo seizures and loss of ships.

Around the time of Adam Smith (1776) there was a massive growth in the banking industry. Within the new system of ownership and investment, the State’s intervention in economic affairs was reduced and barriers to competition were removed.

In the 1970s, a number of smaller crashes tied to the policies put in place following the depression, resulted in deregulation and privatization of government owned enterprises in the 1980s, indicating that governments of industrial countries around the world found private-sector solutions to problems of economic growth and development preferable to state-operated, semi-socialist programs. This spurred a trend that was already prevalent in the business sector, large companies becoming global and dealing with customers, suppliers, manufacturing, and information centers all over the world.

Global banking and capital market services proliferated during the 1980s and 1990s as a result of a great increase in demand from companies,
governments, and financial institutions, but also because financial market conditions were buoyant and, on the whole, bullish. Interest rates in the United States declined from about 15% for two-year U.S. Treasury notes to about 5% during the 20 year period, and financial assets grew then at a rate approximately twice the rate of the world economy. Such growth rate would have been lower, in the last twenty years, were it not for the profound effects of the internationalization of financial markets especially U.S. Foreign investment, particularly from Japan, who not only provided the funds to corporations in the U.S., but also helped finance the federal government; thus, transforming the U.S. stock market by far into the largest in the world.

Nevertheless, in recent years, the dominance of U.S. financial markets has been disappearing and there has been an increasing interest in foreign stocks. The extraordinary growth of foreign financial markets results from both large increases in the pool of savings in foreign countries, such as Japan, and especially, the deregulation of foreign financial markets, which has enabled them to expand their activities. Thus, American corporations and banks have started seeking investment opportunities abroad, prompting the development in the U.S. of mutual funds specializing in trading in foreign stock markets.

Such growing internationalization and opportunity in financial services has entirely changed the competitive landscape, as now many banks have demonstrated a preference for the “Universal banking” model so prevalent in Europe. Universal banks are free to engage in all forms of financial services, make investments in client companies, and function as much as possible as a “one-stop” supplier of both retail and wholesale financial services.
Many such possible alignments could be accomplished only by large acquisitions, and there were many of them. By the end of 2000, a year in which a record level of financial services transactions with a market value of $10.5 trillion occurred, the top ten banks commanded a market share of more than 80% and the top five, 55%. Of the top ten banks ranked by market share, seven were large universal-type banks (three American and four European), and the remaining three were large U.S. investment banks who between them accounted for a 33% market share.

This growth and opportunity also led to an unexpected outcome: entrance into the market of other financial intermediaries: non-banks. Large corporate players were beginning to find their way into the financial service community, offering competition to established banks. The main services offered included insurances, pension, mutual money market and hedge funds, loans and credits and securities. Indeed, by the end of 2001 the market capitalization of the world’s largest 15 financial services providers included four non-banks.

In recent years, the process of financial innovation has advanced enormously increasing the importance and profitability of non-bank finance. Such profitability priorly restricted to the non-banking industry, has prompted the Office of the Comptroller of Currency (OCC) to encourage banks to explore other financial instruments, diversifying banks’ business as well as improving banking economic health. Hence, as the district financial instruments are being explored and adopted by the banking and non-banking industries, the distinction between different financial institutions is gradually vanishing.

The flow of transaction of goods and money in the world need a place with the special rules and regulations for dealing the goods and money. For the
first item, the places of dealing goods and money and other tools of payment appeared in Bourj in the center of Flanders Belgium in the year 1409. Later the money exchangers and money dealers gather in front of the house of famous family who was known as Wander bourse. They knew as bourse since that time. But the real bourse or money market was established in Belgium in the year 1460.

The bourses gradually divided into two sections, bourse of goods and bourse of money. One of the oldest money market which was very famous in the 18th century was capital market of the London. The London money market was the most famous market up to 1914 before the world war but later the security market of New York became the most famous one.

1.3) HISTORY OF BANKING IN INDIA:

Without a sound and effective banking system in India it cannot have a healthy economy. The banking system of India should not only be hassle free but it external and internal factors. For the past three decades India’s banking system has several outstanding achievements to its credit. The most striking in its extensive reach. It is no longer confined to only metropolitans or cosmopolitans in India. In fact, Indian banking system has reached even to the remote corners of the country. This is one of the main reasons of India’s growth process.

