Chapter 3

INDIAN BANKING STRUCTURE
AN OVERVIEW
3.1 Introduction

The existing banking structure in India, evolved over several decades, is elaborate and has been serving the credit and banking services needs of the economy. There are multiple layers in today's banking structure to cater to the specific and varied requirements of different customers and borrowers. The banking structure played a major role in the mobilisation of savings and promoting economic development. In the post financial sector reforms (1991) phase, the performance and strength of the banking structure improved perceptibly. Financial soundness of the Indian commercial banking system compares favourably with most of the advanced and emerging countries.

India cannot have a healthy economy without a sound and effective banking system. The banking system should be hassle free and able to meet the new challenges posed by technology and other factors, both internal and external.

In the past three decades, India's banking system has earned several outstanding achievements to its credit. The most striking is its extensive reach. It is no longer confined to metropolises or cities in India. In fact, Indian banking system has reached even to the remote corners of the country. This is one of the main aspects of India's growth story.

The government's regulation policy for banks has paid rich dividends with the nationalization of 14 major private banks in 1969. Banking today has become convenient and instant, with the account holder not having to wait for hours at the bank counter for getting a draft or for withdrawing money from his account.

3.2 Definition of Bank

Section 5(b) defines bank as accepting for the purpose of lending or investment of deposits of money from the public, repayable on demand or otherwise and withdrawal by cheque, draft, and order or otherwise. Section 49A of the Act prohibits any institution other than a banking company to accept deposit money from public withdrawal by cheque. Students may note that the essence of banking business is the function of
accepting deposits from public with the facility of withdrawal of money by cheque. In other words, the combination of the functions of acceptance of public deposits and withdrawal of the money by cheques by any institution cannot be performed without the approval of Reserve Bank.

A bank is an institution which deals in money and credit. Thus, bank is an intermediary which handles other people's money both for their advantage and to its own profit. But bank is not merely a trader in money but also an important manufacturer of money. In other words, a bank is a factory of credit.

Let us see the definitions of bank and banking, given by various authorities.

Crowther defines a bank as, "one that collects money from those who have it to spare or who are saving it out of their income and lends the money so collected to those who require it".

Dr. L. Hart, says that the bankers are "one who in the ordinary course of business; honours cheques drawn upon him by persons from and for whom he receives money on current accounts".

Sir Jhon Paget says that, "no person or body corporate otherwise can be a banker who does not, (i) take deposit accounts, (ii) take current accounts, (iii) issue and pay cheques, and (iv) collect cheques, for his customers".

Sir Kinley, "A bank is an establishment which makes to individuals such advances of money as may be required and to which individuals entrust money when not required by them for use".

Prof. Sayers says that "Banks are not merely purveyors of money but also in an important sense, manufacturers of money".

Although the above definitions have described the meaning of bank, none of them precisely defined, 'Banking' incorporating its entire functions. However, an attempt has been made in Section 5(1) (b&c) of the Banking Regulation Act, 1949 to define 'Banking' and 'Banking Company'.
According to Section 5 (1) (b), "Banking means accepting for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise and withdrawal by cheques, draft, order or otherwise".

Section 5(1) (c) defines banking company as, "any company which transacts the business of banking in India".

3.2.1 Scheduled Bank

Scheduled Banks are those banks which are listed in the Second Schedule to the Reserve Bank of India Act, 1934. The Banks satisfying the following conditions are only included in the Second Schedule.
(a) That the Bank’s paid up capital plus free reserves are not less than Rs. 5.00 lakh, and
(b) That the affairs of the Bank are not conducted to the detrimental interest of the depositors.

The Reserve Bank also has powers to deschedule a bank, when the abovementioned conditions are not satisfied. It may be noted presently, the RBI has prescribed a minimum capital of Rs. 100 crores for starting a new commercial bank.

3.2.2 Banking Company

The Banking Regulation Act, 1949 defines a banking company as a company which transacts the business of banking in India [Section 5(c)]. The development of 'Banking' is evolutionary in nature. There is no single answer to the question of what is banking, because a bank performs a multitude of functions and services which cannot be comprehended into a single definition. For a common man, a bank means a storehouse of money, for a businessman it is an institution of finance and for a worker it may be a depository for his savings.

It may be explained in brief as "Banking is what a bank does." But it is not clear enough to understand the subject in full. The Oxford Dictionary defines a bank as "an establishment for the custody of money which it pays out on a customer's order ". But this definition is also not enough, because it considers the deposit accepting and repayment functions only. The meaning of the bank can be understood only by its functions just as a
tree-is, known by its fruits. As any other subjects, it has its own origin, growth and development.

**3.3 Historical Perspective of Indian Banking**

The existence of money lending activity in India is as old as about 2000 to 1500 B.C. evident from the literature of Vedic times (Macdonnell and Keith).[1] There is however no confirmation available for professional pursuance of this activity except in the case of a community around 500 B.C The Buddhist literature also contains evidences of the existence of the bankers called *sreshthis* who were present in all the important trade centres having a far-reaching influence on the life of the community. Their chief activity was to lend money to the traders, to merchant adventurers who went to foreign countries, to explorers who marched through forests to discover valuable materials and to kings who were in financial difficulties due to war or other reasons, against the pledge of movable or immovable property or personal surety (Panandikar, 1966).[2] “Usury was practiced but was held in contempt. From the laws of Manu, it appears that money lending and allied problems had assumed considerable importance, and that deposit banking in some form had come into existence by the second or third century of the Christian era” (Ibid).[3] The evidence of banking activities is also found in the works of some Muslim historians and European travelers as well. Further the Ain-e-Akbri and the state records of that time indicate that bankers played an important role and money lending was important in Mughal era. The earliest moneychangers in India were “Seths” or “Sahukars” or “Sowcars” who dealt with this business in various parts of the country. They were mostly “Banias” belonging to the trading community and dealt with “hundies” i.e. indigenous bills of exchange and functioned simultaneously as moneylenders. They catered to the needs of agriculturists and businessmen in a similar way. They formed a significant links between the producers and middlemen. Further they advanced loans to the consumers as well. The modern concept of “Banking” has its roots in the European Continent. According to one galaxy of economists, the word ‘Bank’ has been derived from the German word “BANK” which means “joint stock of firm”. Another opinion of economists indicates that it has been derived from the Italian word ‘BANCO’ meaning “a heap or mound”. As a matter of fact, the Germans were highly influential at the time of
establishment of the Bank of Venice in 1157, this most probably was the reason behind the use the word “BANCO” by the Italians to denote the accumulation of securities with joint stock firm which later on with the passage of time came to be known as Bank. A concise description of this development is essential to get a fair historical background because the East India Company is the precursor of modern banking in India. Being European entity, it brought the concept of commercial banking from Europe. East India Company (EIC) was granted Royal Charter for the purpose of trading in 1600 A.D., the nature and volume of trade necessitated establishment of banking system to facilitate inward and outward remittances; collection and negotiation of bills, cheques, notes etc. and provision of credit.

