CHAPTER 3

PROFILE OF ALL THE BANKS

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3.1 INTRODUCTION

Money makes the mare go is an old saying which is relevant even today. Money and credit provide the pivot around which all the economic activities cluster. Banks are institutions that accept various types of deposits and use these funds for granting loans. By pooling the saving of widely scattered economically surplus units, banks form a vast pool of social capital. This helps in capital formation and capital accumulation. However, banks are not merely the storehouses of the country's wealth but they are reservoirs of resources necessary for economic development—be it building of infrastructure, setting up of basic and key industries, modernization of agricultural sector, boosting domestic and international trade, and so on. By discharging this function efficiently and effectively, a commercial bank increases the productive capacity of the nation and thereby plays a pivotal role in accelerating the pace of economic development.

Banks today are an important part of the payment mechanism of the economy, and it is through them that the monetary and fiscal policies of the government are concretized. By creating credit, banks are in a position to affect prices, nominal national income and other macro-economic variables. Banks are at the heart of the financial system. They are a class of financial institutions which the public views as safe and convenient outlets for their savings. The importance of a viable, sound and safe banking system cannot be overemphasized. [1]

The banking system needs to be sound and effective for a healthy economy (RBI Bulletin, 2007). It should also be effective in terms of applying updated and new technology. It should be capable of handling the various external and internal factors efficiently to remain competitive in the global market.[2]

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1 Elements of Banking and Insurance book by Jyotsna Sethi and Nishwan Bhatia Book

2 Effect of Size and Age on the Performance of Indian Banks under Different Ownership Forms by Harsh Arora

Today Banks have become a part and parcel of our life. There was a time when the dwellers of city alone could enjoy their services. Now banks offer access to even a common man and their activities that extend to areas previously untouched. Apart from their tradition business-oriented functions, they have now come out to fulfill national responsibilities.

Banks cater to the needs of agriculturists, industrialists, traders and to all the other sections of the society. Thus, they accelerate the economic growth of a country and steer the wheels of the economy towards its goal of "*self-reliance in all fields*". It naturally arouses our interest in knowing more about the "bank" and the various men and activities connected with it.

The banking system which combines commercial banking with investment banking is known as *mixed banking*, it is now referred to as *universal banking*. The essence of mixed banking or universal banking is attracting deposits from the general public and in providing short-term, medium-term, and long-term capital to industries.[3]

The Indian banking has finally worked up to the competitive dynamics of the 'new' Indian market and is addressing the relevant issues to take on the multifarious challenges of globalization. Banks that employ IT solutions are perceived to be 'futuristic' and proactive players capable of meeting the multifarious requirements of the large customers' base. Private Banks have been fast on the uptake and are reorienting their strategies using the internet as a medium. The internet has emerged as the new and challenging frontier of marketing with die conventional physical world, tenets being just as applicable like in any other marketing medium.

The Indian banking has come a long way from being a sleepy business institution to a highly proactive and dynamic entity. This transformation has been largely brought about by the large dose of liberalization and economic reforms that allowed banks to explore new business opportunities rather than generating revenues from conventional streams *(i.e.,* borrowing and lending). The banking in India is highly fragmented with 30 banking units contributing to almost 50% of deposits and 60% of advances. Indian nationalized banks (banks owned by the government) continue to be the major lenders in the economy

3 Banking Theory and Practice by R.Rmachandran Book

due to their sheer size and penetrative networks which assures them high deposit mobilization. The Indian banking can be broadly categorized into nationalized, private banks and specialized banking institutions.

The Reserve Bank of India acts as a centralized body monitoring any discrepancies and shortcomings in the system. It is the foremost monitoring body in the Indian financial sector. The nationalized banks *(i.e.,* government-owned banks) continue to dominate the Indian banking arena. Industry estimates indicate that out of 274 commercial banks operating in India, 223 banks are in the public sector and 51 are in the private sector. The private sector bank grid also includes 24 foreign banks that have started their operations here. Under the realm of the nationalized banks come the specialized banking institutions. These co-operatives, rural banks focus on areas of agriculture, rural development etc. [4]

For the past three decades, India's banking system has several outstanding achievements to its credit. The most striking is its extensive reach. It is no longer confined to only metropolitans or cosmopolitans in India. In fact, Indian banking system has reached even to the remote corners of the country. This is one of the main reasons of India's growth process.[5]

Since 1951, many specialized financial institutions were set up by the Government of India with the cooperation of RBI. These institutions — IFCI, ICICI, IDBI, SIDBI and others—were set up as public sector financial institutions with the main aim of helping industries with long-term capital funds. It was however increasingly felt that these development financial institutions could not fully meet the needs of the industry for medium and long-term finance. Accordingly, commercial banks in India have come forward to meet this need. In this connection some of the favourable factors which have appeared on the Indian banking scene are:

4 Banking Theory and Practice by Dr.P.K.Srivastava Himalaya Publishing House book
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i. Bank deposits have been rapidly increasing.

ii. Rise in time deposits as compared to demand deposits has been spectacular, viz., rising from 27 per cent to 75 per cent in recent years. These two factors show that banks are acquiring larger resources. It signifies that banks are highly interested in term loans and it will fit to keep for longer days.

iii. The Reserve Bank of India has been encouraging commercial banks to give up their traditional fear of term advances and medium-term industrial finance. In fact, RBI has provided them with re-finance facilities through the Industrial Development Bank of India.

Indian commercial banks have been displaying commendable initiative in moving away from the traditionally commerce-oriented charter of their operation in to financing and expanding needs of industry to an increased extent. Banks have entered the field of financing industries by way of granting term loans. Some scheduled banks have embarked upon long-term business loan against mortgage of industrial property (such as plants and buildings).[6]

While commercial banks in India are increasingly lending to industries for short and medium periods, the Development Financial Institutions in India (DFIs) have argued in recent years that

i. The conventional distinction between commercial banking and development banking is getting blurred and that there is a need to move progressively towards Universal banking.

ii. The DFIs should be allowed to convert themselves into banks over a period of time and should be permitted to provide both development finance and commercial banking services.

iii. In the short period, however, the DFIs may be permitted to set-up wholly owned or partly owned banking subsidiaries to undertake commercial banking.

6 Banking Theory and Practice by R.Rmachandran Book

In other words, the trend in India is towards mixed banking or universal banking. The role of banks has undergone a revolutionary change after nationalization. The focus of banks since nationalization has been primarily on "widening and deepening the banking system and effecting a structural transformation in the deployment of commercial bank credit in pursuance of the planned objectives of poverty removal, modernization of agriculture and small and cottage industries. Banking has thus emerged as an effective catalytic agent of social economic change." [7]

The major changes that have taken place in Indian banking can be summarized as follows:

1. The presence of strong banking across the country.

2. There is transformation from elite banking to mass banking.

3. The major mobilizer of domestic savings, particularly from household sector.
4. There is Broad-based bank credit with due emphasis on lending to priority sector and in rural areas.

5. Scientific requirement process and improved training, back-up and support are available.

6. The continued commercial viability of banks despite constraints and pressure (e.g. CRR, SLR administered rate of interests, concessional lending, public preference for long-term and high yielding deposits etc.).

7. Many specialized service units like extension counters, specialized branches, merchant banking cells, overseas branches, etc., to meet the banking needs are available.

8. The implementation of Lead Bank Scheme (LBS) with its focus on formulation and implementation of District Credit Plan (DCPs)

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7 Banking Theory and Practice by R.Rmachandran Book

9. There is increased usage of computer service in-house or otherwise, particularly for MIS (management information system) personnel, payroll administration, etc.

10. The presence of well-established IBA, NIBM, Banker's Clubs, block-level and district level coordination committees, state-level banker's committees, etc.[8]

The most significant phase in the evolution of banking was the phase of financial sector reforms that began in 1991-92, which had two sub-phases (1991 -92 to 1997- 1998; and 1998-99 and beyond). The main issues faced in the first sub-phase (1991-92 to 1997-98) were the weak health of the banking sector, low profitability, weak capital base and lack of adequate competition. To infuse competition in the banking sector, several measures were initiated such as allowing the entry of private banks into the system. A major achievement of this phase was significant improvement in the profitability of the banking sector. However, banks in this phase developed risk aversion as a result of which credit expansions slowed down in general and to the agriculture in particular. The focus in the second sub-phase (1998-99 and beyond) was on further strengthening of the prudential norms in line with the international best practices, improving credit delivery, strengthening corporate governance practices, promoting financial inclusion, strengthening the urban co-operative banking sector and improving the customer service. While strengthening the prudential norms, it was necessary to ensure that risk aversion, which had surfaced in the previous sub-phase, did not aggravate. Focused attention, therefore, was paid to put in place appropriate institutional measures to enable banks to recover their NPAs. The impact of these measures was encouraging as banks were able to bring down their non-performing assets sharply. This was the most important achievement of this phase. As the asset quality began to improve, banks also started expanding their credit portfolio. Capital position of banks also improved significantly. Competition intensified during this phase as was reflected in the narrowing down of margins. Despite this, however, banks slightly improved their profitability among others, due to increased volumes and improvement in asset quality. Two concerns arose with regard to corporate governance practices followed by banks. These related to concentrated ownership and quality of management that controlled the banks. The corporate governance

8 Banking Theory and Practice by R.Rmachandran Book

practices were, therefore, strengthened. Another major achievement in this phase was the sharp increase in the flow of credit to the agriculture and SME (Small and Medium Enterprises) sector. With a view to bringing a larger segment of excluded population within the banking fold, banks were advised to introduce a facility of ‘no frills' account. About 13 million 'no frills' accounts were opened in a short span of two year The confidence in the urban co-operative banking segment was eroded in the early 2000s following a run on a multi-state co-operative bank. In order to restore the confidence and overcome the problem of dual control over urban co-operative banks, a mechanism of the TAFCUBs (Task Force for Co-operative Urban Banks) was put in place, which helped restore the confidence in the urban cooperative banking segment. This phase also witnessed some significant changes in the use of technology by banks. Increased use of technology combined with some other specific initiatives helped improve the customer service by banks. [9]

The banking sector in India emerged largely unharmed from the global financial crisis of 2007-08, but faced a slowdown in the momentum of growth due to the weakening of trade, finance and confidence channels. However, post crisis, the economic growth in most emerging market economies (EMEs) including India recovered, while growth remains anemic in advanced economies. Instability of sovereign debt markets in the Euro zone, political turmoil in the Middle East and North African (MENA) region, calamities in Japan, sovereign debt downgrade of the United States in August this year and the persistently elevated levels of commodity prices have together led to an accentuation of downside risks to global growth. While these risks are expected to recede gradually over time, the long-term sustainability of higher growth in India will depend crucially on the ability of the banking sector to mobilize the savings and meet the credit needs of the growing economy through innovative financial instruments and services that foster financial inclusion and provide efficient and transparent delivery of credit.[10]

9 Indian Banks’ Association, Indian Banking Year book 2012
10 Indian Banks’ Association, Indian Banking Year book 2012

The headwinds from domestic and international economic developments posed challenges to the banking sector during the year 2011 -12. Though asset impairment increased, the resilience of the Indian banking sector was manifested in an improvement in the capital base and maintenance of profitability. A series of stress tests conducted by the Reserve Bank in respect of credit, liquidity and interest rate risks showed that banks remained reasonably resilient. However, under extreme shocks, some banks could face moderate liquidity problems and their profitability could be affected.