The government’s regular policy for Indian bank since 1969 has paid rich dividends with the nationalization of 14 major private banks of India. Not long ago, an account holder had to wait for hours at the bank counters for getting a draft or for withdrawing his own money. Today, he has a choice. Gone are days when the most efficient bank transferred money from one
branch to other in two days. Now it is simple as instant messaging or dials a pizza. Money has become the order of the day.

The first bank of India, though conservative, was established in 1786. From 1786 till today, the journey of Indian Banking System can be segregated into three distinct phases. They are as mentioned below:
. Early phase from 1786 to 1969 of Indian Banks.
. Nationalization of Indian Banks and up to 1991 prior to Indian banking sector Reforms.
. New phase of Indian Banking System with the advent of Indian Financial and Banking Sector Reforms after 1991.

Phase-I

The General Bank of India was set up in the year 1786. Next came Bank of Hindustan and Bengal Bank. The East India Company established bank of Bengal (1809), Bank of Bombay (1840) and Bank of Madras (1843) as independent units and called it Presidency banks. These three banks were amalgamated in 1920 and Imperial bank of India was established which started as private shareholders banks, mostly Europeans shareholders.

In 1865 Allhabad Bank was established and first time exclusively by Indians, Punjab National Bank Ltd. was set up in 1894 with headquarters at Lahore. Between 1906 and 1913, Bank of India, central Bank of India, Bank of Baroda, Canara Bank, Indian Bank, and Bank of Mysore were set up. Reserve Bank of India came in 1935. During the first phase the growth was very slow and banks also experienced periodic failures between 1913 and 1948. There were approximately 1100 banks, mostly small. To streamline the functioning and activities of commercial banks, the Government of India came up with The Banking companies Act, 1949.
which was later changed to Banking Regulation Act 1949 as per amending
Act of 1965 (Act No.23 of 1965). Reserve Bank of India was vested with
extensive powers for the supervision of banking in India as the Central
Banking Authority.

During those day’s public has lesser confidence in the banks. As an
aftermath deposit mobilization was slow. Abreast of it the savings bank
facility provided by the Postal department was comparatively safer.
Moreover, funds were largely given to traders.

**Phase-II**

Government took major steps in this Indian Banking Sector Reform after
independence. In 1955, it nationalized Imperial bank of India with
extensive banking facilities on a large scale especially in rural and semi-
urban areas. It formed State Bank of India to act as the principal agent of
RBI and to handle banking transactions of the Union and State
Governments all over the country. Seven banks forming subsidiary of State
Bank of India was nationalized in 1960 on 19th July, 1969 major process of
nationalization was carried out. It was the effort of the then Prime Minister
of India, Mrs. Indira Gandhi, 14 major commercial banks in the country
was nationalized. Second phase of nationalization Indian Banking Sector
Reform was carried out in 1980, more banks. This step brought 80% of the
banking segment in India under Government own.

The following are the steps taken by the Government of India to Regulate
Banking Institution Country:

- **1949**: Enactment of Banking Regulation Act.
- **1955**: Nationalization of State Bank of India
- **1959**: Nationalization of SBI subsidiaries
1961: Insurance cover extended to deposits.
1971: Creation of credit guarantee cooperation.
1975: Creation of regional rural banks.
1982: NABARD was established.
1991: Indian banking sector reformed was started.

After the nationalization of banks, the branches of the public sector bank India rose to app. 800% in deposits and advances took a huge jump by 11,000%. Banking in the sunshine of Government ownership gave the public implicit faith and immense confidence about the sustainability of these instructions.

**Phase-III**

This phase has introduced many more products and facilities in the banking sector in its reforms measure. In 1991, under the chairmanship of M. Narsimham, a committee was set up by his name which worked for the liberalization of banking practices. The country is flooded with foreign banks and their ATM stations. Efforts are being put to give a satisfactory service to customers. Phone banking and net banking is introduced. The entire system became more convenient and swift. Time is given more importance than money.

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

Money Market

Schedule Bank

Non-Schedule banks

State Cooperative Bank

Commercial Bank

Central Cooperative Bank

Non-Scheduled Commercial Bank

Bank and Primary Credit Societies

Foreign Bank

Indian Banks

Public Sector

Private Sector Schedule

State Bank of India

Nationalized Bank

Regional Rural Banks

& it’s Associates

EVENTS IN THE BANKING HISTORY IN INDIA:

<table>
<thead>
<tr>
<th>Year</th>
<th>Events</th>
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<tr>
<td>1770</td>
<td>Bank of Hindustan, the first bank in India on modern lines established.</td>
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<tr>
<td>1850</td>
<td>First general insurance company established.</td>
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<td>1875</td>
<td>Bombay Stock Exchange started formal trading</td>
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<td>1918</td>
<td>Oriental Life Insurance company established.</td>
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1921  Three Presidency banks, Bank of Bengal, Bank of Madras and Bank of Bombay, merged into Imperial Bank.