Modern banking in India which is the form of joint stock companies may be dated back to 1786, with the establishment of the General Bank of India. In 1806, the East India Company established the first Presidency Bank in Kolkata with the name “The Bank of Calcutta Limited”. It received Royal Charter in 1809 and was renamed as the “Bank of Bengal”. In the same manner, two more banks were established in 1840 and 1843 named “Bank of Bombay” and “Bank of Madras”, respectively. The Royal Charter governed the three Presidency banks, which was revised from time to time. There were no legally recognised commercial banks with special right within India other than the Presidency banks. The East India Company’s government reserved the right to regulate the monetary and credit system to itself. The Paper Currency Act of 1861 abolished the right to issue currency notes bestowed upon the Presidency banks. The only authority now empowered to perform this function was the Government. January 1868 marked the establishment of the New Bank of Bombay on the collapse of Bank of Bombay. Further in 1876 the Presidency Bank Act came into existence, which brought the three Presidency banks under the common statute and restriction on business. In terms of Act XI of 1876, the Government of India decided on strict enforcement of the charter and the periodic inspection of the books of these banks. Up to the year 1919, these banks had 70 branches as (26+18+26 respectively), and they were mostly established in the port towns. Under the Imperial Bank of India Act, 1920, these three banks were directed to merge together. In 1921, the three Presidency banks and their branches were amalgamated to form one
strong bank i.e., the Imperial Bank of India. A directive was issued to this bank to open 100 branches in 5 years at potential mandi (trade) towns for the improvement of trade. Imperial Bank of India was formed with the objective to develop it into a Central Bank of the country. However, the Hilton-Young Commission recommended that a separate bank be created to function as the Central Bank of the country which was proposed to be named as the ‘Reserve Bank of India’. Before the establishment of such central entity, the Imperial Bank of India was allowed to discharge all the functions of the central Bank such as, currency and credit, public debt, government receipts and disbursements, management and issue of securities and bonds, banker’s bank, facilitator for remittances to public and banks at rates prescribed and controlled by the government, also to function as sole banker to the government etc.. The Allahabad Bank and the Punjab National Bank were established in 1865 and 1894 respectively. Some other large banks of today, namely, the Bank of India, the Central Bank of India, the Bank of Baroda, the Canara bank, the Indian Bank, and the Bank of Mysore were established in between 1906 to 1913. The period of 1913 to 1948 was marked by a very slow growth as well as frequent bank failures. The Banking Crisis of 1913 revealed the weaknesses of the banking system such as the maintenance of an unduly low proportion of cash and other liquid assets, the grant of large unsecured advances to the directors of banks and to the companies in which the directors were interested. After hectic and uncontrolled expansion, there followed the inevitable crash. The issue of failures of banks was investigated in details by the Indian Central Banking Enquiry Committee (1929-31), with emphasis being laid on “the regulation of banking with a view to protecting the interest of the public”. As per the suggestions of the Report of this Committee the need for enacting a special Bank Act, covering the organisation, management, and audit liquidation of banks was felt. These authoritative recommendations of the Committee have been an important landmark in the history of banking reforms in India. On the strong recommendations of Committee for the establishment of a supreme body from the point of view of the development of banking facilities in India, Reserve Bank of India (RBI) came into formation on April 1, 1935 with the enactment of the Reserve Bank of India Act, 1934. The objective of establishing the Reserve Bank, as stated in the preamble to the RBI Act, was to “regulate the issue of bank notes and the keeping of reserves with a view of securing monetary stability in India
and generally to operate the currency and credit system of the country to its advantage”
Year 1936 stands as a landmark in the Indian banking history as the first attempt at
banking legislation in India was made in this year in the form of the Indian Companies
(Amendment) Act, for incorporating a separate chapter on provisions relating to banking
companies. The new legislature gave a working definition of ‘banking’ and segregate
banking from other commercial operations and special status of scheduled banks was
recognised. In the mid-1938, public got scared due to the failure of the Travancore
National and Quilon Bank (TNQ Bank). The crisis of 1938 was largely localised in South
India. At this instance, RBI observed that the majority of the non-scheduled banks were
working without any control as they were not willing to submit their operations to the
Reserve Bank’s regulation. Between 1939 and 1949, as many as 588 banks had failed in
various states. In October 1939, RBI submitted a report on the non-scheduled banks to
the Central Board, exposing that a number of non-scheduled banks had poor cash
reserves, low investment ratio, over extension of the advances portfolio and a large
proportion of bad and doubtful debts. There had been an extensive growth of banks
whose financial position was suspected but the presentation of their financial health was
on the basis of dressed-up balance sheets, which did not disclose many of the more
unsatisfactory features.

3.4 Origin of Banking in India
Banking in India is indeed as old as Himalayas. But, the banking functions
became an effective force only after the first decade of 20th century. Banking is an
ancient business in India with some of oldest references in the writings of Manu. Bankers
played an important role during the Mogul period. During the early part of the East India
Company era, agency houses were involved in banking. Modern banking (i.e. in the form
of joint-stock companies) may be said to have had its beginnings in India as far back as in
1786, with the establishment of the General Bank of India. Three Presidency Banks were
established in Bengal, Bombay and Madras in the early 19th century. These banks
functioned independently for about a century before they were merged into the newly
formed Imperial Bank of India in 1921. The Imperial Bank was the forerunner of the
present State Bank of India. The latter was established under the State Bank of India Act of 1955 and took over the Imperial Bank.