3.2 A list of some of the important events, which took place in banking sector from 1973 to 2012:

1973-74

- Setting targets for priority sector lending

1974-75

- Prescription of norms for lending and working capital limits

1982-83

- Prof.S. Chakravarty's report on Monetary System in India
- Establishment the National Bank for Agriculture and Rural Development (NABARD)

1985-86

- Introduction of MICR (Magnetic Ink Character Recognition) Technology
- Introduction of Health Code System for bank loans

1987-88

- Permission to banks to float mutual funds
- Vaghul Working Group on Money Market

1988-89

- Establishment of the Discount and Finance House of India (DFHI) and the National Housing Bank (NHB)
- Adaptation of Service Area Approach

1989-90

- Enhancement of access to call money market in terms of number of participants
- Establishment of the Small Industries Development Bank of India (SIDBI)

1990-91

- Report of the Narasimham Committee on Financial sector Reforms
- Introduction of new formats for annual accounts of the banks

1992-93

- Introduction of rupee convertibility on current account

1993-94

- Announcement of norms for floating new private sector banks
- Establishment of State Trading Corporation of India (STCI) Introduction of FCNR (B) (Foreign Currency Non Resident) deposits scheme.
- Introduction of (a)risk-weighted capital adequacy norms (b)prudential norms for asset classifications, income recognition and provisioning for banks
- Valuation of investment in government securities on the basis of market prices
- Constitution of Debt Recovery Tribunals
- Merger of New bank of India with Punjab national bank
- Reduction in the number of prescribed lending rates from six to three
- Introduction of 365-day Treasury Bills with the market related rates
- Aligning of rates of interest on dated securities of the Government with market rates

1994-95

- Deregulation of interest rates on loans over Rs.2 lakh
- Freedom to banks to decide their Prime lending Rates (PLR) and to link loan rates to their PLR
- Permission to the Nationalized Banks to raise capital upto 49 per cent of equity from capital market
- Setting up of the Board for Financial Supervision (BFS)
- Amendment to the State Bank of India Act to allow the bank to access equity market
- Budget provision of Rs.5,700 crore to re-capitalized banks to enable them to meet new provisioning norms
- Prescription of prudential norms for Non-Performing Assets
- Establishment of Debt Recovery Tribunals.

1995-96

- Introduction of the Banking Ombudsman Scheme
- Streamlining of the cash credit system
- Abolishment of Minimum Lending Rate on loans above Rs.2 lakh

1996-97

- Implementation of measures to strengthen secondary market in government securities.
- The State Bank of India (SBI) issued Global Depository Receipt (GDR) and became the first Indian bank to be listed on stock exchanges overseas.
- Six firms, promoted by banks and financial institutions, were granted license to operate as Primary Dealers (PDs) in the Government Security market.

1997-98

- Operationalization of first shared payment ATM network system
- Granting of conditional autonomy to the public sector banks
- Constitution of the Board for Bank Frauds

1998-99

- Report of the Narasimham Committee on Banking Sector Reforms
- Revision of capital adequacy norms
- Deregulation of interest rates on term deposits
- Amendment to The Reserve Bank of India Act empowering it to supervise Non-Banking Financial Companies.

1999-2000

- Issuance of guidelines on asset-liability management
- Tightening of the provisioning norms for government securities and state Goverenment guaranteed loans and assigning risk weights to this category of investment.
- Introduction of Kisan Credit Card Scheme
- Permission to banks to operate different PLRs for different maturities of loans
- Merger of the Times Bank with the HDFC Bank

2000-01

- Introduced a system of off-site surveillance for scheduled UCBs through quarterly returns
- Given freedom to banks to price loans of Rs. 2 lakh
- Guidelines issued for compromise settlement of dues of banks and FIs through Lok Adalat
- Advised banks to formulate polices for recovery/write off/compromise and negotiate settlements with the approval of Boards for old and unresolved cases under NPA category

2001-02

- Advised to build up Investment Fluctuation Reserve (IFR)
- Guidelines issued for raising subordinated debt for inclusion in Tier II capital by foreign banks operating in India
- Guidelines issued on foreign direct investment (FDI) in the banking sector
- Issued guidelines on market risk management
- The RBI approved the merger of ICICI Ltd. with ICICI Bank Ltd.
  The Non-Resident (Non-Repatriable) Rupee Account Scheme and Non-Resident (Special) Rupee Account Scheme discontinued w.e.f. 1.4.2002.

2002-03

- The Accounting Standards AS 17, AS18, AS21 & AS 22 made applicable to banks w.e.f. 31.3.2003
- Advised to take penal measures against willful defaulters
- The Benares State Bank Ltd. merged with Bank of Baroda w.e.f. 20.6.2002
- Scheme formulated for setting up of offshore banking units (OBUs) in Special Economic Zones by banks
- Public sector banks introduced One-time-settlement schemes giving opportunity to the borrowers for settlement of their outstanding dues/NPA accounts below a prescribed value ceiling

2003-04

- RBI gave freedom to banks to determine interest rates on loans and advances (i) for purchase of consumer durables, (ii) to individuals against shares and debentures/bonds, and (iii) other non-priority sector personal loans regardless the size of the loans.
- Banks were given freedom to decide all aspects relating to renewal of overdue deposits.

- The RTGS (Real Time Gross Settlement) was put in live operation from March 26, 2004.

2004-05

- Banks were advised to inform their account holders, at least one month in advance of any change in the prescribed minimum balance and the charges that may be levied if the minimum balance is not maintained.
- All SCBs (Scheduled Commercial Bank) were advised that the subsidy under Swarna jayanti Shahari Rozgar Yojana (SJSRY) would be back-ended, with a lock-in period of 2 year.
- Guidelines issued for implementing the revised Model KCC (Kisan Credit Cards) Scheme of NABARD to take care of the investment credit as also working capital for agriculture and allied activities and a reasonable component for consumption needs.

2005-06

- The Vision Document on Payment and Settlement System 2005-06 was released.
- Guidelines on one time settlement scheme for SME accounts issued to public sector banks for recovery of NPAs below Rs. 10 crore.
- Guidelines on securitization of standard assets issued to all banks.

2006-07

- Fair Practices Code for Lenders - The Banks were advised modify the Fair Practices Code and the same should be placed on the bank's /FI's website and also given wide publicity.
- To improve the credit delivery mechanism revised guidelines on lending to the priority sector were issued.
- Guidelines on 'When Issued' (WI) trading in 'Central Government Dated Securities' were prescribed in May, 2006 and this segment commenced from August, 2006.

2007-08

- The final guidelines on the revised capital adequacy framework (Basel II) were issued to banks in India on 27 April, 2007.
- Revised guidelines on derivatives were issued on 20 April, 2007.
- Two new sections were introduced for the implementation of the 'fit and proper' criteria for elected directors on the boards of banks.

- Guidelines on KYC/AML/CFT were issued to banks on 13 April 2007. An amendment to the PMLA rules was also notified by the Government on 24 May 2007

2008-09

- The Reserve Bank transferred its entire share holding in the State Bank of India to the Government of India.
- Final guidelines on prudential norms for off-balance sheet exposure of banks were issued to all SCBs (Scheduled Commercial Banks)
- The Guidelines on Asset-Liability Management system was amended and all commercial banks advised accordingly.
- The Finance Minister in his Budget Speech (2008-09) had announced the Debt Waiver and Debt Relief Scheme for farmer. A detailed scheme in this regard was notified for implementation by all scheduled commercial banks, besides RRBs and co-operative credit institutions. Banks were advised that the implementation of the Debt Waiver and Debt Relief Scheme should be completed by June 30, 2008.

2009-10

- There were 91 Regional Rural Banks as at end March 2008. However, due to amalgamation, number of such banks came down to 86 as on March 31, 2009 and further down to 84 as on July 20, 2009.
- IDBI Bank Ltd has been included in Nationalized Banks.

2010-11

- All scheduled commercial banks were directed to switch over to the new system of base rate in place of the existing benchmark prime lending rate (BPLR) system from July 1, 2010.
- General permission granted to domestic scheduled commercial banks [other than regional rural banks {RRBs}] to operationalize mobile branches in Tier 3 to Tier 6 centres [with population up to 49,999 as per Census 2001] and in rural, semi-urban and urban centres in the North-Eastern States and Sikkim.
- All Scheduled Commercial Banks (SCBs) directed to pay interest on savings bank accounts on a daily product basis from April 1, 2010.

2011-12

- A new Marginal Standing Facility (MSF) was instituted (May 7, 2011) where banks can borrow overnight from the MSF up to one per cent of their respective net demand and time liabilities or NDTL. The rate of interest on amounts accessed from this facility will be 100 basis points above the repo rate as per the above scheme; the revised corridor will have a fixed width of 200 basis points. The repo rate will be in the middle. The reverse repo rate will be 100 basis points below it, and the MSF rate 100 basis points above it.
- Increase in Savings bank deposit interest rate from the present 3.5 per cent to 4.0 per cent
- Merger of SBI Commercial & International Bank Ltd by State Bank of India effective 29.07.2011.
- "Australia and New Zealand Banking Group Limited" has been included in the Second Schedule to the Reserve Bank of India Act, 1934, from July 7, 2011.
- As on March 2011, there were 82 Regional Rural Banks having 16,001 branches.
- The Government of India has finalized the Credit Mobilisation Targets for the year 2011 -12 under the Swarna jayanti Gram Swarozgar Yojana (SGSY).

2012-13

- In order to provide greater liquidity cushion, it has been decided to raise the borrowing limit of scheduled commercial banks under the marginal standing facility (MSF) from 1 per cent to 2 per cent of their net demand and time liability (NDTL) outstanding at the end of second preceding fortnight with immediate effect. Banks can continue to access the MSF even if they have excess statutory liquidity ratio (SLR) holdings, as hitherto. The MSF rate, determined with a spread of 100 basis points above the repo rate, stands adjusted to 9.0 per cent with immediate effect. Detailed guidelines in this regard will be issued.
- Rs.500 crore to be provided to enable Regional Rural Banks to maintain a CRAR of at least 9 per cent as on March 31, 2012.
- Rabo bank was included in the second schedule of the Reserve Bank of India Act, 1934 with effect from July 30, 2011.

