CHAPTER NO. 1. INTRODUCTION

1.1. Introduction To Banking

Banking plays a very important role in the economic development of all the country of the world. It is a life blood of modern commerce.

The word bank has been derived from the Latin word “bancus” or from “banque”, which means a bench in English. The early bankers were transacting in the market on a bench and when any banker fails, his bench was broken up by the people. While according to some authors the word bank was originally derived from the German word bank meaning a joint stock fund.

Following are some important definitions of the bank.

- “Bank is a manufacturer of credit and machine for facilitating exchanges.”

----------HORACE WHITE.

- “A bank is an establishment which makes to individuals such advances of money as may be required and safely made and to which individuals entrust money when not needed by them for use.”

----------KINLAY.

- “Banker includes person or corporation or a company acting as banker.”

---------- (Sec.3) INDIAN NEGOTIABLE INSTRUMENTS ACT, 1881

- “Any body of persons, whether incorporated or not, who carries on the business of banking, is a banker.”

----------THE ENGLISH BILL OF EXCHANGE ACT, 1882

- In U.S.A. the term “Banker” means the person, firms or company whose business is dealing in credits. They may be capitalist, a stock broker or a financier.
- The Japanese Bank Act, 1, 1927 defined banks as institutions which perform the activities of giving and receiving of credit.
1.2 **Main Functions Of a Bank:**

- To receive deposits: the primary function of bank is to mobilize savings of individuals, and firms.
- Making loans and advances: the second important function of a bank is to lend money and through this function bank makes profit.
- Providing Ancillary services: apart from mobilizing savings and lending money bank also performs some of the miscellaneous service for its customer’s viz. issuing letter of credit, safe custody of valuables and securities.
- Providing agency service: banks also performs the role of a agent viz. collects and pays cheques, bills and promissory notes, collects dividend and interest etc.

Currently, India has 96 scheduled commercial banks (SCBs) - 27 public sector banks (that is with the Government of India holding a stake), 31 private banks (these do not have government stake; they may be publicly listed and traded on stock exchanges) and 38 foreign banks. They have a combined network of over 53,000 branches and 49,000 ATMs. According to a report by ICRA Limited, a rating agency, the public sector banks hold over 75 percent of total assets of the banking industry, with the private and foreign banks holding 18.2% and 6.5% respectively.
Fig. 1. Structure of the Indian Financial System
1.3 Evolution of Indian Banking Industry

1.3.1. Early history of Banking in India

Banking in India originated in the last decades of the 18th century. The first banks were The General Bank of India which started in 1786, and the Bank of Hindustan, both of which are now defunct. The oldest bank in existence in India is the State Bank of India, which originated in the Bank of Calcutta in June 1806, which almost immediately became the Bank of Bengal. This was one of the three presidency banks, the other two being the Bank of Bombay and the Bank of Madras, all three of which were established under charters from the British East India Company. For many years the Presidency banks acted as quasi-central banks, as did their successors. The three banks merged in 1921 to form the Imperial Bank of India, which, upon India's independence, became the State Bank of India.

Indian merchants in Calcutta established the Union Bank in 1839, but it failed in 1848 as a consequence of the economic crisis of 1848-49. The Allahabad Bank, established in 1865 and still functioning today, is the oldest Joint Stock bank in India.

1.3.2. Joint Stock Bank: A company that issues stock and requires shareholders to be held liable for the company's debt) It was not the first though. That honor belongs to the Bank of Upper India, which was established in 1863, and which survived until 1913, when it failed, with some of its assets and liabilities being transferred to the Alliance Bank of Simla.

When the American Civil War stopped the supply of cotton to Lancashire from the Confederate States, promoters opened banks to finance trading in Indian cotton. With large exposure to speculative ventures, most of the banks opened in India during that period failed. The depositors lost money and lost interest in keeping deposits with banks. Subsequently, banking in India remained the exclusive domain of Europeans for next several decades until the beginning of the 20th century.

Foreign banks too started to arrive, particularly in Calcutta, in the 1860s. The Comptoire d'Escompte de Paris opened a branch in Calcutta in 1860, and another in Bombay in 1862; branches in Madras and Pondichery, then a French colony, followed. HSBC established itself in Bengal in 1869. Calcutta was the most active trading port in India, mainly due to the trade of the British Empire, and so became a banking center.
The Bank of Bengal, which later merged with the Bank of Bombay and the Bank of Madras to form the Imperial Bank of India in 1921.