1926  Establishment of Hilton-Young Commission to suggest a Central Bank for the country

1935  Establishment of Reserve Bank of India as the Central bank

1947  Control of Capital Issues Act imposed restrictions on issue of capital.

1948  Establishment of Industrial Finance Corporation, the first DFI

1955  Imperial Bank take over by State Bank of India; Establishment of Industrial Credit and Investment Corporation of India

1956  Life Insurance Company of India came into effect; Securities Contract (Regulation) Act impacted directly and indirectly on securities trading, running of stock exchanges and prevention of undesirable transaction.

1962  Deposit Insurance Corporation established.

1963  Insertion of a new Chapter in RBI Act, 1934 to effectively supervise, control and regulate deposit-taking activities of NBFCs.

1964  Establishment of Industrial Development Bank of India

1966  Deposit insurance extended to co-operative banks

1969  Nationalization of 14 largest banks commercial banks

1973  Nationalization of general insurance companies; Foreign Exchange Regulation Act (FERA) was promulgated which provided an opportunity to develop Indian equity market.

1975  Establishment of Regional Rural Banks.

1980  Second round of nationalization of 6 commercial banks.

1982  Establishment of National Bank for Agriculture and Rural Development; First credit rating agency established in India.

1990  Establishment of Small Industries Development Bank of India.
<table>
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<th>Year</th>
<th>Event</th>
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<td>1992</td>
<td>Introduction of prudential norms for income recognition and asset classification; SEBI obtained statutory powers to promote orderly development of capital market; Incorporation of National Stock Exchange (NSE) as the first screen-based and transparent trading platform for investors; Introduction of auction system for Government securities.</td>
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<td>1993</td>
<td>Introduction of depositories</td>
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<tr>
<td>1994</td>
<td>Board for Financial Supervision, an autonomous body under the aegis of RBI, established; New guidelines for entry of new private sector banks announced; Wholesale debt market operations initiated by NSE.</td>
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<td>1996</td>
<td>Establishment of Institute for Development and Research in Banking Technology; Depositories Act was passed which allowed for holding of securities in dematerialized form.</td>
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<td>1997</td>
<td>Promulgation of RBI(Amendment) Act for intensified regulation of deposit-taking NBFCs; Termination of automatic monetization of Government deficit; Bank Rate activated as a signaling rate; Statutory Liquidity Ratio (SLR) reduced to 25% (legal minimum)</td>
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<td>1999</td>
<td>Insurance Regulation and Development Act passed allowing new players/joint ventures to undertake insurance business; Detailed guidelines on risk management in banks announced; Standing Committee on International Financial Standards and Codes set up to evolve sound standards based on recognized best practices.</td>
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<tr>
<td>2000</td>
<td>Guidelines issued regarding interest rate swaps and forward rate agreement to enable financial entities to hedge interest</td>
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rate risk; New guidelines for categorization and valuation of banks’ investment portfolio announced; Liquidity Adjustment Facility introduced; Foreign Exchange Management Act, replacing the earlier FERA, introduced.

2001 Establishment of Credit Information Bureau of India Ltd

2002 Revised guidelines announced for entry of new private banks; Enactment of SARFAESI Act for enforcement of security interest for secured creditors; Establishment of first universal bank in the country; Clearing Corporation of India limited became operational; Consolidated guidelines issued on FDI in banking.

2003 Central Listing Authority was constituted.

1.4) HISTORY OF BANKING IN IRAN²:

Before a bank in its present form was established in Iran, banking operations had been carried out in traditional form, or in other words in the form of money changing. Simultaneous with promotion of trade and business in the country, more people chose money changing as their occupation. Exchanges of coins and hard currencies were also common in Iran. Before the advent of the Cheapened Dynasty, banking operations had been carried out by temples and princes and seldom had ordinary people been engaged in this occupation. During the Cheapened era, trade boomed and subsequently banking operation expanded to an extent that Iranians manage to learn the banking method from the people of Babylon.