The Swadeshi movement witnessed the birth of several indigenous banks including the Punjab National Bank, Bank of Baroda and Canara Bank. In 1935, the Reserve Bank of India was established under the Reserve Bank of India Act as the central bank of India. In spite of all these developments, independent India inherited a rather weak banking and financial system marked by a multitude of small and unstable private banks whose failures frequently robbed their middle-class depositors of their life’s savings. After independence, the Reserve Bank of India was nationalized in 1949 and given wide powers in the area of bank supervision through the Banking Companies Act (later renamed Banking Regulations Act). The nationalization of the Imperial bank through the formation of the State Bank of India and the subsequent acquisition of the state owned banks in eight princely states by the State Bank of India in 1959 made the government the dominant player in the banking industry. In keeping with the increasingly socialistic leanings of the Indian government,

To understand the history of modern banking in India, one has to refer to the "English Agency Houses" established by the East India Company. These Agency Houses were basically trading firms and carrying on banking business as part of their main business. Because of this dual functions and lack of their own capital (Agency Houses depend entirely on deposits for their capital requirements) they failed and vanished from the scene during the third decade of 18th century, The East India Company laid the foundations for modern banking in the first-half of the 19th century with the establishment of the following three banks:

(i) Bank of Bengal in 1809
(ii) Bank of Bombay in 1840
(iii) Bank of Madras in 1843

These banks are also known as "Presidency Banks" and they functioned well as independent units.
During the last part of 19th century and early phase of 20th century, the 'Swadeshi Movement' induced the establishment of a number of banks with Indian Management. For example, Punjab National Bank Ltd. in 1895, The Bank of India Ltd. in 1906, The Canara Bank Ltd. in 1906, The Indian Bank Ltd. in 1907, The Bank of Baroda Ltd. in 1908, The Central Bank of India Ltd. in 1911 and many other banks were established on the same line. But most of the weak banks went bankrupt due to wrong policy decisions taken by the management and due to severe banking crisis during 1913-18, the period of World War I. However, the stronger and well managed banks like those mentioned above survived the crisis.

In 1920, the "Imperial Bank of India Act" was passed for amalgamating the three Presidency Banks. As such, the 'Imperial Bank of India' was established in 1921. It was given power to hold government funds and manage the Public debt. The branches of the bank were functioning as clearing houses (Agency for effecting settlement of funds among banks). However, it was not authorized to issue currency.

Even though the need for a Central Bank was felt in the 18th century, it could be materialized only in the 20th century. On the basis of the recommendations of the Banking Enquiry Committee, the Reserve Bank of India Act was passed in 1934. Accordingly the Reserve Bank of India was constituted in 1935 to regulate the issue of Bank notes, securing monetary stability in India and to operate the currency and credit system of the country to its economic development. Initially, it was constituted as a private shareholders' bank with a fully paid up capital of Rs. 5 crores. After independence, there was a general attitude towards its nationalization. Thus, the 'Reserve Bank of India' (Transferred to public ownership) Act was passed in 1948. Accordingly, the entire Share Capital of the bank was acquired by the Central Government from the private shareholders against compensation and it was nationalised on January 1, 1949.

In 1955, the 'State Bank of India Act' was passed. Accordingly the 'Imperial Bank' was nationalized and 'State Bank of India' emerged with the objective of extension of
banking facilities on a large scale, specifically in the rural and semi-urban areas and for various other public purposes.

In 1959, the 'State Bank of India' (Subsidiary Banks) Act was passed by which the public sector banking was further extended. The following banks were made the subsidiaries of State Bank of India:

(i) The State Bank of Bikaner  
(ii) The State Bank of Jaipur  
(iii) The State Bank of Indore  
(iv) The State Bank of Mysore  
(v) The State Bank of Patiala  
(vi) The State Bank of Hyderabad  
(vii) The State Bank of Saurashtra  
(viii) The State Bank of Travancore

In 1963, the first two banks were amalgamated under the name of "The State Bank of Bikaner and Jaipur". In 1969, fourteen major Indian commercial banks were nationalized. These banks are Allahabad Bank, Bank of Baroda, Bank of India, Canara Bank, Central Bank of India, Dena Bank, Indian Bank, Indian Overseas Bank, Punjab National Bank, Syndicate Bank, Union Bank of India, United Bank of India, United Commercial Bank and Vijaya Bank. And in 1980 six more banks were nationalized. These banks constitute the public sector banks while the other scheduled banks and nonscheduled banks are in the private sector.

3.5 Evolution of Bank

It is interesting to trace the origin of the word 'bank' in the modern sense, to the German word "Banck" which means, heap or mound or joint stock fund. From this, the Italian word "Banco" meaning heap of money was coined.

Some people have the opinion that the word "bank" is derived from the French words " bancus" or "banque" which means a 'bench'. Initially, the bankers, the Jews in Lombardy, transacted their business on benches in the market place and the bench
resembled the banking counter. If a banker failed, his 'banque' (bench) was broken up by the people, hence the Word "bankrupt" has come. In simple term, bankrupt means a person who has lost all his Money, wealth or financial resources.

Thus, the origin of the word bank can be traced as follows

- **Banck** — German (Joint stock fund)
- **Banco** — Italian (Heap of money)
- **Bancus/** — French (Bench/chest a place where valuables are kept)
- **Bank** — English (Common meaning prevalent today, i.e., as an institution accepting money as deposit for lending)

In India, the Banking Regulation Act, 1949, under which banks are regulated by the Reserve Bank of India, defines a banking company and banking as under:

### 3.6 Evolution of Public Sector Banks

Public sector in the banking industry emerged with the nationalization of Imperial Bank of India (1921) and creating the State Bank of India (1955) as a part of integrated scheme of rural credit proposed by the All India Rural Credit Survey Committee (1951). The Bank is unique in several respects and it enjoys a position of preeminence as the agent of RBI wherever RBI has no branches. It is the single largest bank in the country with large international presence, with a network of 48 overseas offices spread over 28 countries covering all the time zones. One of the objectives of establishing the SBI was to provide extensive banking facilities in rural areas by opening as a first step 400 branches within a period of 5 years from July 1, 1955. In 1959, eight banking companies functioning in formerly princely states were acquired by the SBI, which later came to be known as Associate Banks. Later, two of the subsidiary banks', viz., the State Bank of
Bikaner and Jaipur were merged to form the State Bank of Bikaner and Jaipur, thus form eight banks in the SBI group then making banks in the state bank group.