The first entirely Indian joint stock bank was the Oudh Commercial Bank, established in 1881 in Faizabad. It failed in 1958. The next was the Punjab National Bank, established in Lahore in 1895, which has survived to the present and is now one of the largest banks in India.

Around the turn of the 20th Century, the Indian economy was passing through a relative period of stability. Around five decades had elapsed since the Indian Mutiny, and the social, industrial and other infrastructure had improved. Indians had established small banks, most of which served particular ethnic and religious communities.

The presidency banks dominated banking in India but there were also some exchange banks and a number of Indian joint stock banks. All these banks operated in different segments of the economy. The exchange banks, mostly owned by Europeans, concentrated on financing foreign trade. Indian joint stock banks were generally under capitalized and lacked the experience and maturity to compete with the presidency and exchange banks. This segmentation let Lord Curzon to observe, "In respect of banking it seems we are behind the times. We are like some old fashioned sailing ship, divided by solid wooden bulkheads into separate and cumbersome compartments."

The period between 1906 and 1911, saw the establishment of banks inspired by the Swadeshi movement. The Swadeshi movement inspired local businessmen and political figures to found banks of and for the Indian community. A number of banks established then have survived to the present such as Bank of India, Corporation Bank, Indian Bank, Bank of Baroda, Canara Bank and Central Bank of India.
The fervour of Swadeshi movement lead to establishing of many private banks in Dakshina Kannada and Udupi district which were unified earlier and known by the name South Canara (South Kanara) district. Four nationalised banks started in this district and also a leading private sector bank. Hence undivided Dakshina Kannada district is known as "Cradle of Indian Banking".

1.3.3. From World War I to Independence

The period during the First World War (1914-1918) through the end of the Second World War (1939-1945), and two years thereafter until the independence of India were challenging for Indian banking. The years of the First World War were turbulent, and it took its toll with banks simply collapsing despite the Indian economy gaining indirect boost due to war-related economic activities. At least 94 banks in India failed between 1913 and 1918 as indicated in the following table:

<table>
<thead>
<tr>
<th>Years</th>
<th>Number of banks that failed</th>
<th>Authorised capital (Rs. Lakhs)</th>
<th>Paid-up Capital (Rs. Lakhs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1913</td>
<td>12</td>
<td>274</td>
<td>35</td>
</tr>
<tr>
<td>1914</td>
<td>42</td>
<td>710</td>
<td>109</td>
</tr>
<tr>
<td>1915</td>
<td>11</td>
<td>56</td>
<td>5</td>
</tr>
<tr>
<td>1916</td>
<td>13</td>
<td>231</td>
<td>4</td>
</tr>
<tr>
<td>1917</td>
<td>9</td>
<td>76</td>
<td>25</td>
</tr>
<tr>
<td>1918</td>
<td>7</td>
<td>209</td>
<td>1</td>
</tr>
</tbody>
</table>

Table 1.1 Number of Banks that Failed between 1913-1918

1.3.4. Post-independence

The partition of India in 1947 adversely impacted the economies of Punjab and West Bengal, paralyzing banking activities for months. India's independence marked the end of a regime of the Laissez-faire for the Indian banking. The Government of India initiated measures to play an active role in the economic life of the nation, and the Industrial Policy Resolution adopted by the government in 1948 envisaged a mixed economy. This resulted into greater
involvement of the state in different segments of the economy including banking and finance. The major steps to regulate banking included:

- In 1948, the Reserve Bank of India, India's central banking authority, was nationalized, and it became an institution owned by the Government of India.
- In 1949, the Banking Regulation Act was enacted which empowered the Reserve Bank of India (RBI) “to regulate, control, and inspect the banks in India.”
- The Banking Regulation Act also provided that no new bank or branch of an existing bank could be opened without a license from the RBI, and no two banks could have common directors.

However, despite these provisions, control and regulations, banks in India except the State Bank of India, continued to be owned and operated by private persons. This changed with the nationalisation of major banks in India on 19 July 1969.

India had a system of indigenous banking from very early times. With the coming of English traders in seventeenth century and the establishment of trading centers by east India Company the agency houses were established.

The first bank in India was established in 1786. From 1786 till today, the journey of Indian Banking System can be segregated into three distinct phases as 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 & Banking Sector Reforms after 1991.

1.4. Phases of the Evolution

1.4.1. Phase I

During the first phase (1786 to 1969) different banks were established in India among which following were some of the important establishment in the history of Indian banking.