Following a boost in trade and use of bank notes and coins in trade during the Parthian and Sassanian eras, exchange of coin and hard currencies began in the country. Some people also managed to specialize in
determining the purity of coins. Bank notes and gold coins were first used in the country following the conquest of Lidi by Achaemenid king Darius the Great in 16 B.C. At that time, a gold coin called Derk was minted as the Iranian currency.

During Parthian and Sassanides eras, both Iranian and foreign coins were used in trade in the country. However, with the advent of Islam in Iran, money changing and use of bank notes and coins in trade faced stagnation because the new religion forbade interest in dealing. In the course of Mongol rule over Iran, a bank note which was an imitation of Chinese bank notes was put in circulation. The bank notes, called Chav bore the picture and name If Keikhatu. On one side of the bank notes there was the following sentence: “Anybody who does not accept this bank note, will be punished along with his wife and children.” The face value of the bank notes ranged from half to 10 dirhams. Besides Chav, other bank notes were used for a certain period of time in other Iranian cities and then got out of circulation. These bank notes were called ‘Shahr-Rava’ which meant something that was in use in cities.

Before the printing of first bank notes by the Bank Shahanshai (Imperial Bank), a kind of credit card called Bijak had been issued by money dealers. It was in fact a receipt of a sum of money taken by money dealers from the owners of Bijak. The credence of the Bijak depended on the creditability of the money dealer who had issued it. As mentioned before, money changing got out of fashion with the advent of Islam under which usury is strictly forbidden. At the time, only a few persons with weak religious faith continued their occupation as money dealers. It was the same persons who promoted usury even during the post-Islamic era. They offered various excuses to justify their unlawful act.
With a boost in trade during the rule of Safavid Dynasty, particularly during the reign of Shah Abbas the Great, money changing brisked again and wealthy money dealers started their international activities by opening accounts in foreign banks. Major centers for money changing at the time were Tabriz, Mashhad, Isfahan, Shiraz and Boushehr.

Money changing continued until the establishment of New East Bank in 1850. With the establishment of the bank, money changing actually came to a standstill. The New East Bank was in fact the first banking institute in its present form established in Iran. It laid the foundation of banking operations in the country. It was a British bank whose headquarters was in London. The bank was established by the British without receiving any concession from the Iranian government.

The bank opened its branches in the cities of Tabriz, Rasht, Mashhad, Esfahan, Shiraz and Boushehr. Of course, at that time foreigners were free to engage in economic and trade activities in the country without any limitations. For the first time, the New East Bank allowed individuals to open accounts, deposit their money with the bank and draw checks. It was at this time that people began to draw checks in their dealings.

In order to complete with money dealers, the bank paid interest on the fixed deposits and current accounts of its clients. The head office of the bank in Tehran issued five ‘qeran’ bank notes in the form of drafts. These drafts were used by people in the every day’s dealings and could be changed into silver coins when offered at the bank. According to a concession granted by the Iranian government to Baron Julius De Reuter in 1885, Bank Shahanshahi (Imperial Bank) was established. This bank purchased the properties and assets of the New East Bank, thus putting an end to the banking operations of the former.
These activities of Bank Shahansahi ranged from trade transactions, printing bank notes, and serving as the treasurer of the Iranian government at home and abroad in return for piecework wage. In return for receiving this concession, Reuter obliged to pay six percent of the annual net income of the bank, providing that sum should not be less than 4,000 pounds, and 16 percent of incomes form other concession to the Iranian government. The legal center of the bank was in London and it was subject to the British laws but its activities were centered in Tehran. In 1984, the right of printing bank notes was purchased from Bank Shahanshahi for a sum of 200,000 pounds and ceded to the Bank Melli of Iran.

Bank Shahanshahi continued its activities until 1948 when its name was changed into Bank of Britain in Iran and Middle East. The activities of the bank continued until 1952. In 1856, a Russian national by the name of Jacquet Polyakov, received a concession from the then government of Iran for establishment of Bank Esteqrazi for 75 year. Besides, banking and mortgage operations, the bank had an exclusive right of public auction. In 1898 the Tazrist government of Russia bought all shares of the bank for its political ends. Under a contact signed with Iran, the bank was transferred to the Iranian government in 1920. The bank continued its activities under the name of Bank Iran until 1933 when it was incorporated into the Bank Keshavarzi (Agriculture Bank).