The Public sector in the Indian banking got widened with two rounds of nationalization-first in July 1969 of 14 major private sector banks each with deposits of Rs. 50 crore or more, and thereafter in April 1980, 6 more banks with deposits of not less than Rs. 2 Crore each. It resulted in the creation of public sector banking with a market share of 76.87 per cent in deposits and 72.92 per cent of assets in the banking industry at the end of March 2003. With the merger of 'New Bank of India' with 'Punjab National Bank' in 1993, the number of nationalized banks became 19 and the number of public sector banks 27. The number of branches of public sector banks, which was 6,669 in June 1969, increased to 41874 by Mach 1990 and again to 46,752 by March 30, 2003. The public sector banks thus came to occupy a predominant position in the Indian banking scene. It is however, important to note that there has been a steady decline in the share of PSB's in the total assets of SCB's during the latter - half of 1990s. While their share was 84.5 per cent at the end of March 1996, it declined to 81.7 per cent in 1998 and further to 81 per cent in 1999.

3.6.1 Public vs Private Ownership of Banks

• Abstracting from ideology, from a pragmatic perspective, both public and private banks have respective advantages and disadvantages. Private ownership brings competition, professionalism and operational efficiency. Public ownership makes it easier to pursue social objectives such as mass banking, financial inclusion etc.

• Private banks have comparatively greater freedom in terms of recruitment, salary and compensation. On the other hand, PSBs are perceived to offer more job security, and consequently, employee turnover is lower.

• PSBs dominate the banking sector in India and will continue to be dominant in the foreseeable future. However, these banks require substantial capital to support growth.
• The critical question is whether the Government, given its limited fiscal space, can meet the enhanced capital needs of public sector banks under the Basel III capital regulations.

• Reserve Bank has made an estimate of the additional capital requirements of domestic banks for full Basel III implementation till March 2018. These estimates are based on two broad assumptions: (i) increase in the risk weighted assets of 20% p.a.; (ii) internal accrual of the order of 1% of risk weighted assets.

• The estimates suggest that the Indian banks will require an additional capital (on top of internal accruals) to the tune of `4.95 trillion; of this, non-equity capital will be of the order of over `3.30 trillion, while equity capital will be of the order of `1.65 trillion.

• Specific to public sector banks, the estimates suggest that public sector banks would require an additional capital to the tune of `4.15 trillion; of which equity capital will be of the order of `1.43 trillion, while non-equity capital will be of the order of `2.72 trillion. The Government’s contribution to the equity capital of PSBs would be of the order of `900 billion at the existing level of shareholding of the Government. The Government’s contribution will come down to approximately `660 billion if its shareholding comes down to 51%.

3.7 Banking Development during Post-Independence Era

After Independence, in 1948 the long debated regulation of overall banking system by the RBI took a shape in the form of The Banking Regulation Act which provided with the legal framework and came into effect on February 17, 1949. At the time of Independence, the banking system was deficient in many respects. The banks were mainly urban oriented and were beyond the reach of rural population. A large section of the rural population still had to look upon the moneylenders as their resort for credit. Rural infiltration of banks was inadequate, as agriculture was not considered as an
economic proposition of banks in those days. In 1951, the First Five Year Plan was launched, the development of rural India was accorded the highest priority (GoI, 1951)\textsuperscript{4}. At that time RBI constituted a working group to undertake survey of rural areas in order to find out the state of agrarian economy and provide data on rural indebtedness, savings, investments, asset-ownership etc. so that planning could be done on long term basis for betterment of rural poor, development of agriculture, improvement in the package of support system & ultimate removal of rural poverty, and as a whole to make India self-sufficient in food production. It was named as All India Rural Credit Survey Committee (1954), the recommendations of this survey incorporated nationalisation of Imperial Bank of India so that a directional change could be given to its lending policy for rural development. Accordingly, Imperial Bank of India (IBI) was taken over by the Government of India under the State Bank of India Act, 1955. State Bank of India (SBI) came into effect from July 1, 1955. Later, in 1959, the State Bank of India (Subsidiary Banks) Act was passed which made SBI to take over eight state-owned or sponsored banks as its subsidiaries. These are now called as Associate Banks of SBI. With amalgamation of two of them i.e., State Bank of Jaipur and State Bank of Bikaner, the number of these Associate Banks reduced to seven.

3.8 Banking development during Post-Nationalisation Era:

Indian banking, however, made considerable advancement both functionally and geographical coverage, but there were still many rural and semi-urban areas that were not served by banks. Large industries, big and established business houses tended to enjoy a major portion of the credit facilities. Vital sectors, like agriculture, small scale industries and exports did not receive the attention they deserved. Therefore, the Government in 1968 imposed social control over banks by amending banking laws. This social control was exercised with effect from February 1, 1969 with the main objective to achieve a wider disbursal of bank’s credit, preventing its misuse, directing its flow to priority areas and making it more effective instrument of economic development. The outcome of implementation of social control over banks was visible in the form of two major changes, firstly; the system of credit planning became an integral part of formulation of
credit policy, and secondly; the introduction of the Lead Bank Scheme to make the banking system function as an instrument of development.