- Industrial & Commercial Bank of China was included in the second schedule of the Reserve Bank of India Act, 1934 with effect from February 3, 2012.
- National Australia Bank was included in the second schedule of the Reserve Bank of India Act, 1934 with effect from February 4, 2012.
- Woori Bank was included in the second schedule of the Reserve Bank of India Act, 1934 with effect from February 4, 2012.[11]

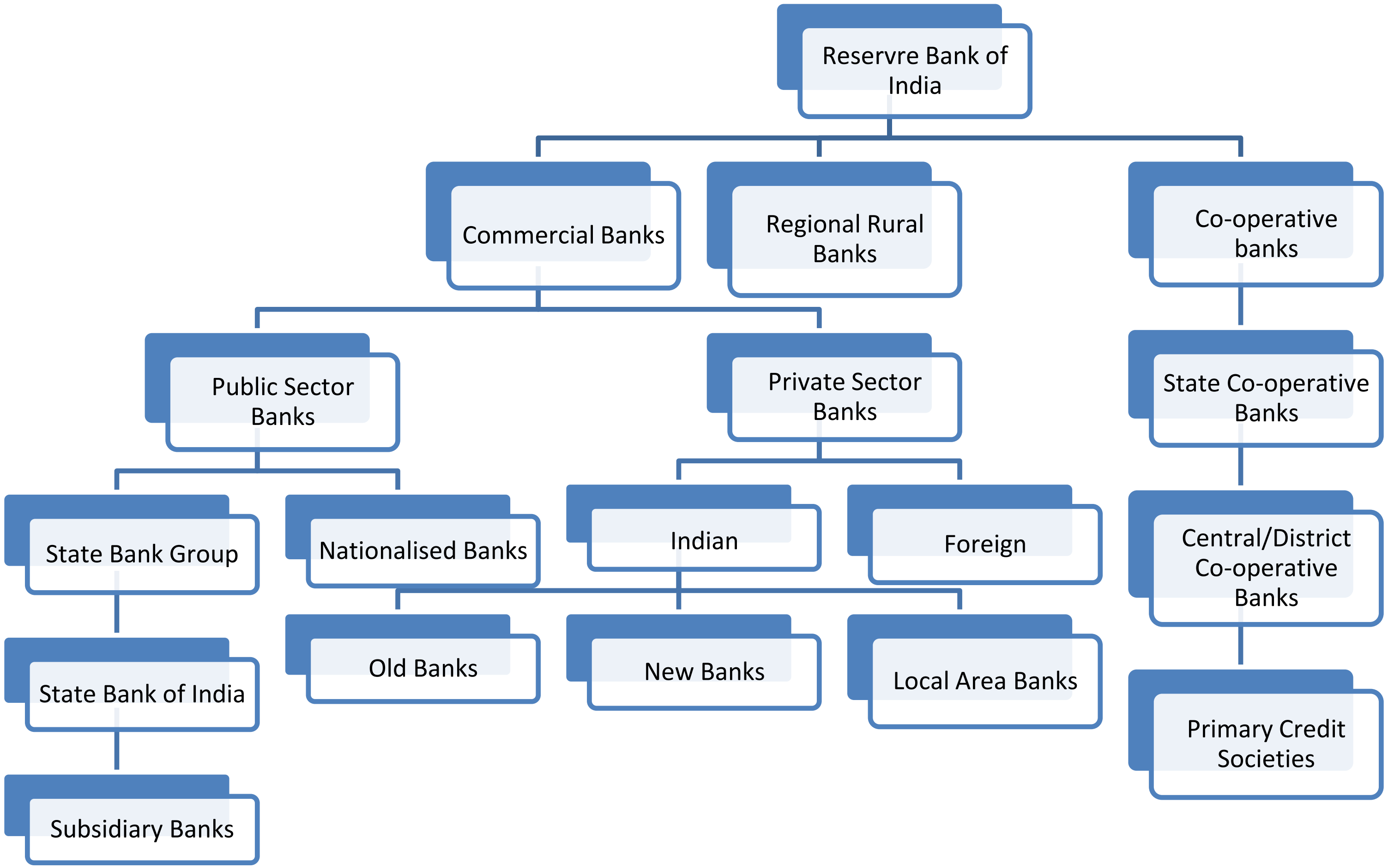
3.3 CLASSIFICATION OF BANKS

The Indian financial system comprises a large number of commercial and cooperative banks, specialized developmental banks for industry, agriculture, external trade and housing, social security institutions, collective investment institutions, etc. The banking system is at the heart of the financial system.

The Indian banking system has the RBI at the apex. It is the regulatory body for all banks in India. It is the central bank of the country under which there are the commercial banks including public sector and private sector banks, foreign banks and local area banks. It also includes regional rural banks as well as co-operative banks. The structure of the Indian banking system is given below.

11 Indian Banks' Association, Indian Banking Year book 2012

Indian Banking System



India banks are being segregated in different groups. Each group has their own benefits and limitations in operating in India. Each has their own dedicated target market. Few of them only work in rural sector, while others in both rural as well as urban. Many even are only catering in cities. Some are of Indian origin and some are foreign players.

Banks operating in India can be broadly classified into two categories viz., commercial banks, and co-operative banks. Within the category of commercial banks, there are two types of banks namely scheduled commercial banks (i.e., which are listed in Schedule II of the Reserve Bank of India Act 1934), and non-scheduled commercial banks. Depending upon the pattern of ownership, commercial banks can be classified into three groups. They are: (i) Public Sector Banks which include the State Bank of India, its Associate Banks and Nationalized Banks and other Public Sector banks (ii) Private Sector Banks consisting Indian Private Sector Banks (which can be sub-divided into two i.e. banks existing prior to 1991 and the banks established after 1991) and Foreign Banks operating in India, (iii) others comprising Regional Rural banks and Local Area Banks. As on March 31, 2012 total number of scheduled commercial banks stood at 87.

Of these, public sector banks have a countrywide network of branches and account for over 75 percent of total banking business. They have strong presence in rural and semi-urban areas. Private sector banks and foreign banks are more techno savvy and have limited number of branches. Public sector banks sponsor the RRBs and their activities are localized.[12]

In addition, we have cooperative banks and regional rural banks controlled by government and private agencies that play a vital role particularly in the rural economy. However, public sector banks continue to dominate the banking industry, in terms of lending and borrowing by virtue of their wide branch network. This helps them in pooling resources and in revenue generation for credit creation. A recognition of the role of banks in accelerating economic development prompted the nationalization of 14 major commercial banks in 1969 and six more in 1980. This facilitated the rapid expansion of banking in terms of its geographical reach across rural India, in turn leading to significant growth in deposits and advances.

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12 Indian Banks' Association, Indian Banking Year book 2012

It may be noted that the government ownership of major banks resulted in an automatic monetization of the fiscal deficit, which partially subjected the banking sector to large pre-emptions both in terms of statutory holdings of government securities and administrative directions of credit to priority sectors. Further, a multifarious **(assorted)** arrangement of administered interest rates necessitated cross-subsidization to sustain the commercial viability of institution. These, not only distorted the interest rate mechanism but also adversely affected the efficiency of these banks. [13]

3.3.1. Reserve Bank of India

There is only one central bank in a country whose main function is to control the operations of the rest of the banking system. Reserve Bank of India (RBI), the central bank of India, is the apex institution responsible for managing and supervising the monetary and financial system of the economy.

The need for a central bank to control and coordinate currency and credit was felt for a very long time. The Reserve Bank of India Act was passed in 1934. In the beginning, it was a shareholders' bank with a capital of Rs. 5 crore divided into shares of Rs. 100 each. In 1948, in accordance with the Reserve Bank (Transfer to Public Ownership) Act, 1948, the Reserve Bank of India was nationalized, and all its shares were purchased by the Government of India.[14]

Establishment and Early History of RBI:-

The Imperial Bank of India which emerged as a consequence of the amalgamation of three Presidency Banks of Bengal, Bombay and Madras in 1921 assumed certain central banking functions except currency management. The control of currency management continued to be with the Government of India in order to ensure that the central banking entity did not appropriate powers greater than those mandated by the political authority. The Reserve Bank of India Act was placed on the statute book on March 6, 1934. The Reserve Bank commenced operations on April 1, 1935 and was nationalized on January 1, 1949. The

13 Efficiency and Productivity Growth in Indian Banking by S. S. Rajan and V. Pandit
14 Banking Theory and Practice by Dr.P.K.Srivastava Himalaya Publishing House book

head office of the Bank is in Mumbai and its executive head is called the Governor

The objective of establishing the Reserve Bank, as stated in the preamble to the RBI Act 1934, was to "regulate the issue of bank notes and the keeping of the reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage". The Bank's functions as laid down in the statutes were: (a) issue of currency (b) banker to Government; and (c) banker to other banks. Except in the sphere of agriculture, the Bank was not entrusted with any great promotional role and that too on a limited scale.

Central banks occupy a pivotal position in the institutional fabric of an economy. The functions of a modern central bank are vastly different from what was expected from the early central banks founded in Europe in the 17th century. The evolution of central banking in the Indian context has its own specificity. The Reserve Bank of India (RBI), while discharging its statutory responsibilities, has played a crucial role in the nation building process, particularly in the development of the financial sector. In-fact, institution building constitutes a distinguishing feature of central banking in India.

During most of the pre-independence period, RBI was a private bank, though formed under a statute and overseen by the then colonial government. The functions of the Bank during this phase were confined essentially to traditional central banking, *i.e.,* note issue authority and banker to the Government. During the war and post war years, its major preoccupation was facilitation of war finance, repatriation (**banishment**) of sterling debt and planning and administration of exchange control.

The initial phase of RBI was marked by several wars and postwar developments including the separation of Burma (modern Myanmar) in 1937, partition of the country in 1947 and nationalization of the Reserve Bank, which altered the area of operations of the Bank. After the separation of Burma, the Bank acted as currency authority of that country till 1942 and as banker to the Burmese government till March 1947. Upon the partition of the country in 1947, the Bank rendered central banking services to the Dominion of Pakistan until June 1948. In terms of the Pakistan Monetary System and Reserve Bank (Amendment)

Order, 1948, the Bank ceased to function as the central bank for Pakistan from July 1, 1948.[15]

Management of RBI

The general superintendence and direction of the affairs and business of the bank are entrusted to a central Board of Directors consisting of 20 directors, including:

(a) A Governor and four Deputy Governors, appointed as whole-time officers of the bank by the Central Government for a term not exceeding five years;
(b) Four directors nominated by the Central Government, one from each of the four Local Boards constituted as given below (Point c & d);
(c) Ten directors nominated by the Central Government for a term of four years; these directors are experts in business, industry, finance and cooperation; and
(d) One official nominated by the Government of India (Secretary, Finance Ministry, Government of India).
All the powers of the Bank are exercised by the Central Board which must meet at least six times each year and at least once in each quarter.

The whole country has been divided into four areas: the Western Area, the Eastern Area, the Northern Area, and the Southern Area, having headquarters at Mumbai, Kolkata, New Delhi and Chennai respectively. For each of these four areas, there is a Local Board consisting of five members appointed by the Central Government for a term of four years, to represent, as far as possible, territorial and economic interests and the interests of cooperative and indigenous banks. The function of the local board is to advise the Central Bank on such matters as may be generally or specially referred to it and to perform such duties as the Central Board may delegate to it. [16]

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15 Banking Development in India 1947 to 2007 Growtg, Reform and Outlook book by Niti Bhasin New Centurian Publication, New Delhi

16 Banking Theory and Practice by Dr.P.K.Srivastava Himalaya Publishing House book

Achievements of the Reserve Bank

As a Government banker, the Reserve Bank has achieved a remarkable measure of success in the management of the public debt. In addition, it has floated loans for the Central and State Governments at low rates. From time-to-time, it has also provided ways and means to State Governments through sale of Treasury Bills. As a lender of last resort, the Bank has advanced large amounts to scheduled banks during periods of crisis.

In the field of industrial finance, the Reserve Bank has played a very important role in organizing the Industrial Finance Corporation, the State Financial Corporations and the Industrial Development Banks of India as agencies for providing long-term finance to industry.

In the field of agricultural finance, the Reserve Bank has done a very valuable work by developing rural credit in India and maintaining a special department to render expert advice to Government on co-operative credit.