Bank Speah was the first bank to be established with Iranian capitals in 1925 under the name of Bank Pahlavi Qoshun, in order to handle the financial affairs of the military personnel and set up their retirement fund. The capital of the bank was 388,395 tomans (3.88 million rials). With Bank Speah opening its branches in major Iranian cities, the bank began carrying financial operations such as opening (current accounts and transfer of money across the country. The Iran-Russia Bank was formed by the
The proposal to establish a national Iranian bank was first offered by a big money dealer to Qajar king Nazer-o-Din Shah before the Constitutional revolution. But the Qajar kind did not pay much attention to the proposal. However, with the establishment constitutional rule in the country, the idea of setting up a national Iranian bank in order to reduce political and economic influence of foreigners gained strength and at least in December 1906 the establishment of the bank was announced and its articles of association complied.

In April 1927, the Iranian Parliament gave final approval to the law allowing the establishment of Bank Melli of Iran. But due to problems arising from preparing a 150 million rial capital needed by the bank, the Cabinet ministers and the parliament’s financial commission approved the articles of association of the bank in the spring of 1928. The bank was established with a primary capital of 20 million rials, 40 percent of which was provided by the government. The bank formally inaugurated in September, 1928. The Central Bank of Iran was established in 1928, tasked with trade activities and other operations (acting as the treasurer of the government, printing bank notes, enforcing monetary and financial policies
and so on). The duties of the CBI included making transactions on behalf of the government, controlling trade banks, determining supply of money, foreign exchange protective measures determining the value of hard currencies against rial) and so on.

In June 1979, after the Islamic Revolution, all the Iranian banks were nationalized in order to preserve the rights of depositors and national funds, to increase industrial production of the country, and to guarantee refunding of deposits. The banking regulations changed with the approval of the Islamic banking law and the role of banks in accelerating trade deals, rendering services to clients, collecting deposits, “offering credits to applicants on the basis of the CBI’s policies and so on was strengthened. After nationalization of the banks in 1979, 37 banks have been merged into 6 commercial bank including Bank Refah, Bank Melli Iran, bank Saderat, Bank Tejarat, Bank Mellat, and Bank Sepah and 3 special banks including Bank Keshavarzi, Bank Maskan, and Mine and Industry Bank.

While government ownership of the banking system has protected depositors against possible default or bankruptcy by periodically covering bank losses in the annual budgets, banking nationalization has involved a number of serious structural flaws. The banks as a group have remained significantly under–capitalized, interspersed in too many branches, over-staffed, and run by risk-averse inexperienced managers. (Tejarat Trade, 1998).

Twenty-three years after Iran’s banking sector was nationalized in the wake of the Islamic revolution, the first full-service private bank namely Bank Karafarin received its operating license form the central Bank of the Islamic republic of Iran on 26 December 2001 after months of anticipation. Other private banks that licensed were Bank Eqtesade-e Novin and Bank
Persian and bank Saman. These three banks had been previously run as credit institutions, but since being privatized each institution have flourished as a bank. Not to all behind, two state-owned banks – bank Saderat and Bank Refah have volunteered to be denationalized, and allowed to compete with the new private banks. This near frenzy for private banking business is a reflection of the public frustration with the country’s state-owned, tightly regulated, and poorly managed, inadequately supervised, non-competing, and underdeveloped banking system.

The increasingly evident shortcomings of the system, and the leadership’s acknowledged concerns about its deficiencies, have made banking renovation and restricting a top priority in government’s economic rehabilitation agenda. But knowing the fact that the banks had been state owned for over 20 years means the process of privatization was done very carefully, and slowly.

Iranian parliament required the CBI to prepare the grounds for the activity of non-governmental banking and credit institutions and organizations set up by Iranian enteritis. The CBI has also been required to supervise those organizations, while preventing the formation and activity of illegal institutions. The policy of the CBI is to supervise setting up of private banks and fostering competition in the financial sector. There is no restriction for the establishment of private credit institutions, while there is a high demand for private banks system since the country’s banking system cannot accommodate the public’s financial needs and request at this time. Licenses for private banks will continue to be issued in the future. However, ownership of these banks is restricted to Iranian citizens.

The re-establishment of private banking revolutionized the banking practices in Iran. Iran is a country of 70 million people and it has the
world’s second largest gas reserves, and it has a flexible market. The Iranian banking system has been going through very positive reforms in the last six to seven years, and now that the government has a serious agenda for privatization this will create a positive environment for business. If privatization is fully implemented, not only will it this industry. The high quality service is the solution for these questions strengthens the economy by establishing and hopefully modernizing the uncompetitive financial system.