Under social control, the banking system including smaller banks started gaining strength as evidenced by the absence of voluntary or compulsory mergers of banks. Apart from this the Banking Commission was appointed on January 22, 1969 to recommend changes in structure, procedures and policy for the Indian banking system. However, the Commission did not have much time to complete its task as it was overtaken by swift politico-economic developments, which culminated in the nationalization, on July 19, 1969, of the 14 major Indian scheduled commercial banks, in the private sector. On April, 1980, six more private sector banks were nationalised, thus extending further the area of public control over the Indian banking system. Nationalisation was the landmark in the growth of banking system in India as it was a major step to ensure adequate credit flow into genuine productive areas in the conformity with plan priorities. The main objectives of nationalisation of banks were, lending to priority sector; helping weaker sections of society by granting need based credit for asset generation at cheaper rates; extension of banking facilities to unbanked and underbanked areas; and removal of control over banks by a few etc.. Although banks penetrated in rural areas, but amount of credit extended to the weaker sections of the society was not satisfactory. In 1974, the Narasimham Committee went into these problems and recommended the establishment of Regional Rural Banks (RRBs) under the ‘Regional Rural Banks Act, 1975. Banking in collaboration with central and state governments, set up RRBs in selected regions where the co-operative system was weak and commercial banks were not very active.
The primary objective of bank nationalisation was balance sheet growth or an increase in deposits and loans driven primarily by an expansion of branches. The Indian banking system delivered admirably on these objectives. All the major development indicators such as number of branches, deposit mobilisation credit disbursed, per capita deposits and per capita credit marked a significant expansion during 1969-1991. Evident from Table-1, during this period, there was almost four fold expansion in the number of commercial banks as from 73 to 272 and a seven fold in the number of branches from 8,262 to 60,570 during the same period. The growing number indicates the banking system in India as one of the vast branch network in the world. Population per bank office also decreased from 64,000 in 1969 to 14,000 in 1991. This banking expansion also led to a rapid growth in the volume of transaction in relating to gross domestic product (GDP) while in 1969 deposits amounted to 13.7 percent, it increased to 42.4 percent in 1991.
The spread to banking to the masses is evident from Table-2 in the form of increase in the share of rural offices from 17.6 percent in 1969 to 55.7 percent by 1989. The share of rural areas in the total deposits rose from 3.1 percent to 15 percent during the same period. The rise in the share of credit was larger than the deposits as, from 1.5 per cent in 1969 to 16.3 percent in 1989. In the case of bank credit the gains of the rural areas is entirely explained by the loss of the metropolitan areas. Overall, the two decades since nationalisation of commercial banking in India saw banking being taken from its urban confines to the vast rural stretches. Expansion of banking into the rural areas meant a phenomenal expansion in terms of number of deposit and loan accounts. Table-3 explains the sector wise expansion. The total number of loan accounts showed a rapid

### Table 3.2
Deposits and Credits of Scheduled Commercial Banks (1969-1989)

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<td>15.1</td>
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**Deposits**

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**Credit**

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<tr>
<td>Semi urban</td>
<td>11.3</td>
<td>14.7</td>
<td>15.6</td>
<td>16.4</td>
<td>17.3</td>
</tr>
<tr>
<td>Urban</td>
<td>20.0</td>
<td>22.9</td>
<td>22.7</td>
<td>23.5</td>
<td>23.0</td>
</tr>
<tr>
<td>Metro</td>
<td>67.2</td>
<td>57.1</td>
<td>53.3</td>
<td>45.3</td>
<td>43.5</td>
</tr>
</tbody>
</table>

*Source: Banking Statistics 1972-1995, RBI.*
increase from 4.34 million in 1972 to over 65 million by 1992. The share of agriculture in this total increased sharply to over 50 percent by 1982 itself. Transport operators and trade also showed significant increase. In addition to all these improvements, totally neglected segments, such as artisans and craftsmen and small-scale industries also gained an important place. Its share improved from 0.68 percent to 5.41 percent.

Table 3.3
Distribution of Loan Accounts by Sectors in India (1972-1992)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>31.61</td>
<td>40.77</td>
<td>50.53</td>
<td>47.87</td>
<td>42.11</td>
</tr>
<tr>
<td>Industry</td>
<td>5.13</td>
<td>3.77</td>
<td>4.51</td>
<td>6.95</td>
<td>9.56</td>
</tr>
<tr>
<td>Transport Operators</td>
<td>1.21</td>
<td>1.75</td>
<td>.2.10</td>
<td>2.48</td>
<td>2.20</td>
</tr>
<tr>
<td>Professional Services and Personal Loans</td>
<td>27.03</td>
<td>19.64</td>
<td>17.01</td>
<td>14.90</td>
<td>16.78</td>
</tr>
<tr>
<td>Trade</td>
<td>6.75</td>
<td>6/46</td>
<td>9.87</td>
<td>14.29</td>
<td>17.94</td>
</tr>
<tr>
<td>Others</td>
<td>28.27</td>
<td>27.61</td>
<td>15.98</td>
<td>13.49</td>
<td>11.41</td>
</tr>
<tr>
<td>Artisans &amp; Craftsmen</td>
<td>0.68</td>
<td>1.36</td>
<td>3.67</td>
<td>3.61</td>
<td>5.41</td>
</tr>
<tr>
<td>Other small Scale Industries</td>
<td>3.98</td>
<td>3.34</td>
<td>2.29</td>
<td>6.24</td>
<td>3.32</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Accounts (millions)</td>
<td>(4.34)</td>
<td>(10.75)</td>
<td>(23.52)</td>
<td>(43.44)</td>
<td>(65.86)</td>
</tr>
</tbody>
</table>

Source: Banking Statistics 1972-1995, RBI.

Note: Others include Financial Institutions and miscellaneous.

The focus of the nationalisation was to break the nexus and improved flow of credit to agriculture and small-scale industries. Table-4 shows the shift taken place in the composition of the bank credit flow as an effect of nationalisation. Till the nationalisation of banks in 1969, industry hatched over 60 percent of the total bank credit and agriculture could get hardly 9 percent and small-scale industries about 8 per cent. By the early 1980s, the share of agriculture had risen to 17.15 percent and transport operators 5.15 percent,
and small-scale industries 11.95 percent. With the diversification of portfolio, industry’s share came down from 61.16 percent in early 1970s to 47.35 percent by the early 1980s and to 47.70 percent by 1992.