In the field of research, the Bank's Department of Research and Statistics, which is staffed by competent economists and statisticians, has been doing a useful service to the country.

As regards the control and supervision of banking institutions the Reserve Bank, in exercise of the powers vested in it under the Banking Companies Act of 1949, has taken steps to promote sound banking practice in the country. Constant vigilance by the Reserve Bank and sustained efforts on its part to remove defects have tended to strengthen individual banks, and to inspire public confidence in the banking system as a whole. [17]

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Failures of the Reserve Bank

In certain fields, the Reserve Bank of India has not been able to perform its functions successfully.

It has failed to stabilize the internal value of the currency, which is admittedly an important function of central bank. It has also failed to maintain the external value of the Rupee.

It has failed to control and coordinate the services of the various credit agencies and cooperative societies, smaller banks and indigenous bankers, who are still outside its purview and supervision.

It has failed to develop an organized bill market to provide rediscounting facilities to scheduled banks and to enable them to invest their surplus funds profitably.

The Reserve Bank has not succeeded in reducing the differences between the bank rate and other money market rates. Despite these failures, however, the Reserve Bank of India has ushered in a new era of financial stability and banking reform. [18]

Control of Credit by the Reserve Bank

It has been provided in the Preamble to the Reserve Bank of India Act that one of the functions of the Bank is to control currency and credit. The control that a Central Bank is able to exercise on the monetary system largely depends upon the control that it is able to exercise on the constituents of the purchasing power. In all countries, including India, token coins and currency notes form the bulk of the purchasing power, the latter being more important than the former. In countries where banking has developed, the deposit currency also plays an important role in the creation of credit and purchasing power.

The methods of credit control are usually categorized into: *(i)* General (or) quantitative methods and *(ii)* Selective (or qualitative) methods. The Bank Rate Policy, variable reserve requirements, statutory liquidity requirements, and open market operations policy fall in the category of general credit control method. The various directives issued by the

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Reserve Bank restricting the quantum and other terms of granting credit against certain specified commodities constitute the selective control method.

The main difference between the general and selective credit control methods is that the former influence the cost and overall volume of credit granted by banks. They affect credit granted to the whole economy, whereas the selective controls affect the flow of credit to only a specified sector of the economy, wherein speculative tendency and rising trend of prices, due to excessive bank credit, is noticed.

The general credit control measures affect the: *(i)* cost, and *(ii)* availability (or quantum) of bank credit. The cost of credit is influenced by the Bank Rate at which the central bank provides refinance to the banks. During recent years the Reserve Bank has relied upon its powers to regulate the interest rates on the bank advances and is directly regulating the interest rates of banks rather than through the instrument of Bank Rate.

The overall quantum of credit created by banks depends on their cash reserves, comprising cash in hand and balances with the Reserve Bank. The cash reserve increase through: *(i)* arise in deposit resources of banks, *(ii)* borrowing from the Reserve Bank, or *(iii)* by sale of their investments. Regulation of credit by the Reserve Bank means regulations of quantum of cash reserves of commercial banks. These control measures exert their influence on the assets pattern of commercial banks. When the Reserve Bank desires to control, it adopts various methods, whereby the quantum of refinance is restricted and the flow of bank resources to investments and statutory reserves with the Reserve Bank is enhanced, thereby curtailing **(shortening)** the availability of loanable resources with the bank. [19]

Control of Currency

The Reserve Bank of India has been given the monopoly of note issue to enable it to exercise control over the volume of bank notes. Ordinarily, the expansion or contraction of currency is affected under Section 33 (i) by increasing or decreasing the assets of the Issue Department, which are kept in the form of rupee coins, including rupee notes, gold coin and

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bullion, rupee securities, including Treasury Bills and foreign securities. An expansion in currency can be affected by increasing any of these forms of assets and issuing notes of equal value from the Issue Department. A contraction in currency can be similarly effected withdrawing notes from circulation and reducing any of the assets held by the Reserve Bank. Ordinarily, when it wants to expand currency, the Bank increases the assets of the issue Department by transferring rupee or foreign securities or both from the Banking Department or by cancelling *ad hoc* Treasury Bills held in the Issue Department. Sometimes, currency is expanded or contracted as a result of a revaluation of securities held in Issue Department.[20]

Inspection by Reserve Bank

Under Section 35, the Reserve Bank either at its own initiative or at the instance of the Central Government, is empowered to cause an inspection to be made, by one or more of its officers, of any banking company and its books and accounts. Every director, officer or employee of banking company under inspection must produce all books, accounts and other documents, etc., required by the inspecting officer. The Reserve Bank has also powers to examine on oath any director, officer or employee of a banking company.[21]

The Reserve Bank regulates and supervises the major part of the financial system. In the past five decades, the Indian banking system has traversed through a difficult path endeavoring to balance several competing and conflicting demands on it from large, medium, small and tiny borrowers in both the organized and unorganized sector. The banking system's activities were initially tightly regulated and their freedom was restricted. It also confronted several domestic stresses and external shocks. However, the regulations have changed over time to ensure that the banking system steps out of the restrictive operational environment and functions in an atmosphere that provides the freedom to innovate. In recent years, innovations in instruments and processes, advances in technology and the increasing volumes of capital intermediated by the financial system have necessitated a proactive strengthening of the regulatory and supervisory framework. Emergence

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of several players with diversified and significant presence in the financial sector makes it imperative for supervision and regulation to be spread across various segments of the financial system. In recent years, there has been a shift in emphasis from micro-regulation to macro-management, supported by a tightening of prudential norms and improvements in the functioning of the financial system. Central banks have robust frameworks for macroeconomic analysis, and in India, the Reserve Bank has the responsibility for micro-prudential supervision of banks and non-banking financial companies. As a result, while macroeconomic analysis has helped in strengthening the micro prudential supervision, supervisory information aggregated for the financial system as a whole has also helped in conducting more appropriate macroeconomic policies. The Reserve Bank has been deeply involved in the development of markets, and it monitors and analyses the impact of market trends on the economy and financial institutions. Another important reason why the RBI has to be the systemic risk regulator is because of their mandate of Lender of Last Resort (LOLR). The Reserve Bank of India is also entrusted with the responsibility of regulating and supervising the Non-Banking Financial Companies. As at end-March 2012, there were five financial institutions (FIs) under the full-fledged regulation and supervision of the Reserve Bank, viz., Export Import Bank of India (EXIM Bank), National Bank for Agriculture and Rural Development (NABARD), National Housing Bank (NHB), Small Industries Development Bank of India (SIDBI) and Industrial Investment Bank of India (IIBI). However, IIBI is in the process of voluntary winding-up.[22]

Licensed Banks

No bank can carry on the business of banking unless it holds a license granted by the Reserve Bank of India. Provisions regarding licensing are contained in section 22 of the Banking Regulation Act, 1949. A license is usually granted if the RBI is satisfied that the bank has the capacity to pay its depositors as and when their claims accrue, and that its operations are not detrimental to the interests of the depositors. Licensing is done to ensure that the working of individual banks improves, and that the weaker and unsound ones can be weeded out.

22 Indian Banks' Association, Indian Banking Year book

Licenses can be cancelled at any time if the RBI feels that the affairs of a bank are not being carried on in a satisfactory manner. [23]

3.3.2. Scheduled Banks

A **scheduled bank** means a bank included in the second schedule of the Reserve Bank of India Act, 1934. A bank is included in this schedule if,

1. It is carrying on the business of banking in India.
2. Its paid-up capital and reserves are not less than Rs.5 lakhs.
3. It is:

    i. A state cooperative bank.
    ii. A company as defined in the Companies Act of 1956.
    iii. An institution notified by the central government in this behalf.
    iv. A corporation or company incorporated by, or under any law in force in any place outside India.

All nationalized banks, e.g., Canara Bank, Syndicate Bank and almost all private sector banks, such as Axis, ICICI and HDFC are commercial scheduled banks in India. Foreign banks like ABN Amro and HSBC are also scheduled banks in India. Since 1965, the state cooperative banks have also been made eligible to be included in the second schedule. At present, scheduled commercial banks (SCBs) consist of 28 public sector banks, 9 new private sector banks, 20 old private sector banks and 31 foreign banks.

A scheduled bank enjoys certain privileges like becoming eligible for availing the facilities of accommodation from the Reserve Bank, dealing in foreign exchange, etc. It also has certain obligations like maintaining statutory reserves with the Reserve Bank. [24]

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3.3.3. Non-Scheduled Banks

Those banks which are not included in the second schedule of the Reserve Bank of India Act is termed as **non-scheduled banks.** Usually they are small sized institutions which restrict their activities to local areas. Their paid-up capital and reserves do not aggregate up to more than Rs.5 lakhs. Their banking activities are also limited, e.g., they cannot deal in foreign exchange. The classification of Indian commercial banks into scheduled and non-scheduled banks had significance prior to nationalization but now almost all commercial unscheduled banks have been weeded out. Their role has become very small in terms of deposits as well as number of branches. It carries little practical meaning except that of academic interest. [25]

3.3.4. Scheduled Bank Includes The Following Banks:-

COMMERCIAL BANKS

In the organized sector of the money market, commercial banks and cooperative banks have been in existence for the past several decades. A commercial bank is run on commercial line that is to earn profits unlike a cooperative bank which is run for the benefit of a group of members of the cooperative body, e.g., a housing cooperative society. The commercial banks are spread across the length and breadth of the country, and cater to the short-term needs of industry, trade and commerce and agriculture unlike the developmental banks which focus on long-term needs. These days the commercial banks also look after other needs, of their customers including long-term credit requirements.

The banking sector has been undergoing drastic metamorphosis. The rapid progress witnessed in the realm of banking services has been engineered by the trends in globalization, liberalization and privatization. The technological revolution and demographic changes have also helped to change the face of banking in India. More banks are switching over to virtual banking from the brick and mortar banks, and are providing a vast range of products through very innovative channels and at highly competitive prices. Banks are now free to quote their own interest rates on loans/advances and term deposits. They now have to

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25 Elements of Banking and Insurance book by Jyotsna Sethi and Nishwan Bhatia Book

manage their investments and loans portfolios based on the international norms and practices of risk management including asset liability management.

Commercial banks operating in India may be categorized into public sector, private sector, and Indian or foreign banks depending upon the ownership, management and control. They may also be differentiated as scheduled or non-scheduled, licensed or unlicensed.[26]

A commercial bank is a financial intermediary which accepts deposits of money from the public and lends them with a view to make profits. A post office may accept deposits but it cannot be called a bank because it does not perform the other essential function of a bank, i.e. lending money. Similarly, some other institutions like Unit Trust of India may be lending to others but since they do not accept chequable deposits, they cannot be termed as banks. They are non-banking financial institutions.

Commercial banks play an important role in the development process of underdeveloped countries. By offering attractive saving schemes and ensuring safety of deposits, commercial banks encourage willingness to save among the people. By reaching out to people in rural areas, they help convert idle savings into effective ones. Commercial banks improve the allocation of resources by lending money to priority sectors of the economy. These banks provide a meeting ground for the savers and the investors.[27]

Functions of a Commercial Bank

1. It accepts deposits which are of various types like current, savings, recurring and fixed deposits.
2. It grants credit in various forms such as loans and advances, discounting of bills and investment in open market securities.
3. It collects cheques, drafts, bills and other instruments for its depositors.
4. It provides remittance facilities through drafts and telegraphic transfers.