Knowing the fact the re-establishment of private banking revolutionized the banking practices in Iran. As the government abolishes barriers for the private sector foreign banks feel very positive about growing in Iran and they desire to be active in Iran because they feel there is a wide basis for business in Iran. (Amouzgar, 2002). In this competitive environment a very important question for every bank is how to live in the uncertainty environment and how to outstanding in this industry. The high quality service is the solution for these questions.
Structure of Iranian Money Market

- Iranian Money Market
  - Banks
  - Housing Banks
  - Co-operative Funds
  - Retirement Funds
  - Insurance Companies

The Central Bank of Iran

Government Banks
  - Specialized Bank
    - Keshavarazi Bank
    - Maskan Bank
    - San’at & Madan
  - Commercial Banks
    - Tejarat Bank
    - Mellat Bank
    - Saderat Bank
    - Sepsah Bank
    - Refah Bank
    - Melli Bank

Private Banks
  - Eghtesad-e-Novin Bank
  - Karafarin Bank
  - Saman Bank
  - Parsian Bank
  - Pasargad Bank
  - Sarmayeh Bank
1.5) WORD BANK:

The **World Bank**\(^1\) is an international financial institution that provides loans to developing countries for capital programmes. The World Bank's official goal is the reduction of poverty. By law, all of its decisions must be guided by a commitment to promote foreign investment, international trade and facilitate capital investment.

The World Bank differs from the World Bank Group, in that the World Bank comprises only two institutions: the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA), whereas the latter incorporates these two in addition to three more: International Finance Corporation (IFC), Multilateral Investment Guarantee Agency (MIGA), and International Centre for Settlement of Investment Disputes (ICSID).

**History:**

The World Bank is one of five institutions created at the Bretton Woods Conference in 1944. The International Monetary Fund, a related institution, is the second. Delegates from many countries attended the Bretton Woods Conference. The most powerful countries in attendance were the United States and United Kingdom, which dominated negotiations. Although both are based in Washington, D.C., the World Bank is, by custom, headed by an American, while the IMF is led by a European.

1945–1968

From its conception until 1967 the bank undertook a relatively low level of lending. Fiscal conservatism and careful screening of loan applications was common. Bank staff attempted to balance the priorities of providing loans
for reconstruction and development with the need to instill confidence in the bank.

Bank president John McCloy selected France to be first recipient of World Bank aid; two other applications from Poland and Chile were rejected. The loan was for $250 million, half the amount requested and came with strict conditions. Staff from the World Bank monitored the use of the funds, ensuring that the French government would present a balanced budget and give priority of debt repayment to the World Bank over other governments. The United States State Department told the French government that communist elements within the Cabinet needed to be removed. The French Government complied with this diktat and removed the Communist coalition government. Within hours the loan to France was approved.

The Marshall Plan of 1947 caused lending by the bank to change as many European countries received aid that competed with World Bank loans. Emphasis was shifted to non-European countries and until 1968, loans were earmarked for projects that would enable a borrower country to repay loans (such projects as ports, highway systems, and power plants).

1968–1980
From 1968 to 1980, the bank concentrated on meeting the basic needs of people in the developing world. The size and number of loans to borrowers was greatly increased as loan targets expanded from infrastructure into social services and other sectors.

These changes can be attributed to Robert McNamara who was appointed to the presidency in 1968 by Lyndon B. Johnson. McNamara imported a technocratic managerial style to the Bank that he had used as United States Secretary of Defense and President of the Ford Motor Company.
McNamara shifted bank policy toward measures such as building schools and hospitals, improving literacy and agricultural reform. McNamara created a new system of gathering information from potential borrower nations that enabled the bank to process loan applications much faster. To finance more loans, McNamara told bank treasurer Eugene Rotberg to seek out new sources of capital outside of the northern banks that had been the primary sources of bank funding. Rotberg used the global bond market to increase the capital available to the bank. One consequence of the period of poverty alleviation lending was the rapid rise of third world debt. From 1976 to 1980 developing world debt rose at an average annual rate of 20%.

1980–1989

In 1980, A.W. Clausen replaced McNamara after being nominated by US President Jimmy Carter. Clausen replaced a large number of bank staffers from the McNamara era and instituted a new ideological focus in the bank. The replacement of Chief Economist Hollis B. Chenery by Anne Krueger in 1982 marked a notable policy shift at the bank. Krueger was known for her criticism of development funding as well as third world governments as rent-seeking states.