- The General Bank of India was set up in the year 1786.
• 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 consisting mainly the European shareholders.
• In 1865 Allahabad Bank was established 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 wherein 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 such deposit mobilization was slow. Whereas the savings bank facility provided by the Postal department was considered comparatively safer.

1.4.2. 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 were nationalized.
Second phase of nationalization of Indian Banking Sector Reform was carried out in 1980 with seven more banks. This step brought 80 percent of the banking segment in India under Government ownership.

1.4.3. Nationalization Of Banks In India:

The RBI was nationalized on January 1, 1949 in terms of the Reserve Bank of India (Transfer to Public Ownership) Act, 1948 (RBI, 2005b).[Reference www.rbi.org.in]

By the 1960s, the Indian banking industry had become an important tool to facilitate the development of the Indian economy. At the same time, it had emerged as a large employer, and a debate had ensued about the possibility to nationalise the banking industry. Indira Gandhi, the-then Prime Minister of India expressed the intention of the GOI in the annual conference of the All India Congress Meeting in a paper entitled "Stray thoughts on Bank Nationalisation." The paper was received with positive enthusiasm. Thereafter, her move was swift and sudden, and the GOI issued an ordinance and nationalised the 14 largest commercial banks with effect from the midnight of July 19, 1969. Jayaprakash Narayan, a national leader of India, described the step as a "masterstroke of political sagacity." Within two weeks of the issue of the ordinance, the Parliament passed the Banking Companies (Acquisition and Transfer of Undertaking) Bill, and it received the presidential approval on 9 August 1969.

A second dose of nationalization of 6 more commercial banks followed in 1980. The stated reason for the nationalization was to give the government more control of credit delivery. With the second dose of nationalization, the GOI controlled around 91% of the banking business of India. Later on, in the year 1993, the government merged New Bank of India with Punjab National Bank. It was the only merger between nationalized banks and resulted in the reduction of the number of nationalised banks from 20 to 19. After this, until the 1990s, the nationalised banks grew at a pace of around 4%, closer to the average growth rate of the Indian economy.

The nationalization of banks in India took place in 1969 by Mrs. Indira Gandhi the then prime minister. Where in nationalization of 14 banks were undertaken. These banks were mostly owned by businessmen and even managed by them.
• Central Bank of India
• Bank of Maharashtra
• Dena Bank
• Punjab National Bank
• Syndicate Bank
• Canara Bank
• Indian Bank
• Indian Overseas Bank
• Bank of Baroda
• Union Bank
• Allahabad Bank
• United Bank of India
• UCO Bank
• Bank of India

Before the steps of nationalization of above Indian banks, only State Bank of India (SBI) was nationalized. It took place in July 1955 under the SBI Act of 1955. Nationalization of Seven State Banks of India (formed subsidiary) took place on 19th July, 1960.

The State Bank of India is India's largest commercial bank and is ranked one of the top five banks worldwide. It serves 90 million customers through a network of 9,000 branches and it offers, either directly or through subsidiaries, a wide range of banking services.

The second phase of nationalization of Indian banks took place in the year 1980. Seven more banks were nationalized with deposits over 200 crore. Till this year, approximately 80% of the banking segment in India was under Government ownership.

After the nationalization of banks in India, the branches of the public sector banks rose to approximately 800% in deposits and advances took a huge jump by 11,000%.

The following are the steps taken by the Government of India to Regulate Banking Institutions in the 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.

1969: Nationalization of 14 major banks.

1971: Creation of credit guarantee corporation.

1975: Creation of regional rural banks.

1980: Nationalization of seven banks with deposits over 200 crore.

1.4.4. 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 Narshimham, a committee was set up by his name which worked for the liberalization of banking practices.

The country was flooded with foreign banks and their ATM stations. Efforts were being put to give a satisfactory service to customers. Phone banking and net banking was introduced. The entire system was made more convenient and speedy.

1.5. Liberalization Of Banks In India

In the early 1990s, the then Narsimha Rao government embarked on a policy of liberalization, licensing a small number of private banks. These came to be known as *New Generation tech-savvy banks*, and included Global Trust Bank (the first of such new generation banks to be set up), which later amalgamated with Oriental Bank of Commerce, Axis Bank (earlier as UTI Bank), ICICI Bank and HDFC Bank. This move, along with the rapid growth in the economy of India, revitalized the banking sector in India, which has seen rapid growth with strong contribution from all the three sectors of banks, namely, government banks, private banks and foreign banks.