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26 Elements of Banking and Insurance book by Jyotsna Sethi and Nishwan Bhatia Book
27 Banking Development in India 1947 to 2007 Growth, Reform and Outlook book by Niti Bhasin New Century Publication, New Delhi, India

5. It renders investment services such as underwriter and banker for new issues of securities to the public.
6. It provides such agency services as purchase and sale of foreign exchange, acceptance of tax payments, electricity bills etc.
7. It provides facilities like travelers cheques, gift cheques and safe deposits vaults to its customers. [28]

PUBLIC SECTOR BANKS

The Central Government entered the banking business with the nationalization, of the Imperial bank of India (now the State Bank of India) in 1955. In 1969, fourteen large banks were nationalized and again in 1980 six more banks were taken over by the Government. These nationalized banks are called public sector banks.

Public sector banks have acquired a place of prominence since nationalization. These continue to be the major lenders in the economy due to their sheer size and penetration of network. The public sector banks comprise 19 nationalized banks, the State Bank of India and its 7 associates. Till 1955 they were used to be only private commercial bank—whether scheduled or non-scheduled, licensed or unlicensed, foreign or Indian, they were all owned and controlled by private entrepreneurs, and shareholders. There were three phases of bank nationalization. First was in July 1955, when Government of India nationalized the Imperial Bank of India to create the State Bank of India. It was a pioneering attempt in introducing public sector banking in the country. In 1959, eight state banks of erstwhile princely states were also nationalized to form the subsidiaries of the State Bank of India. But now only seven of them are in existence, since the state banks of Bikaner and Jaipur were merged. The second phase of public sector banking came into existence when 14 major commercial banks were nationalized on July 19, 1969. This was done with the view to serve the needs of development of the economy in conformity with national priorities and objectives. On April 15, 1980, six more private sector banks were nationalized. This led to the dominance of public sector banks as nearly 90 per cent of the banking activity in the country was brought into the public sector. Most people generally rely on nationalized banks backed

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28 Banking Development in India 1947 to 2007 Growth, Reform and Outlook book by Niti Bhasin New Century Publication, New Delhi, India

by the government. The public sector banks were socially controlled and publicly owned. It was done with the objective of giving a professional bent to bank management and provision of adequate credit for agricultural and rural sector, small industries, export and a new class of entrepreneurs. It also aimed to professionalize bank management through adequate training of bank staff. [29]

The public sector was originally conceived as holding the commanding heights of the economy and leading technological advance. It was also intended to generate investible surpluses and become an engine for self-reliant growth. The public sector has contributed significantly to the diversification of India's industrial structure. But its contribution in terms of generating internal resources for further expansion has fallen short of expectations, and its inability to do so has now become a major constraint on economic growth.[30]

In retrospect, it appears that political motives dominated the decision about the two nationalizations. Large-scale branch expansion, mass recruitment of staff to take banking to grass roots level, direct investments and credit programmes, administered interest rate regime, credit dispensation towards poverty alleviation programmes through loan melas, etc., ruled the roost in the Indian banking scene for over two decades. However, when faced with stiff competition from private sector and foreign banks, the public sector banks have reinvented themselves, and have markedly improved their services and operational results.

It is imperative that the public sector attains the objective originally set for it. This will require a sustained improvement in productivity and profitability. The budgetary support to public sector enterprises will need to be scaled down and they will be expected to maintain financial discipline in their operation. The sector should be exposed to competitive pressures wherever possible. Some of the enterprises can be restructured so as to improve their capital base and access to the market.

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To enable the public sector to work efficiently, the public sector units have to be given the greatest autonomy in their operations. A system of full responsibility and complete accountability will have to be enforced on public sector managements. In 1991-92 the Government undertook a limited disinvestment of a part of public sector equity to the public through public financial institutions and mutual fund in order to raise non-inflationary finance for development. The disinvestment will also in greater public accountability and help to create a new culture in their working which would improve efficiency. The objective of public sector policy is to improve the operational efficiency of these units and return them to their original goods. Recognizing that sickness is a serious problem in many public sector units, the Government amended the 'Sick Industrial Companies Act' to bring public sector undertakings also within their purview. This makes sick public sector units subject to the same discipline as private sector units including reference to the BIFR (Board for Industrial and Financial Reconstruction) for identification of a viable restructuring package or closure as the case may be. [31]

Public sector banks work as catalyst agents of economic growth and prosperity by following the right kind of policies in their working depending upon the socio-economic conditions prevailing in a country. In our planned economy Public Sector Banks perform functions of technical nature including the fulfillment of credit requirements as per government's economic plans and controlling the utilization of these credits according to planned priorities. The role of public sector banks has become increasingly crucial over time to mobilize savings for the purpose of credit to the agriculture, industry, trade and commerce in accordance with the plan priorities and targets.

Public Sector Banks, works as channel manager of financial expansion and success by following the correct type of rules in their operation depending upon the economic circumstances existing in a nation. Public Sector Banks by their nature are Government banks and therefore their Banking obligations have to be focused on the Government’s economic programme. For the continued existence of Public Sector Banks, management of the NPA and capital adequacy has been considered as one of the major criteria.

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PRIVATE SECTOR BANKS (INDIAN)

The entry of new private sector banks into the Indian banking industry has brought in a torrent **(flow)** of new challenges for Public Sector Banks (PSBs) at a time when they are fighting to survive in this highly competitive environment. Due to this new emerging competition, all Indian banks, are trying their best to improve their performance and preparing to compete in the emerging global market. It is believed that private ownership helps improve efficiency and performance.

Private sector banks have existed for over a century in India. Prior to the first major nationalization in 1969, private capital called the shots in commercial banking. The Tatas owned the Central Bank of India, the Birlas—the United Commercial Bank (UCO Bank now), and so on. Following the recommendations of the Narasimham committee on financial sector (1991), the Reserve Bank of India issued guidelines for the setting up of new private sector banks in India in January 1993. It was hoped that these financially viable, technologically sound and professionally managed banks will infuse greater competition and propel the entire banking sector to much higher levels of productivity and efficiency. At present, there are 21 old private sector banks and 9 new private sector banks. The new private sector banks are aggressive, professionalized and fastest growing. The old private sector banks are typically smaller with the specific regional buyers and less than satisfactory performance.

The minimum paid-up capital shall be Rs.100 crore with promoter's contribution being 25 per cent. In case the capital is more than Rs. 100 crore, then the promoter's contribution shall be 20 per cent. NRI participation can be to the extent of 40 per cent. The shares of the bank should be listed on stock exchanges. The bank shall be subject to prudential norms in respect of banking operations norms for income recognition, asset classification and provisioning as well as capital adequacy of 8 per cent of the risk weighted average.

The bank shall have to observe priority sector lending targets as applicable to other banks, though some modifications in their composition may be allowed by the RBI in the initial three years. RBI instructions with respect to export credit will also have to be complied with. For at least three years after its establishment they will not be allowed to set up a subsidiary or mutual fund.

Branch licensing shall be governed by the existing policy whereby banks are free to open any branches without prior approval of the RBI, if they satisfy capital adequacy and prudential accounting norms. If the RBI so directs, they might be required to open branches in rural and semi-urban areas. [32]

After giving free field to nationalized banks which account for 91 per cent of total bank branches and handle 86 per cent of the banking business in the country for over two decades now, the Reserve Bank has decided to permit setting up of new private sector banks.

It laid down conditions for setting up of new private banks. Such banks must subserve the underlying goals of financial sector reforms which are to provide competitive, efficient and low cost financial intermediation services for the society at large. They should be financially viable. Their presence should result in up-gradation of technology in the banking sector. They should be equipped to avoid the shortcomings such as unfair pre-emption and concentration of credit, monopolization of economic power, cross holdings with industrial groups, etc., which beset the private sector banks prior to nationalization. Freedom of entry in the banking sector may have to be managed carefully and judiciously.

RBI has laid down detailed guidelines of establishment of new banks in the private sector. Such a bank should be registered as a public limited company under the Companies Act, 1956. The RBI may, no merits, grant a license under the Banking Regulation Act, 1949 for such a bank. The bank may also be included in the second schedule of the Reserve Bank of India Act, 1934 at the appropriate time. The decision of the RBI in these matters shall be final.

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The bank will be governed by the provisions of the Banking Regulation Act, 1949 in regard to its authorized, subscribed and paid-up capital. The minimum paid-up capital for such a bank shall be Rs. 100 crore. The promoters' contribution for such a bank shall be determined by the RBI and will also be subject to other applicable regulations. The shares of the bank should be listed on stock exchanges.

To avoid concentration of the headquarters of new banks in metropolitan cities and other overbanked areas, while granting a license preference would be given to those the headquarters of which are proposed to be located in a centre which does not have the headquarters of any other bank. Voting rights of an individual shareholder shall be governed by the ceiling of one per cent of the total voting rights as stipulated by Section 12(2) of the Banking Regulation Act. However, exemption from this ceiling may be granted under Section 53 of the said Act, to public financial institutions.

The new bank shall not be allowed to have as a director any person who is a director of any other banking company, or of companies which among themselves are entitled to exercise voting rights in excess of 20 per cent of the total voting rights of all the shareholders of the banking company, as laid down in the Banking Regulation Act, 1949. The bank will be governed by the provisions of the Reserve Bank of India Act, 1934, the Banking Regulation Act, 1949 and other relevant statutes, in regard to its management set up, liquidity requirements and the scope of its activity. The directives, instructions, guidelines and advices given by the RBI shall be applicable to such a bank as in the case of other banks. It would be ensured that a new bank would concentrate on core banking activities initially.

Such a bank shall be subject to prudential norms in respect of banking operations, accounting policies and other policies as are laid down by RBI. [33]

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The Reserve Bank of India issued specific guidelines on 22nd Jan., 1993 for the entry of new private sector banks:-

1. The bank shall be registered as a public limited company under the Companies Act.
2. The RBI may, on merits, grant a license under the Banking Regulation Act, 1949 for as bank. The bank may also be included in the Second Schedule of the Reserve Bank of India Act, 1934 at the appropriate time. The decision of the RBI in these matters shall be final.
3. The bank will be governed by the provisions of the Banking Regulation Act, 1949, in regard to its authorized, subscribed and paid-up capital. The minimum paid-up capital shall be Rs. 100 crore. The promoters' contribution shall be determined by the RBI and will also be subject to other applicable regulations.
4. The shares of the bank should be listed on Stock Exchanges.
5. To avoid concentration of the headquarters of new banks in metropolitan cities and other overbanked areas, while granting a license, preference may be given to those, the headquarters of which are proposed to be located in a centre which does not have the headquarters of any other bank.
6. Voting rights of an individual shareholder shall be governed by the ceiling of 1 % of the total voting rights as stipulated by Section 12(2) of the Banking Regulation Act. However, exemption from this ceiling may be granted under Section 53 of the said Act, to public financial institutions. (This was raised by 10% in 1994)
7. The bank shall not be allowed to have as a director, any person who is a director of any other banking company, or of companies which among themselves are entitled to exercise voting rights in excess of 20% of the total voting rights of all the shareholders of the banking company, as laid down in the Banking Regulation Act, 1949.
8. The bank will be governed by the Provisions of the Reserve Bank of India Act, 1934, the Banking Regulation Act, 1949 and other relevant statutes, in regard to its management setup, liquidity requirements and scope of its activities. The directives, instructions, guidelines and advices given by the RBI, shall be applicable to such a bank as in the case of other banks. It would be ensured that a new bank would concentrate on core banking activities initially.