Table 3.4
Distribution of Loans Outstanding by Sectors in India (1972-1992)

(Percent)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>9.02</td>
<td>10.40</td>
<td>17.15</td>
<td>17.29</td>
<td>14.80</td>
</tr>
<tr>
<td>Industry</td>
<td>61.16</td>
<td>47.94</td>
<td>47.35</td>
<td>44.46</td>
<td>47.70</td>
</tr>
<tr>
<td>Transport Operators</td>
<td>1.58</td>
<td>2.70</td>
<td>5.15</td>
<td>4.01</td>
<td>2.62</td>
</tr>
<tr>
<td>Professional Services and Personal Loans</td>
<td>4.96</td>
<td>4.89</td>
<td>6.19</td>
<td>10.74</td>
<td>11.02</td>
</tr>
<tr>
<td>Trade</td>
<td>14.85</td>
<td>28.45</td>
<td>18.51</td>
<td>18.75</td>
<td>14.76</td>
</tr>
<tr>
<td>Artisans &amp; Craftsmen</td>
<td>0.09</td>
<td>0.21</td>
<td>0.31</td>
<td>0.62</td>
<td>069</td>
</tr>
<tr>
<td>Other small Scale Industries</td>
<td>11.87</td>
<td>10.87</td>
<td>11.95</td>
<td>11.96</td>
<td>12.00</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Banking Statistics 1972-1995, RBI.

Thus, the two decades since nationalisation have seen progress with respect to its various objectives in the form of:

i) Massive branch expansion particularly in rural areas,

ii) Expansion in volume of deposits, which constituted two fifth of the financial sector of the household sector in 1991,

iii) Rural deposits as a proportion of total deposits increased,

iv) Deployment of increasing proportion of bank credit to priority sectors,
v) Increase in deposits accounts and borrowable accounts, and
vi) Enormous contributions by commercial banks, particularly public sector banks, to the development programmes under five year plans. “Despite these commendable progresses serious problems have emerged and reflected in a decline in productivity and efficiency and erosion of the profitability of the banking sector” (GoI, 1991)\(^5\). In this period, the viability of the banking system has come under question. This period of 1985-91 may be regarded as period of consolidation for banking system. The consolidation involved action on several fronts. Individual banks restores to Enterprise Resource Planning System (ERPS) related to action plans covering organisational structure, housekeeping, training, customer service, credit management, recovery of loans productivity and profitability. Although progress made by banking system in terms of geographical and functional coverage, resources mobilised and credit deployed was tremendous, but it was still an unexplained characteristics of repressed financial system.

### 3.9 Features of Banking

From the views of above authorities, we can derive the following basic characteristics of Banking:

(i) **Dealing in money:** The banks accept deposits from the public and advancing them as loans to the needy people. The deposits may be of different types – current, fixed, saving etc. accounts. The deposits are accepted on various terms and conditions.

(ii) **Deposits must be withdraw able:** The deposits (other than fixed deposits) made by the public can be withdraw able by cheques, draft on otherwise, i.e. the bank issue and pay cheques. The deposits are usually withdrawable on demand.

(iii) **Dealing with credit:** The banks are the institutions that can create i.e., creation of additional money for lending. Thus, “creation of credit” is the unique feature of banking.
(iv) Commercial in nature: Since all the banking functions are carried on with the aim of making profit, it is regarded as commercial institutions.

(v) Nature of agent: Besides the basic functions of accepting deposits and lending money as loans, banks possess the character of an agent because of its various agency services.

3.10 Classification of Banks

Today is the age of specialization and we can find specialization in all fields including banking. The banks have specialized in a particular line of finance. Various types of banks have developed to suit the economic development and requirements of the country. The principal banking institutions of a country may be classified into following types:

(1) Central Banks
(2) Commercial Banks
(3) Industrial Or Development Banks
(4) Exchange Banks (authorized dealers in foreign exchange)
(5) Co-operative Banks
(6) Land-mortgage Banks
(7) Indigenous Banks
(8) Savings Banks
(9) Supranational Banks
(10) International Banks

Central Banks: Central Bank is the bank of a country – a nation. Its main function is to issue currency known as ‘Bank Notes’. This bank acts as the leader of the banking system and money market of the country by regulating money and credit. These banks are the bankers to the government; they are banker’s banks and the ultimate custodian of a nation’s foreign exchange reserves. The aim of the Central Bank is not to earn profit, but to maintain price stability and to strive for economic development with all round growth of the country.
Commercial Banks: A bank, which undertakes all kinds of ordinary banking business, is called a commercial bank.

Industrial Banks or Financial Institutions: An Industrial Bank is one which specializes by providing loans and fixed capital to industrial concerns by subscribing to share and debenture issued by public companies.

Exchange Banks (Authorised Dealers in Foreign Exchange): These types of banks are primarily engaged in transactions involving foreign exchange. They deal in foreign bills of exchange import and export of bullion and otherwise participate in the financing of foreign trade.

Co-operative Banks: They are organized on co-operative principles of mutual help and assistance. They grant short-term loans to the agriculturists for purchase of seeds, harvesting and for other cultivation expenses. They accept money on deposit from and make loans to their members at a low rate of interest.

Land-mortgage Banks (Presently known as Agriculture and Rural Development Banks): They are agriculture development banks. The Land-mortgage banks supply long-term loans for a period up to 15 years for development of land to improve agricultural yields. They grant loan for permanent improvements in agricultural lands. The National Bank for Agriculture and Rural Development (NABARD) was constituted by the Government to promote rural development.

Indigenous Banks: The Central Banking Enquiry Commission defined an indigenous banker as an individual or film accepting deposits and dealing in indigenous lending of money to the needy. They form unorganized part of the banking structure, i.e., these are unrecognized operators in receiving deposits and lending money.

Savings Banks: These are institutions which collect the periodical savings of the general public. Their main object is to promote thrift and saving habits among the middle and lower income sections of the society.
**Supranational Banks:** Special Banks have been created to deal with certain international financial matters. World Bank is otherwise known as International Bank for Reconstruction and Development (IBRD) which gives long-term loans to developing countries for their economic and agricultural development. Asian Development Bank (ADB) is another Supranational Bank which provides finance for the economic development of poor Asian countries.

**International Banks:** International Banks are those which are operating in different countries. While, the registered office/head office is situated in one country, they operate through their branches in other countries. They specialize in Banking business pertaining to foreign trade like opening of letters of credit, providing short-term finance in foreign currency, issue of performance guarantee, arranging foreign currency credits, etc. They are the main traders in International Currencies like US 'dollars', Japanese 'Yen', the new-born European Currency 'Euro', etc.