The next stage for the Indian banking has been setup with the proposed relaxation in the norms for Foreign Direct Investment, where all Foreign Investors in banks may be given voting rights which could exceed the present cap of 10%, at present it has gone up to 74% with some restrictions.

The new policy shook the Banking sector in India completely. Bankers, till this time, were used to the 4-6-4 method (Borrow at 4%; Lend at 6%; Go home at 4) of functioning. The new
wave ushered in a modern outlook and tech-savvy methods of working for traditional banks. All this led to the retail boom in India. People not just demanded more from their banks but also received more.

Currently (2007), banking in India is generally fairly mature in terms of supply, product range and reach-even though reach in rural India still remains a challenge for the private sector and foreign banks. In terms of quality of assets and capital adequacy, Indian banks are considered to have clean, strong and transparent balance sheets relative to other banks in comparable economies in its region. The Reserve Bank of India is an autonomous body, with minimal pressure from the government. The stated policy of the Bank on the Indian Rupee is to manage volatility but without any fixed exchange rate-and this has mostly been true.

With the growth in the Indian economy expected to be strong for quite some time-especially in its services sector-the demand for banking services, especially retail banking, mortgages and investment services are expected to be strong. One may also expect M&As, takeovers, and asset sales.

In March 2006, the Reserve Bank of India allowed Warburg Pincus to increase its stake in Kotak Mahindra Bank (a private sector bank) to 10%. This is the first time an investor has been allowed to hold more than 5% in a private sector bank since the RBI announced norms in 2005 that any stake exceeding 5% in the private sector banks would need to be vetted by them.

In recent years critics have charged that the non-government owned banks are too aggressive in their loan recovery efforts in connection with housing, vehicle and personal loans. There are press reports that the banks' loan recovery efforts have driven defaulting borrowers to suicide.

1.6. The Structure of banks in India:-

The report submitted by advisory panel on financial stability assessment and Stress testing in March 2009 as the follows:
## Table 1.2 The Indian Banking Sector

<table>
<thead>
<tr>
<th>Institution</th>
<th>No of institutions</th>
<th>Total assets (Rs. crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>The Banking Sector</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. <strong>Commercial Banks</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Scheduled Commercial Banks</td>
<td>169</td>
<td>4450027</td>
</tr>
<tr>
<td>Public Sector Bank</td>
<td>28</td>
<td>3022237</td>
</tr>
<tr>
<td>State Bank Group</td>
<td>8</td>
<td>1011169</td>
</tr>
<tr>
<td>Nationalized Bank Group</td>
<td>14</td>
<td>1880374</td>
</tr>
<tr>
<td>Other Public Sector Bank</td>
<td>1</td>
<td>130694</td>
</tr>
<tr>
<td>Private Sector Bank</td>
<td>23</td>
<td>940150</td>
</tr>
<tr>
<td>Old Private Bank</td>
<td>15</td>
<td>194555</td>
</tr>
<tr>
<td>New Private Bank</td>
<td>8</td>
<td>745595</td>
</tr>
<tr>
<td>Foreign Banks</td>
<td>28</td>
<td>364099</td>
</tr>
<tr>
<td>Regional Rural Banks</td>
<td>91</td>
<td>123541</td>
</tr>
<tr>
<td>Non-Scheduled Commercial Banks(local area banks)</td>
<td>4</td>
<td>654</td>
</tr>
<tr>
<td>2. <strong>Co-Operative Banks</strong></td>
<td>2889</td>
<td>550140</td>
</tr>
<tr>
<td>a. <strong>UCBs</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Scheduled</td>
<td>53</td>
<td>79318</td>
</tr>
<tr>
<td>Non-Scheduled</td>
<td>1717</td>
<td>100103</td>
</tr>
<tr>
<td>b. <strong>#Rural Co-Operative Banks</strong></td>
<td>1119</td>
<td>370719</td>
</tr>
<tr>
<td>Short term structure</td>
<td>402</td>
<td>324609</td>
</tr>
<tr>
<td>State Co-Operative Banks</td>
<td>31</td>
<td>85756</td>
</tr>
<tr>
<td>District Central Co-Operative Banks</td>
<td>371</td>
<td>158894</td>
</tr>
<tr>
<td>@Primary Agriculture Credit Societies</td>
<td></td>
<td>79959</td>
</tr>
<tr>
<td>Long term structure</td>
<td>717</td>
<td>46110</td>
</tr>
<tr>
<td>SCARDBs*</td>
<td>20</td>
<td>24336</td>
</tr>
<tr>
<td>PCARDBs+</td>
<td>697</td>
<td>21774</td>
</tr>
</tbody>
</table>

Source: (INDIA’S FINANCIAL SECTOR AN ASSESSMENT, Committee on Financial Sector Assessment March 2009(RBI)
SCARDBs: State Cooperative Agriculture & Rural Development Banks

PCARDBs: Primary Cooperative Agriculture & Rural Development Banks

Data for rural co-operative banks pertains to end March 2007.