9. The bank shall be subject to prudential norms in respect of banking operations, accounting policies and other policies as laid down by RBI. The bank will have to achieve capital adequacy of 8% of the risk weighted assets from the very beginning. Similarly, norms for income recognition, asset classification and provisioning will also be applicable to it from the beginning. So will be the single borrower and group borrower exposure limits that will be in force from time-to-time.
10. The bank shall have to observe priority sector lending targets as applicable to other domestic banks. However, in recognition of the fact that new entrants may require sometime to lend to all categories of the priority sector, some modification in the composition of the priority sector lending may be considered by the RBI for an initial period of three years.
11. The bank will also have to comply with such directions of the RBI as are applicable to existing banks in the matter of export credit. As a facilitation of this, it may be issued an authorized dealer's license to deal in foreign exchange, when applied for.
12. A new bank shall not be allowed to set up a subsidiary or mutual fund for at least three years after its establishment. The holding of such a bank in the equity of other companies shall be governed by the existing provisions applicable to other banks, viz.,
    (i) 30%of the bank's or the investee company's capital funds, whichever is less, as set out under the Banking Regulation Act, 1949, and
    (ii) 1.5% of the bank's incremental deposits during a year as per RBI guidelines.

    The aggregate of such investments in the subsidiaries and mutual fund (if and when set up) and portfolio investments in other companies shall not exceed 20% of the bank's own paid-up capital and reserves.
13. In regard to branch opening, it shall be governed by the existing policy that banks are free to open branches at various centres including urban/metropolitan centres without the prior approval of the RBI once they satisfy the capital adequacy and prudential accounting norms. However, to avoid over-concentration of their branches in metropolitan areas and cities, a new bank will be required to open rural and semi-urban branches also, as may be laid down by RBI.

14. The bank shall have to lay down its loan policy within the overall policy guidelines of RBI. While doing so, it shall specifically provide prudential norms covering related party transactions.
15. The bank shall make full use of modern infrastructural facilities in office equipment, computer, telecommunications, etc., in order to provide good customer service. The Bank should have a high-powered customer grievances cell to handle customer complaints.
16. The bank shall have to satisfy such other conditions as RBI may prescribe from time-to-time. [34]

Revised guidelines issued by the RBI in January 2001 brought in some changes. The major changes are:

- Minimum paid-up capital for a new bank should be Rs.200 crore which shall be increased to Rs.300 crore in subsequent three years after commencement of business.
- A non-banking financial company (NBFC) may convert into a commercial bank, if it satisfies the prescribed criteria.
- A large industrial house should not promote any new bank.
- Preference would be given to promoters with expertise of financing priority areas, and in setting up banks specializing in the financing of rural and agro-based industries.[35]

Private banking in India was practiced since the beginning of banking system in India. The first private bank in India to be set up in Private Sector Banks was Induslnd Bank. It is one of the fastest growing Private Sector Banks in India. IDBI ranks the tenth largest development bank in the world as Private Banks in India and has promoted world-class institutions in India.

The first private bank in India to receive an in principle approval from the Reserve Bank of India was Housing Development Finance Corporation Limited, to set up a bank in the private sector banks in India as part of the RBI's liberalization of the Indian Banking Industry. It was incorporated in August 1994, as HDFC Bank Limited with registered office in Mumbai and commenced operations as Scheduled Commercial Bank in January 1995.

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ING Vysya, yet another Private Bank of India was incorporated in the year 1930. Bangalore has a pride of place for having the first branch inception in the year 1934. With successive years of patronage **(support)** and constantly setting new standards in banking, ING Vysya Bank has many credits to its accounts. [36]

PRIVATE SECTOR BANKS (FOREIGN)

In the last two decades, financial systems in many developing countries became globalized. India provides a clear example of how globalization can change the financial structure of a country. The banking scenario in India is rapidly changing and in order to succeed amidst the rapid changes and arrive, one would need a vision. A "*Vision is a mental articulation about the future state of things".*it provides direction to an organization or a country. India is gradually integrating with the world economy and the world is becoming more and more interdependent. Progressively, globalization of financial markets is taking place. The growing international flows, mainly started by large mutual funds, pension funds and in recent times, hedge funds, have been matched by the increasing penetration of domestic markets by foreign financial institutions. The host of financial instruments now available allows both borrowers and lenders to obtain precisely the combination of return, risk and liquidity they desire with single firms operating worldwide and in different time zones, extremely independent markets in financial instruments operate 24 hours a day.

Foreign banks are incorporated in foreign countries with their head offices outside India. They are scheduled banks and generally specialize in the field of foreign exchange.

Foreign branches are operating banks like local banks, except that the directors and owners tend to reside elsewhere. Generally, foreign branches are subject to both local banking rules and the rules at home, but because they can benefit from loopholes, the extra tier of regulations is not necessarily onerous **(difficult)**. The books of a foreign branch are incorporated with those of the parent bank, although the foreign branch will also maintain separate books for revealing separate performance, for tax purposes, and so on for local authorities. The existence of foreign branches can mean very rapid check clearing for

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customers in different countries, because the debit and credit operations are internal and can be initiated by fax or electronic mail. This can offer a great advantage over the lengthy clearing that can occur via correspondents. The foreign branch also offers bank customers in small countries all the service and safety advantages of a large bank, which the local market might not be able to support.

The story of foreign banks in India goes back to the 19th century when the colonial economy brought with it the need for modern banking services, uniform currency and remittances by British army personnel and civil servants. The earliest banking institutions, joint stock banks, agency houses and the presidency banks, established by the merchants during the East India Company regime largely catered to this growing need. While the agency houses and joint stock banks largely failed and disappeared, the three presidency banks would later merge to form the State Bank of India, India's largest lender. British owned and controlled, these early banks may be considered India's first 'foreign hanks'. It was decades after their establishment that the first bank owned and controlled by Indians, the Allahabad Bank, would be established.

Milestone events for banking in India such as the passing of the Reserve Bank of India (RBI) Act, 1934, the creation of the central bank in 1935, bank nationalization in 1969 and 1980 did not impact foreign banks much. They adapted well to the changing economy and retained their niche **(position)** as service providers and employers of the elite **(choice)**; bringing capital, innovation and best practices from their home countries.

The first phase of banking reforms, triggered by recommendations of the Narasimhan Committee in 1991 and the licensing of the new private sector banks through the next two decades inaugurated an era of change. Meanwhile, the opening-up of the economy to increased participation by foreign players created greater opportunities for foreign banks to work with their multinational clients in India. In the more recent past, foreign banks have followed Indian corporate entities in their outbound expansions. [37]

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37 Article from PricewaterhouseCoopers [pwc] "Foreign Banks in India at an Inflation" www.pwc.in chapter 1

Reasons for the Growth of International Banking

There are a number of explanations or theories provided to support the growth in international banking operations. International banking theories explain the reasons behind the bank's choice of a particular location for their banking facilities, maintaining a particular organizational structure, and the underlying causes of international banking. Certain theories explanations are listed below:

i. "*Follow-the-leader*" explanation suggests that banks expand across national borders to continue to serve customers by establishing branches or subsidiaries abroad. This is mostly done in the context of monopolistic competition, so that they can take advantage of the differentiation of their services package from those provided by different banks.
ii. Expansion abroad has a pervasive effect on competition. Many a time banks operating under intense competition in the home markets are forced to develop low cost technologies for financial intermediation without proper incentives; therefore they try to exploit their competitive advantage in other markets.
iii. An explanation drawn from the analysis of foreign direct investment proposed that banks use management technology and marketing know-how developed for domestic uses at very marginal cost abroad.
iv. "Electic Theory of Production" says that, banks can take the ownership-specific and location-specific advantages while operating abroad.
v. Market imperfections due to domestic rules, regulation and taxation along with the drastic reduction in the cost of communications prompt the banks to set-up operations abroad.
vi. Intercountry differences in the cost of capital attract banks to set-up their operations in different countries.
vii. Phillip Callier in his research paper "Professional Trading, Exchange Rate Risk and the Growth of International Banking" has put forth that the establishment of money market and foreign exchange operations in major trading centers throughout the world are helping the banks (operating internationally) to significantly reduce the risk of these operations or increase their return without increasing their risk.[38]

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38 International Banking, The ICFAI University, 52, Nagarjuna Hills, Hyderabad

Characteristics and Dimensions of International Banking

Though international banking concept is quite old, it has acquired certain new characteristics and dimensions. Some of the characteristics of the international banking are:

- The number of participants, which at the beginning of the period were mainly American banks, has considerably widened to include German, UK, Japanese, French and Italian banks operating directly or through foreign branches and subsidiaries.
- The foreign component of total assets of the big international banks has grown at a rate considerably above the average so that many major banks now have more international loans outstanding than domestic ones.
- Nearly three quarters of the deficit of less developed countries are financed by commercial banks operating internationally.
- The amount of individual loans has risen considerably thus increasing the default risk from individual borrowers.
- The maturities have risen considerably. Average maturities are now about ten years.
- Banks have started diversifying their sources of funds along with the assets.

Apart from the above, two novel kinds of overseas bank operations characterized international bank expansion in the late 1960s and 1970s.

i. A multinational consortium **(group)** bank, was created by several established parent banks, and
ii. The shell branch, which is not really a bank but a device to get around the domestic government regulation, was created.

The global network of banks has increased the volume of international banking business. Consequently loans and other international business began to grow much more rapidly than domestic business.[39]

39 International Banking, The ICFAI University, 52, Nagarjuna Hills, Hyderabad

INTERNATIONAL PRIVATE BANKING

Today the banking industry throughout the world is facing an unprecedented competition. The competition is forcing the banking institutions into a reappraisal of the existing clientele base and an attempt to penetrate into newer markets. The domestic home-protected banks no more enjoy monopoly. A number of private banks has entered the fray in many countries and are continuously striving to differentiate themselves from others. These private banks are entering the international scene and are creating a lot of competition in the banking system. This evolved the concept of international private banking.

International private banking is counseling service for different people. Basically, the services offered by banks internationally focus either on the asset or liability side of the balance sheet or on a combination of both. Lately, international private banking is becoming an integral part of the banking system across the world to cater to the needs of high net worth people.

International private banking consists of banking services primarily provided for non-residents. It differs in the priorities given to the clients. Safety and secrecy are given the highest priority. Clients keen on maintaining and increasing their wealth in an environment safe from the potential scrutiny of third parties, added with a confidence are attracted to these banks. Investment options for the clients include:

i. Equity Portfolio Management,
ii. Fixed Income Portfolio,
iii. Balanced Portfolio,
iv. Offshore Mutual Fund, and
v. Short-term Portfolio Management[40]

Private Banks operating internationally help in arriving at customizing solution for lasting assets protection. It ensures a safe haven in a stable environment, minimization of taxes, continuity from generation to generation with immense confidentiality that the customers expect.