Lending to service third world debt marked the period of 1980–1989. Structural adjustment policies aimed at streamlining the economies of developing nations were also a large part of World Bank policy during this period. UNICEF reported in the late 1980s that the structural adjustment programs of the World Bank were responsible for the "reduced health, nutritional and educational levels for tens of millions of children in Asia, Latin America, and Africa".
From 1989, World Bank policy changed in response to criticism from many groups. Environmental groups and NGOs were incorporated in the lending of the bank in order to mitigate the effects of the past that prompted such harsh criticism. Bank projects "include" green concerns.

1.6) PRIVATE BANKS AND PRIVATE BANKING:

Private Banks are banks that are not incorporated. A private bank is owned by either an individual or a general partner(s) with limited partner(s). In any such case, the creditors can look to both the "entirety of the bank's assets" as well as the entirety of the sole-proprietor's/general-partners' assets.

These banks have a long tradition in Switzerland, dating back to at least the revocation of the Edict of Nantes (1685). However most have now become incorporated companies, so the term is rarely true anymore. There are a few private banks remaining in the U.S. One is Brown Brothers Harriman & Co., a general partnership with about 30 members. Private banking also has a long tradition in the UK where Coutts & Co has been in business since 1692.

"Private Banks" and "private banking" can also refer to non-government owned banks in general, in contrast to government-owned (or nationalized) banks, which were prevalent in communist, socialist and some social democratic states in the 20th century. Private Banks as a form of organization should also not be confused with "Private Banks" that offer financial services to high net worth individuals and others.
**Private banking** is a term for banking, investment and other financial services provided by banks to private individuals investing sizable assets. The term "private" refers to the customer service being rendered on a more personal basis than in mass-market retail banking, usually via dedicated bank advisers. It should not be confused with a private bank, which is simply a non-incorporated banking institution.

Historically private banking has been viewed as very exclusive, only catering for high net worth individuals with liquidity over $2 million, although it is now possible to open some private bank accounts with as little as $250,000 for private investors. An institution's private banking division will provide various services such as wealth management, savings, inheritance and tax planning for their clients. A high-level form of private banking (for the especially affluent) is often referred to as wealth management. For private banking services clients pay either based on the number of transactions, the annual portfolio performance or a "flat-fee", usually calculated as a yearly percentage of the total investment amount.

The word "private" also alludes to bank secrecy and minimizing taxes through careful allocation of assets or by hiding assets from the taxing authorities. Swiss and certain offshore banks have been criticized for such cooperation with individuals practicing tax evasion. Although tax fraud is a criminal offense in Switzerland, *tax evasion* is only a civil offence, not requiring banks to notify taxing authorities.

**1.7) IMPORTANCE OF BANKS:**

Bankers play very important role in the economic life of the nation. The health of the economy is closely related to the soundness of its banking system. Although banks create no new wealth but their borrowing, lending
and related activities facilitate the process of production, distribution, exchange and consumption of wealth. In this way they become very effective partners in the process of economic development. Today modern banks are very useful for the utilization of the resources of the country. The banks are mobilizing the savings of the people for the investment purposes. If there would be no banks then a great portion of a capital of the country would remain idle. A bank as a matter of fact is just like a heart in the economic structure and the Capital provided by it is like blood in it.

As long as blood is in circulation the organs will remain sound and healthy. If the blood is not supplied to any organ then that part would become useless, so if the finance is not provided to Agricultural sector or industrial sector, it will be destroyed. Loan facility provided by banks works as an incentive to the producer to increase the production. Many difficulties in the international payments have been overcome and volume of transactions has been increased. Cheques, drafts bills of exchange and letters of credit are very important instruments of the banks. The banks collect these instruments drawn on banks in other cities or countries and proceeds according to the accounts of the customer's concerns.

1.8) ROLE OF BANKS:

Banking system and the Financial Institutions play very significant role in the economy. First and foremost is in the form of catering to the need of credit for all the sections of society. The modern economies in the world have developed primarily by making best use of the credit availability in their systems. An efficient banking system must cater to the needs of high end investors by making available high amounts of capital for big projects in the industrial, infrastructure and service sectors. At the same time, the medium and small ventures must also have credit available to them for new
investment and expansion of the existing units. Rural sector in a country like India can grow only if cheaper credit is available to the farmers for their short and medium term needs.