3.11 Banking System

The structure of banking system differs from country to country depending upon their economic conditions, political structure and financial system. Banks can be classified on the basis of volume of operations, business pattern and areas of operations. They are termed as system of banking. The commonly identified systems are,

1. Unit banking
2. Branch Banking
3. Correspondent Banking System
4. Group Banking
5. Chain Banking
6. Pure Banking
7. Mixed Banking
8. Relationship banking
9. Narrow Banking
10. Universal Banking
11. Retail Banking
12. Wholesale Banking
13. Private Banking:

**Unit banking:** Unit banking is originated and developed in U.S.A. In this system, small independent banks are functioning in a limited area or in a single town i.e., the business of each bank is confined to a single office, which has no branch at all. It has its own board of directors and stockholders. It is also called as "localized Banking".

**Branch Banking:** The Banking system of England originally offered an example of the branch banking system, where each commercial bank has a network of branches spread throughout the country.

**Correspondent Banking:** Correspondent banking system is developed to remove the difficulties in unit banking system. It is the system under which unit banks are linked with bigger banks. The big correspondent banks are linked with still bigger banks in the financial centers. The smaller banks deposit their cash reserve with bigger banks. The bigger banks with whom such deposits are so made are called correspondent banks.

Therefore, correspondent banks are intermediaries through which all unit banks are linked with bigger banks in financial centers. Through correspondent banking, a bank can carry-out business transactions in another place where it does not have a branch.

**Group Banking:** Group Banking is the system in which two or more independently incorporated banks are brought under the control of a holding company. The holding company may or may not be a banking company. Under group banking, the individual banks may be unit banks, or banks operating branches or a combination of the two.

**Chain Banking:** Chain banking is a system of banking under which a number of separately incorporated banks are brought under the common control by a device other than holding company. This may be:
(a) Through some group of persons owning and controlling a number of independent banks. (b) Each bank retains its separate identity. (c) Each one carries out its operations without the intervention of any central organization.

**Pure Banking and Mixed Banking:** On the basis of lending operations of the bank, banking is classified into:

(a) Pure Banking

(b) Mixed Banking

(a) **Pure Banking:** Under pure Banking, the commercial banks give only short-term loans to industry, trade and commerce. They specialize in short term finance only. This type Of banking is popular in U.K.

(b) **Mixed Banking:** Mixed banking is that system of banking under which the commercial banks perform the dual function of commercial banking and investment banking, i.e., it combines deposit and lending activity with investment banking. Commercial banks usually offer both short-term as well as medium term loans. The German banking system is the best example of mixed Banking.

**Relationship banking:** Relationship banking refers to the efforts of a bank to promote personal contacts and to keep continuous touch with customers who are very valuable to the bank. In order to retain such profitable accounts with the bank or to attract new accounts, it is necessary for the bank to serve their needs by maintaining a close relationship with such customers.

**Narrow Banking:** A bank may be concentrating only on collection of deposits and lend or invest the money within a particular region or certain chosen activity like investing the funds only in Government Securities. This type of restricted minimum banking activity is referred to 'Narrow Banking’.

**Universal Banking:** As Narrow Banking refers to restricted and limited banking activity Universal Banking refers to broad-based and comprehensive banking activities.
Under this type of banking, a bank will deal with working capital requirements as well as term loans for developmental activities. They will be dealing with individual customers as well as big corporate customers. They will have expanded lines of business activity combining the functions of traditional deposit taking, modern financial services, selling long-term saving products, insurance cover, investment banking, etc.

**Regional banking:** In order to provide adequate and timely credits to small borrowers in rural and semi-urban areas, Central Government set up Regional Banks, known as Regional Rural Banks all over India jointly with State Governments and some Commercial Banks. As they are permitted to operate in particular region, it may help develop the regional economy.

**Local Area Banks:** With a view to bring about a competitive environment and to overcome the deficiencies of Regional Banks, Government has permitted establishment of a one type of regional banks in rural and semi-urban centers under private sector known as “Local Area Banks”.

**Wholesale Banking:** Wholesale or corporate banking refers to dealing with limited large-sized customers. Instead of maintaining thousands of small accounts and incurring huge transaction costs, under wholesale banking, the banks deal with large customers and keep only large accounts. These are mainly corporate customer.

**Private Banking:** Private or Personal Banking is banking with people — rich individuals instead of banking with corporate clients. Private or Personal Banking attends to the need of individual customers, their preferences and the products or services needed by them. This may include all round personal services like maintaining accounts, loans, foreign currency requirements, investment guidance, etc.

**Retail Banking:** Retail banking is a major form of commercial banking but mainly targeted to consumers rather than corporate clients. It is the method of banks' approach to the customers for sale of their products. The products are consumer-oriented like offering a car loan, home loan facility, financial assistance for purchase of consumer
durables, etc. Retail banking therefore has large customer-base and hence, large number of transactions with small values. It may therefore be cost ineffective in a highly competitive environment. Most of the Rural and semi-urban branches of banks, in fact, do retail banking. In the present day situation when lending to corporate clients lead to credit risk and market risk, retail banking may eliminate market risk. It is one of the reasons why many a wholesale bankers like foreign banks also prefer to go for consumer financing albeit for marginally higher net worth individual.