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40 International Banking, The ICFAI University, 52, Nagarjuna Hills, Hyderabad

Some of the services offered by the International private banks are:

- Primarily, a bank should ensure that funds are where they are needed. In most cases, clients are not permitted to hold foreign currency under exchange control and other regulations imposed by their national authorities and any transaction involving offshore currency will take time to materialize because the transaction has to process abroad. The international private banking reduces the transit time as well as the expenses to a large extent.
- In some cases, banks lend their international clients certain small amounts that are backed by assets for short time periods. Generally banks operating internationally do not provide unsecured loans as part of their business, but certain institutions provide trade financing and other forms of transactional or corporate lending activities.
- Many a time clients have complex financial objective functions encompassing a variety of financial products in a number of currencies and across a range of portfolios. The objective of private international banks is to build a portfolio appropriate to each client's needs by managing effectively the inter-relationship among risk, return, liquidity and confidentiality. The banks provide clients with access to financial assistance.
- Private international banks also provide wide-ranging personal services for international clients on similar lines as those provided for domestic clients.
- Private international banks also provide ancillary services such as circular letters of credit, forex, bill paying, traveller's cheques, mail holding or forwarding and safe deposit boxes as per their financial requirements and needs.

Banks rendering international services require and deserve certain qualities in their private banking relationship like innovative products and sophisticated services. A bank's approach towards a service differentiates it from the other banks. A commitment on the part of the banks in propagating services brings them a wide-publicity as well as maximizes their assets in a changing world.[41]

41 International Banking, The ICFAI University, 52, Nagarjuna Hills, Hyderabad

The RBI has shown certain interest to involve more of foreign banks than the existing one recently. This step has paved a way for few more foreign banks to start business in India.[42]

As of March 2013, there are 43 foreign banks from 26 countries operating as branches and 46 banks from 22 countries operating as representative offices. Although the discussion around differential licensing is still nascent **(emerging)**, there is one foreign bank present as a credit card issuer with limited banking license. In addition, a number of foreign banks have also entered India via the NBFC (Non-Banking Financial Company) route, while a considerable number have set up captive centers in the country.

Foreign banks present in India as representative offices often have correspondent banking relationships with domestic banks and provide a useful platform for foreign banks to access opportunities for foreign currency lending to Indian corporate and financial institutions.

With the growing importance of IT to banks, foreign bank BPO centers in India have expanded the scope of their services, providing data analytics, and data-backed solutions, that contribute to the efficiency and profitability of these banks globally. [43]

Currency traders move their immense resources electronically, instantaneously from country-to country, governments and central banks watch helplessly. In the cybertech globalized world, money has become free of its place and it has become a product which is bought and sold. The net effect is that world financial system has become vulnerable to technological break down and risks of speculation.[44]

Liberalization of Foreign Direct- Investment (FDI) norms for financial services provided further strategic entry routes for foreign banks in the form of NBFCs (Non-Banking Financial Company) that could provide specialized non-banking financial services such as stock broking,

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42 Banking Theory and Practice by Dr.P.K.Srivastava Himalaya Publishing House book

43 Article from PricewaterhouseCoopers [pwc] "Foreign Banks in India at an Inflation" www.pwc.in chapter 1

44 Banking Theory and Practice by Dr.P.K.Srivastava Himalaya Publishing House book

merchant banking, leasing and finance and others to specific segments of the economy.

Foreign banking groups present in India as branches also took this opportunity to set up separate entities to provide specialized services. This led to the formation of financial conglomerates or large franchises with multiple entities. In the absence of flexibility on expanding the branch network, the lending NBFCs (Non-Banking Financial Company) also created an opportunity for foreign banks targeting retail clients to create the level of outreach required for their operations.

In addition to setting up the first formal banking institutions in India, foreign banks have made considerable contribution to the banking sector over the years by bringing capital and global best practices as well as grooming talent.

Foreign banks have been innovative in identifying specific needs of the market, creating products, and developing organizational constructs. A good example is the cash management offering in the early 1990s that targeted inefficiencies in cash collection and check processing, identified as a specific issue for the Indian market. Built around this were products such as Citicash and Citicheck. More importantly, the bank had a dedicated division in the organization to address the needs of this market and after a successful stint **(stretch)** in India; the product was successfully introduced in other emerging markets. There are many such examples, including securitization, foreign exchange derivatives, travellers' cheques, channel financing and credit scorecards. Similarly, these banks often introduced risk management practices from their countries and were took steps to become part of the local cultural and community landscape through their initiatives relating to corporate social responsibility, sustainability, and contribution to protection of heritage buildings, local arts and crafts.[45]

Foreign direct investment in the banking sectors is mainly driven by banks' international expansion activities. **Goldberg (2004)** indicates that banks make a two-step decision for their international expansions. First, should the bank provide deposit-taking, lending, and other

45 Article from PricewaterhouseCoopers [pwc] “Foreign Banks in India at an Inflation” www.pwc.in chapter 1

services to a market? If so, second, should the bank use cross-border activities (arms-length transactions) or foreign direct investment (FDI) by setting up branches or subsidiaries to provide various services to the local market?

Like manufacturing firms, a bank becomes foreign-owned either through greenfield investment *(de novo* in the banking industry) or via mergers and acquisitions (M&As) of pre-existing banks (banking networks). Other forms of foreign participation in the banking industry include outsourcing of administrative and financial services, targeted purchases of specific activities, minority equity participations, strategic alliances with local banks, and majority-owned joint ventures, etc. **(Hawkins & Mihalhek, 2001; Montgomery, 2003).**

Representative offices, branches, and subsidiaries are the most commonly used organizational structures in banking sector FDI. Representative offices and branches are integral parts of the parent and operate on the basis of the parent's capital and reputation **(Antonio & Piscitello, 2002).** According to **Hawkins and Mihalhek (2001)**, representative offices typically handle trade credit operations, and arrange international private debt and equity placements between borrowers in the host country and lenders in the source country. A branch is an overseas office of a bank incorporated in a foreign country and constitutes a higher level of commitment than a representative office (Song, 2004). Compared to representative offices and branches, subsidiaries are different in the sense that they are incorporated separately from the parent bank and trade on the basis of their own capital and reputation **(Antonio & Piscitello, 2002; Hawkins & Mihalhek, 2001).**

With demonstration effects, local banks can learn to develop new services and products that foreign banks introduced to local market, copy foreign rivals' modem and more efficient banking techniques, especially the risk management techniques, and improve the overall management by learning from foreign managers **(Hermes & Lensink, 2004)**.

Foreign entry can have significant influence on human capital formation for domestic banking sectors. The influence can be achieved in three ways **(Konopielko, 1999; Lensink & Hermes, 2004; Mathieson & Roldos, 2000)**. First, foreign banks become "salary leaders" to attract highly qualified specialists available. Second, foreign banks supplement the staffs with expatriate personnel at the beginning of entry. Third, foreign banks invest in training programs for new employees, including local employees.

The improved human capital can contribute to a more efficient banking sector. With labor turnover, local employees/bankers would have a chance to learn from the foreign managers and the training programs, assimilate the practices, and retain the skills when they move back to domestic banks **(Mathieson & Roldos, 2000).** Improved human capital will reduce operation costs and contribute to more efficient banking practices **(Lensink & Hermes, 2004).**

Foreign banks generally outperform local banks in emerging markets; the increased level of competition provides incentives for managers to take advantage of the positive spillovers in order to withstand the increasing pressure.[46]

The survival of the banking system in India through the financial crisis has demonstrated its strengths and most foreign banks present in India believe that India is a market with undeniable potential However, like their predecessors, they continue to look for the best possible role they can play amidst the challenging political economy, heightened competition and changing financial services regulations.

This is just another stage in the long journey and partnership that these institutions have with this country of tremendous potential, diversity, colour and charm. As the foreign banks and the Indian economy adapt and change and diversify, the bonds will only grow stronger.

CO-OPERATIVE BANKS

Cooperative banks originated with the enactment of the Co-operative Credit Societies Act of 1904. A new Act was passed in 1912, which provided for the establishment of the co-operative central banks by a union of primary credit societies, or by a union of primary credit society and individuals. After 1991, a number of reforms have taken place under which licensing of UCBs (Urban Co-operative Banks) has been liberalized greatly, lending and deposit rates of all co-operative banks have been completely freed or deregulated, a co-operative development fund has

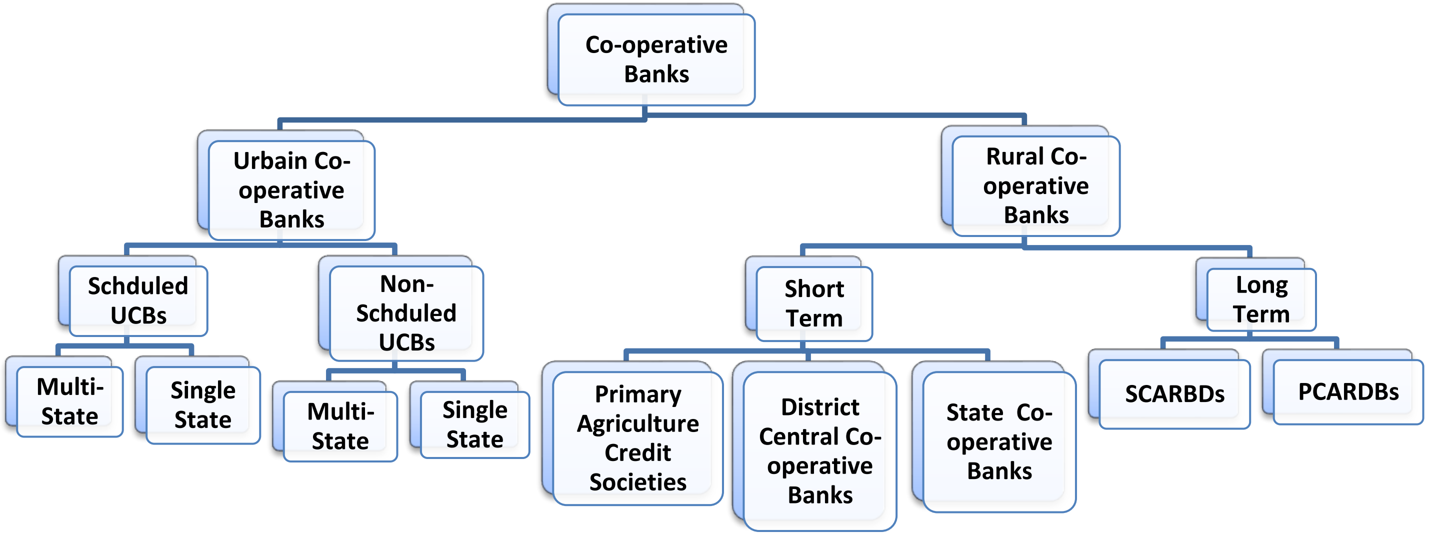
46 Impact of Foreign Entry On Banks In Emerging Markets: The Role of the Pre-Existing Competitive Environment by Lili Zhu

been set up by NABARD (National Bank for Agriculture and Rural Development) for improvement of managerial systems and skills. UCBs have been allowed to invest in equity/bonds of all India Financial Institutions, PSUs (Public Sector Union), UTI (Unit Trust of India), CDs (Certificates of Deposit) of scheduled commercial banks, subject to certain ceilings.