Credit availability for infrastructure sector is also extremely important. The success of any financial system can be fathomed by finding out the availability of reliable and adequate credit for infrastructure projects. Fortunately, during the past about one decade there has been increased participation of the private sector in infrastructure projects.

The banks and the financial institutions also cater to another important need of the society i.e. mopping up small savings at reasonable rates with several options. The common man has the option to park his savings under a few alternatives, including the small savings schemes introduced by the government from time to time and in bank deposits in the form of savings accounts, recurring deposits and time deposits. Another option is to invest in the stocks or mutual funds.

In addition to the above traditional role, the banks and the financial institutions also perform certain new-age functions which could not be thought of a couple of decades ago. The facility of internet banking enables a consumer to access and operate his bank account without actually visiting the bank premises. The facility of ATMs and the credit/debit cards has revolutionised the choices available with the customers. The banks also serve as alternative gateways for making payments on account of income tax and online payment of various bills like the telephone, electricity and tax. The bank customers can also invest their funds in various stocks or mutual funds straight from their bank accounts. In the modern day economy, where people have no time to make these payments by standing in queue, the service provided by the banks is commendable.
While the commercial banks cater to the banking needs of the people in the cities and towns, there is another category of banks that looks after the credit and banking needs of the people living in the rural areas, particularly the farmers. Regional Rural Banks (RRBs) have been sponsored by many commercial banks in several States. These banks, along with the cooperative banks, take care of the farmer-specific needs of credit and other banking facilities.

Till a few years ago, the government largely patronized the small savings schemes in which not only the interest rates were higher, but the income tax rebates and incentives were also in plenty. The bank deposits, on the other hand, did not entail such benefits. As a result, the small savings were the first choice of the investors. But for the last few years the trend has been reversed. The small savings, the bank deposits and the mutual funds have been brought at par for the purpose of incentives under the income tax. Moreover, the interest rates in the small savings schemes are no longer higher than those offered by the banks.

Banks today are free to determine their interest rates within the given limits prescribed by the RBI. It is now easier for the banks to open new branches. But the banking sector reforms are still not complete. A lot more is required to be done to revamp the public sector banks. Mergers and amalgamation is the next measure on the agenda of the government. The government is also preparing to disinvest some of its equity from the PSU banks. The option of allowing foreign direct investment beyond 50 per cent in the Indian banking sector has also been under consideration.

Banks and financial intuitions have played major role in the economic development of the country and most of the credit-related schemes of the government to uplift the poorer and the under-privileged sections have been
implemented through the banking sector. The role of the banks has been important, but it is going to be even more important in the future.

1.9) CHAPTER SCHEME

The purpose of chapter scheme is to present an introduction that other next chapters are to be followed. In other words the issues and problems under this study that through next chapters would be discussed in short view as introduction to other steps of this research are presented as follows:

Chapter 1: Introduction and history of banking
This chapter presents an introduction of this study; explain the development of banking in the World and in India and Iran; explain the importance and private banks and banking.

Chapter 2: Research Methodology
This chapter describes the approaches that are used in this study in order to the hypotheses testing of the problem under the study and provides the reader with a basis for evaluating the validity of findings, an understanding of the basis for choices that were made, so a short review is given to explain the problem under study, the objectives, hypotheses and their methodologies developed for them, are to be presented, the methodology and data instruments including collection of data and analysis of data are to be explained and at the end of this chapter the limitations of research have been expressed.

Chapter 3: Research Literature
This chapter presents an overview of the literature that related to the topic under investigation. This chapter consists of two main sections; the first section discusses the conceptual theoretical framework of banking like;
meanings of banks, the role of banks, objective of banks, the bank's financial statements, analysis of financial statements and bank audit…. The second section covers the previous research studies related to the topic.

**Chapter 4: Profile of selected banks**
In this chapter the researcher explains various aspects concerning the organizing, developing and growth of banks in Iran and India like; banks in Iran and India, reserve bank of Iran and India, money market of Iran and India and profile of selected private banks in Iran and India.

**Chapter 5: Data Analysis and hypotheses**
In this chapter on the basis of numerous collected data, various tables and charts have been presented and hypotheses on the basis of statistical methods have been tested and reported.

**Chapter 6: Findings and Suggestions**
In this chapter, the findings and necessary suggestions on the basis of findings have been presented.
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