97,224 Primary Agricultural Credit Societies (PACS) with loans outstanding of Rs.58, 600 crore at end March 2007

Commercial bank dominates the Indian banking sector. A new private and foreign bank represents a rising share with strong technological backup and varieties of products.

Table 1.3: Offices of Commercial Banks in India - 2005 to 2009

<table>
<thead>
<tr>
<th>Bank Group</th>
<th>As on March 31</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2005</td>
</tr>
<tr>
<td>State Bank of India and its Associates</td>
<td>14006</td>
</tr>
<tr>
<td>Nationalised Banks $</td>
<td>35096</td>
</tr>
<tr>
<td>Foreign Banks</td>
<td>242</td>
</tr>
<tr>
<td>Regional Rural Banks</td>
<td>14763</td>
</tr>
<tr>
<td>Other Scheduled Commercial Banks</td>
<td>6462</td>
</tr>
<tr>
<td>Non-Scheduled Commercial Banks</td>
<td>37</td>
</tr>
<tr>
<td>Total</td>
<td>70606</td>
</tr>
</tbody>
</table>

Notes: No. of offices includes administrative offices.
$ Includes IDBI Bank Ltd.
Data for 2005 to 2008 have been revised and data for 2009 are provisional.

Source: Master Office File (latest updated version) on commercial banks, Department of Statistics and Information Management, RBI.

1.7. Lending Procedures of the Term Lending Financial Institutions

1.7.1. Essential Requirements:

The essential requirements insisted upon by the financial institutions before taking up a request for financial assistance for consideration are:

1. The applicant concerned include the following should have obtained industrial license or should have made some kind of commitment, where necessary
2. The applicant should have obtained/applied for permission of the Securities and Exchange Board of India to issue capital, wherever necessary
3. The applicant should have obtained the approval of the Government regarding the terms of technical and/or financial collaboration agreement, if any.

4. The applicant should have a clearance from the Capital Goods Committee in respect of the machinery proposed to be imported.

5. The applicant should have selected a site for the location of the factory and has prepared a detailed 'project report'.

After the receipt of the filled up application in triplicate in the case of non-corporate units and quadruplicate in the case of corporate bodies, the project is appraised by a team of technical, financial and economic officers of the Corporation from several angles — technical, financial, economic, managerial and social.

1.7.2. Appraisal by Financial Institution:

1.7.2.1. Technical Appraisal

The technical appraisal of the project involves a critical analysis of the following:

1. Feasibility of the selected technical project and its suitability in Indian conditions.
2. Location of the project in relation to the sources and availability of inputs — raw materials, water, power, transport, skilled and unskilled labour and in relation to the market to be served by the product/service.
3. Adequacy of the plant and machinery and their specifications
4. Adequacy of the plant layout
5. Arrangements for securing technical know-how, if necessary
6. Availability of skilled and unskilled labour and arrangements for training for the labourers.
7. Provision for the disposal of factory effluents and utilisation of byproducts if any.
8. Whether the process proposed for selection is technically sound up-to-date etc.

Another important feature of technical appraisal relates to the technology to be adopted for the project. In case of new technical processes adopted from abroad, attention is to be paid to the terms and conditions.
1.7.2.2. Economic Appraisal

The economic appraisal of a project involves:

1. Consideration of natural and industrial property of the project and contribution to the national economy of the country in terms of contribution to GDP, down stream and upstream projects.
2. Savings in foreign exchange or prospects of exports.
3. Employment potential, direct and indirect
4. A critical study of the existing and future demand for the products proposed to be manufactured, the licensed and installed capacity, the level of competition etc.
5. Scrutiny of the project in relation to the import and export policies of the Government and various other factors like regulatory controls, if any, in regard to production, prices and raw materials.

1.7.2.3. Financial Appraisal

Financial appraisal of the existing concern deals with an analysis of its working results, balance sheets and cash flow for the past years/projected future years and an examination of the following aspects in all cases.