3.12 Structure of Banking Sector in India:

The Indian banking system has emerged as a sluggish business institution to a highly proactive and dynamic entity. It is highly fragmented with 30 banking units contributing to almost 50 percent of deposits and 60 percent of advances. India’s banking system mainly consists of “non-scheduled” banks and “scheduled banks”. Scheduled banks refer to those that are included in the Second Schedule of the Banking Regulation Act of 1965 and satisfy the twin conditions that a bank must have paid-up capital and reserves of not less than Rs. 500,000 and secondly satisfy the Reserve Bank of India (RBI) as its affairs are not conducted in a manner detrimental to the interests of its depositors. Scheduled banks consist of scheduled commercial banks and scheduled cooperative banks. The former are divided into four categories: (i) public sector banks (which are further classified as nationalised banks and State Bank of India [SBI] banks); (ii) private sector banks (which are further classified as old private sector banks and new private sector banks that emerged after 1991); (iii) foreign banks in India; and, (iv) regional rural banks (which operate exclusively in rural areas to provide credit and other facilities to small and marginal farmers, agricultural workers, artisans, and small entrepreneurs). Non-scheduled banks are those banks which does not come under the Schedule of the Banking Regulation Act of 1965 and, thus, do not satisfy the conditions laid down by that schedule. Nonscheduled banks are further divided into two classifications non-scheduled cooperative banks and non-scheduled commercial banks. The scheduled commercial banks with the exception of foreign banks are registered in India under the Companies Act. The SBI banks consist of eight independently capitalised banks: seven associate banks, and SBI itself.
The SBI is the largest commercial bank in India in terms of assets, deposits, branches, and employees and has 13 head offices governed each by a board of directors under the supervision of a central board. It was originally established in 1806 when the Bank of Calcutta (latter called the Bank of Bengal) was established, and then amalgamated as the Imperial Bank of India after merger with the Bank of Madras and the Bank of Bombay. The shares of Imperial Bank of India were sold to the RBI in 1955. Nationalised banks refer to private sector banks that were nationalised (14 banks in 1969 and six in 1980) by the Central Government. Unlike SBI, nationalised banks are centrally governed by their respective head offices. Thus, there is only one board for each bank and meetings are less frequent. In 1993, Punjab National Bank merged with another nationalized bank, New Bank of India, so the number of nationalized banks fell from 20 to 19. Regional rural banks account for only 4 percent of total assets of scheduled commercial banks. Scheduled cooperative banks are further divided into scheduled urban
cooperative banks and scheduled state cooperative banks. As at the end of March 2010, the number of scheduled banks is as follows: 19 nationalized banks, eight SBI banks, 23 old private sector banks, 8 new private sector banks, 38 foreign banks, 82 regional rural banks, 53 urban cooperative banks, and 31 state cooperative banks.

**Reserve Bank of India (RBI)**

The RBI is India’s central bank. The RBI was established on April 1, 1935 in accordance with the provisions of the Reserve Bank of India Act, 1934. RBI acts as a banker to the Government and Banks. The Central Bank maintains record of Government revenue and expenditure under various heads. It maintains deposit accounts of all other banks and advances money to other banks, when needed. Another important function of the Central Bank is the issuance of currency notes, regulating their circulation in the country by different methods. Banks in the country are broadly classified as scheduled banks and non-scheduled banks.

**Scheduled Banks**

All banks which are included in the Second Schedule to the Reserve Bank of India Act, 1934 are scheduled banks. These banks comprise Scheduled Commercial Banks and Scheduled Cooperative Banks. These banks are eligible for certain facilities such as financial accommodation from RBI and are required to fulfill certain statutory obligation. The RBI is empowered to exclude any bank from the schedule whose:

1. Aggregate value of paid up capital and reserves fall below Rs 5 lakh
2. Affairs are conducted in a manner detrimental to the interests of depositors
3. Goes into liquidation and ceases to transact banking business

**Commercial Banks**

Commercial banks may be defined as, any banking organization that deals with the deposits and loans of business organizations. Commercial banks issue bank checks and drafts, as well as accept money on term deposits. Commercial banks also act as moneylenders, by way of installment loans and overdrafts. Commercial banks also allow
for a variety of deposit. These institutions are run to make a profit and owned by a group of individuals.

**Public Sector Banks**

These are banks where majority stake is held by the Government of India.

**Foreign Banks**

These banks are registered and have their headquarters in a foreign country but operate their branches in our country.

**Private Sector Banks**

These are banks majority of share capital of the bank is held by private individuals. These banks are registered as companies with limited liability.

**Regional Rural Banks**

Regional Rural Banks were established under the provisions of an Ordinance promulgated on the 26th September 1975 and the RRB Act, 1976 with an objective to ensure sufficient institutional credit for agriculture and other rural sectors. The area of operation of RRBs is limited to the area as notified by Government of India covering one or more districts in the state. RRBs are jointly owned by Government of India, the concerned State Government and Sponsor Banks (27 Scheduled commercial banks and one State Cooperative Bank); the issued capital of a RRB is shared by the owners in the proportion of 50%, 15% and 35% respectively. Prathama bank is the first Regional Rural Bank is India located in the city Moradabad in Uttar Pradesh.

**Cooperative Banks**

A cooperative bank is a financial entity which belongs to its members, who are at the same time the owners and the customers of their bank. Cooperative banks are often created by persons belonging to the same local or professional community or sharing a common interest. Co-operative banks generally provide their members with a wide range of banking and financial services (loans, deposits, banking and accounts, etc.). They provide limited banking products and are specialists in agriculture-related products. Cooperative banks are the primary financiers of agricultural activities, some small-scale
industries and self employed workers. Cooperative banks function on the basis of “no-profit no-loss”. Anyonya Co-operative Bank Limited (ACBL) is the co-operative bank in India located in the city of Vadodara in Gujarat.

**The Co-operative Credit system consists of**

a. Short-term agricultural credit institutions  
b. Long-term agricultural credit institutions  
c. Non-agricultural credit institutions

**Export-Import Bank of India (EXIM BANK)**

Export-Import Bank of India is the premier export finance institution of the country, established in 1982 under the Export-Import Bank of India Act, 1981.

**Industrial Development Bank of India (IDBI)**

The Export-Import Bank of India (IDBI) was established on 1 July 1964 under an Act of Parliament as wholly owned subsidiary of the Reserve Bank of India. In 16 February 1976, the ownership of IDBI was transferred to the Government of India and it was made the principal financial institution for coordinating the activities of institutions engaged in financing, promoting and developing industry in the country.

**National Bank for Agriculture and Rural Development (NABARD)**

NABARD is an apex development bank in India having headquarters based in Mumbai (Maharashtra) and other branches are all over the country. It was established on 12 July 1982 on the recommendations of Shivaram Committee, by an act of parliament on 12 July 1982 to implement the National Bank for Agriculture and Rural Development Act 1981.
References


3) 13. Ibid.