1. Estimated cost of the project
2. Financial plan with reference to capital structure, promoter’s contribution, debt-equity ratio and the availability of other resources.
3. Crucial examination of the investments made outside the business and justification therefore.
4. Projections of cash flow, both during the construction and the operation periods.
5. Projects break-even level of operation and time required to reach that level of operation.
7. Internal rate of return, debt-service coverage and projected dividends on share capital, payback period, abandonment value at the end of different levels of milestones or years of operation.
1.7.2.4. Managerial Appraisal

The confidence of the lending institution in the repayment prospects of a loan is largely conditioned by its opinion of the borrowing unit’s management. Therefore, it has been remarked that appraisal of management is the touchstone of term credit analysis. Where the technical competence, administrative ability, integrity and resourcefulness of the management are well established, the loan application gets the most favourable consideration. The expertise, experience and earnestness of the management tells in the efficiency, effectiveness and excellence of the project.

1.7.2.5. Social Appraisal

The social objectives of the project are considered keeping in view the interest of the general public. The projects, which provide large employment opportunities and canalize the income of the agricultural sector for productive use, projects located in totally less developed areas and projects that stimulated small scale industries are considered to serve the society well. The social benefits are more. The social cost of pollution consumption of scarce resources, etc. is also to be weighed.

1.8. Conditions for Assistance from Financial Institutions

Different financial institutions stipulate different kinds of conditions depending on the nature of the project, the borrower etc. The main conditions of a term loan are as follows:

1. The borrower (applicant) has to obtain all relevant Government clearances such as licensing, capital goods clearance for imported machines, import license, clearance from pollution control board, etc.
2. For consortium loan, the borrower has to satisfy all the institutions participating in lending
3. Concurrence of the financial institution is necessary for repayment of any existing loan or long-term liabilities.
4. The term loan agreement may stipulate the debt-equity ratio to be followed by the company.
5. As long as the loan is outstanding, the declaration of dividend is made subject to the institution’s approval.
6. The term lending institution reserves the right to nominate one or more directors in the management of the company.

7. Once the loan agreement is signed, any major commercial agreements such as orders for equipment, consultancy, collaboration agreement, selling agency agreement etc. and further expansion need the concurrence of the term lending institution.

8. The borrower is not permitted to create any additional charge on the assets without the knowledge of the financial institutions.

9. The financial institutions may appoint suitable personnel in the areas of marketing, research and development, depending upon the nature of the project.

10. The promoters cannot dispose their shareholders without the consent of the lending institutions. This is stipulated for keeping the promoters involved as long as the institutions are involved in the business.

1.9. **Profitability:**

Profitability is an assessment of earning capacity of an institution. Net profit/Income is an indicator of the firm's profitable operations, is the amount by which the revenues earned during a period exceed the expenses incurred during that period. If the firm's operations prove to be unprofitable, total expenses will exceed total revenues and the difference is referred to as net loss. Revenues are the amounts which the customers pay to the firm for providing them the goods and services and the income earned by doing the investment. The firm uses the economic resources to earn the revenues during the period of time, for which it incurs the cost that cost is known as expenses.

Profitability of an institution can be measured by applying different methods. For banking institution the profitability can be assessed through finding its Net Profit Ratio. Return on Asset Ratio, Interest and Non-Interest Income as percentage of working fund etc.

1.10. **Loans & advances:**

It is an arrangement of advancing a sum of money on interest for a pre-agreed period sometimes for a particular purpose as well.

General principles of a sound lending:-
1. Safety

2. Liquidity

3. Profitability

4. Purpose of the loan

5. Diversification of risks.

1.1. Provisioning:

As per the RBI guidelines the following provision has to be made
Standard Asset: The provision requirement for Standard Asset was 0.25 percent but from November 2005 it has been raised to 0.4 percent excluding direct advances to agricultural and small and medium enterprises. the general provisioning requirements for banks (excluding RRBs) in May 2006 has been increased to 1.0 percent in respect of the advances to - personal loans, loans and advances qualifying as capital market exposures, residential housing loans beyond Rs.20 lakh, commercial real estate loans.

Sub- Standard Asset: Secured advances: 10 percent
Unsecured advances: 20 percent

Doubtful Asset: Secured: 20 to 100 percent
(depending upon the period for which the asset has remained doubtful)
Unsecured: 100 percent

Loss Asset: 100 percent.