Co-operative banking is small scale banking carried on a *no profit, no loss* basis for mutual co-operation and help. Co-operative banks were assigned the important role of delivering of fruits of economic planning at the grass roots level. Co-operative banking structure is viewed as a vehicle for democratization of the Indian financial system. They were conceived to supplant moneylenders and indigenous bankers by providing adequate short-term and long-term institutional credit at reasonable rates of interest.[47]

47 Elements of Banking and Insurance book by Jyotsna Sethi and Nishwan Bhatia Book

CO-OPERATIVE BANKS



SCARBDs-State Co-operative Agriculture and Rural Development Banks

PCARDBs-Primary Cooperative Agriculture and Rural Development Banks

PRIMARY AGRICULTURAL CREDIT SOCIETIES (PACS)

Primary Agricultural Credit Societies (PACS) continued to play an important role in providing institutional credit to agricultural and rural sectors. PACS are an integral part of short term rural credit co-operatives, which work at a grass root level and provide short term crop loans and other working capital loans to farmers and rural artisans. The primary co-operative credit society is an association of borrowers and non-borrowers residing in a particular locality. The funds of the society are derived from the share capital and deposits of members and loans from Central Cooperative Banks. The borrowing power of the members as well as of the society is fixed. The loans are given to members for the purchase of cattle, fodder, fertilizers, pesticides, implements, etc.

Total working capital of PACS increased as at end-March 2011 mainly on account of increase in deposits. Borrowings constituted more than half of the total resources of PACS in the year 2010-11, indicating their heavy reliance on external sources for funding.

There was a slow decline in the percentage of loss-making PACS over recent years, particularly since 2008. Despite the decline, the percentage of loss-making PACS competed closely with the percentage of profit-making PACS. The percentage of loss-making PACS was much larger in the eastern and north-eastern regions.

The credit growth of Primary Agricultural Credit Societies (PACS) slowed slightly in 2010-11 compared to 2009-10. The borrower-to-member ratio is a useful indicator of access to credit from PACS. This ratio has generally remained below 50 per cent since 2003, suggesting that only about half the members of PACS access credit during each year. Moreover, among the backward groups, *viz.,* Scheduled Castes and Scheduled Tribes (SCs/STs), the ratio generally ranged below 30 per cent.[48]

48 Indian Banks' Association, Indian Banking Year book 2012

DISTRICT CENTRAL COOPERATIVE BANKS (DCCB)

DCCBs form the second tier of the rural short-term co-operative credit structure. The District Central Co-operative Banks is the central financing agency in the entire district. The primary object of which is financing other co-operatives, particularly the PACBs in the district. The DCCBs are mainly doing three activities in their area of operation like (i) advancement of agricultural finance (ii) collection of deposits and (iii) providing banking services.[49]

These are the federations of primary credit societies in a district, and are of two types — those having a membership of primary societies only and those having a membership of societies as well as individuals. The funds of the bank consist of share capital, deposits, loans and overdrafts from State Co-operative Banks and joint stocks. These banks finance member societies within the limits of the borrowing capacity of societies. They also conduct all the business of a joint-stock bank.[50]

District Central Co-operative Banks (DCCBs) witnessed a slowdown in their balance sheet in 2010-11. The slowdown in the balance sheet of DCCBs was on account of a slowdown in deposits on the liabilities side and investments on the assets side, although the credit growth of DCCBs posted an increase. Although DCCBs as a whole reported profits in 2010-11, there was a decline in the quantum of profits reported by these institutions. As on March 31,2012,42 DCCBs, remained unlicensed. Subsequently, one bank was licensed after fulfilling the norms. At present, 41 DCCBs are unlicensed and continue to be under directions. Further, it was decided to form a Task Force to closely monitor the progress of unlicensed DCCBs through a Monitorable Action Plan (MAP). This plan would be prepared by the concerned banks and approved by the Task Force. The aim of this Task Force would be to ensure that the DCCBs attained the eligibility for issue of a license in the shortest possible time.[51]

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49 Indian Banks' Association, Indian Banking Year book 2012

50 Banking Theory and Practice by Dr.P.K.Srivastava Himalaya Publishing House book

51 Indian Banks' Association, Indian Banking Year book 2012

STATE CO-OPERATIVE BANKS (STCBS)

State co-operative banks play a crucial role in financial inclusion by providing funds to lower tiers of the rural co-operative sector. Every State has one StCB in place to provide funds to the lower tiers of the rural co-operative sector. The State Co-operative Bank is a federation of central co-operative banks and acts as a watchdog of the co-operative banking structure in the State. Its funds are obtained from share capital, deposits, loans and overdrafts from the Reserve Bank of India. The State Co-operative Banks lend money to central co-operative banks and primary societies and not directly to farmers.

There was a decline in the growth of the balance sheet of State Co-operative Banks (StCBs) in 2010-11 over 2009-10. On the liabilities side, the growth in the balance sheet of StCBs in 2010-11 emanated from high growth in borrowings, while on the assets side, the growth was attributed to loans and advances or credit. Advance information on scheduled StCBs for 2011-12 available from Section 42(2) returns has been analyzed to gauge the more recent trends. The trends suggest that although there has been a revival in the growth of both deposits and SLR investments of scheduled StCBs in 2011-12, there has been a slowdown in the growth of credit from StCBs during this year.[52]

STATE CO-OPERATIVE AGRICULTURE AND RURAL DEVELOPMENT BANKS (SCARDBS)

These co-operative banks were earlier known as Land Development Banks. They are now called Agriculture and Rural Development Banks. They operate under a two-tier system known as (a) State Co-operative Agriculture and Rural Development Banks (SCARDB) and (b) Primary Co-operative Agriculture and Rural Development Banks (PCARDB).

SCARDBs should make opening of thrift deposit account compulsory for all members with an initial deposit of Rs. 500 through appropriate board decisions/provisions in the bye laws. In federal structure, member deposits can be collected only by primaries which need to be transferred to SCARDBs for proper management and deployment of funds. SCARDBs should use on-line real time fund transfer facilities (through NEFT/RTGS

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52 Indian Banks’ Association, Indian Banking Year book 2012

[National Electronic Funds Transfer/ Real Time Gross Settlement]) offered by banks for transfer of funds to avoid transit delays and minimize bank charges.

SCARDBs to invest not less than 50% of total deposits in securities and bank deposits for maintaining liquidity and ensuring safety of funds. Balance amount should be deployed in short term credit products. SCARDBs are dependent on NABARD's refinance for advancing loans.[53]

PRIMARY CO-OPERATIVE AGRICULTURE AND RURAL DEVELOPMENT BANKS (PCARDBS)

PCARDBs is a self-reliant autonomous member driven organization, capable of delivering financial services to the rural sector effectively, in a competitive environment, with focus on capital formation in agriculture. PCARDBs should use on-line real time fund transfer facilities (through NEFT/RTGS) offered by banks for transfer of funds to avoid transit delays and minimize bank charges.

The long term structure of rural co-operatives consists of PCARDBs operating at district/block level. There was negligible expansion in the balance sheet of Primary Co-operative Agriculture and Rural Development Banks (PCARDBs) in 2010-11. The major component of uses of funds of PCARDBs, namely credit, and that of sources of funds, namely borrowings, showed a negligible growth of less than 1 per cent in 2010-11, broadly in line with the trend during the previous year. Although the long-term co-operative structure as a whole was weak, within this structure financial health deteriorated significantly as we moved from the higher tier to the lower tier.[54]

URBAN CO-OPERATIVE BANKS (UCBS)

The Urban Co-operative Bank (UCB) sector has emerged financially stronger since 2005, when the Reserve Bank conceived a Vision Document for the revival of this sector. Through the Document, the Reserve Bank laid down a multi-layered regulatory and supervisory approach aimed at the merger/amalgamation of viable UCBs and the exit of unviable UCBs. On account of this process of consolidation, there

53 Indian Banks' Association, Indian Banking Year book 2012
54 Indian Banks' Association, Indian Banking Year book 2012

has been a continued reduction in the number of UCBs. In continuation with this trend, at end-March 2012, the total number of UCBs stood at 1,618 as against 1,645 at end-March 2011.[55]

<u>Licenses for Setting up new Urban Co-operative Banks</u>

In the Second Quarter Review of Monetary Policy 2012-13 it was mentioned that based on comments/feedback received from the public on the recommendations of the Expert Committee (Chairman: Shri Y. H. Malegam), it has been decided to initiate steps for setting up of new UCBs after issues relating to governance arrangements are resolved with the Government.[56]

<u>Regulatory Initiatives</u>

During 2011-12, a number of policy initiatives have been taken to strengthen co-operative banking in India. Important ones are as follows:-

- Internet banking permitted for eligible UCBs
- Revision in housing loan limits and repayment period
- Extension of interest rate subvention on Rupee export credit
- Grant of NDS-OM (Negotiated Dealing System – Order Matching) membership to UCBs
- Submission of credit information to CIBIL and other credit information companies
- Supervisory Action Framework for UCBs
- Convergence of IAS (Indian Accounting Standards) with IFRS (International Financial Reporting Standards) standards
- Revision of UCBs exposure to housing/commercial real estate loans.[57]

55 Indian Banks' Association, Indian Banking Year book 2012
56 Indian Banks' Association, Indian Banking Year book 2012
57 Indian Banks' Association, Indian Banking Year book 2012

SCHEDULED URBAN CO-OPERATIVE BANKS

As on March 31, 2012, there are 52 Scheduled Urban Co-operative Banks. Over the years, partly as a fall-out of consolidation, there has been an increase in asset concentration within the UCB sector. The number of UCBs with an asset size of more than Rs.10 billion quadrupled between 2008 and 2012. Notably, the percentage share of such UCBs in the total assets of the UCB sector increased from about 37 per cent to 48 per cent during this period. The growth in credit witnessed a slowdown in 2011-12, possibly reflecting the high interest and slack credit demand prevailing during most part of the year. Investments, the second major use of funds of UCBs, also posted slower growth in 2011-12, on account of a decline in the growth of SLR investments.[58]

NON-SCHEDULED URBAN CO-OPERATIVE BANK

There was a decrease in the number of non-scheduled UCBs at end-June 2012 over the previous year. There are 1564 non-scheduled urban co-operative banks. Non-scheduled UCBs witnessed expansion of their balance sheet at a higher rate than their scheduled counterparts. As at end-March 2012, share of deposits in total liabilities was 80 per cent implying that UCBs are heavily dependent on deposits for resources. The share of deposits in total liabilities increased marginally in 2011-12 as compared to the previous year. Capital and reserves together constituted almost 12 per cent of total liabilities in 2011-12. On the assets side, loans and advances constituted almost half of total assets followed by investments and balances with banks. Non-scheduled UCBs witnessed a higher growth in SLR investments as compared to their scheduled counterparts. The overall levels of UCB profits exhibited an improvement in 2011-12, attributable to an almost doubling of the growth in the total income of these institutions Provisions and contingencies, taxes and staff expenses increased marginally.[59]

58 Indian Banks' Association, Indian Banking Year book 2012

59 Indian Banks' Association, Indian Banking Year book 2012

THE REGIONAL RURAL BANKS

Regional Rural Banks (RRBs) were established under Regional Rural Banks Act, 1976 (RRB Act) to create an alternative channel to the 'co-operative credit structure and to ensure sufficient institutional credit for the rural and agriculture sector. RRBs are jointly owned by the Government of India, the concerned State government and sponsor banks, with the issued capital shared in the proportion of 50 per cent, 15 per cent and 35 per cent, respectively. As per provisions of the Regional Rural Banks Act, 1976, the authorized capital of each RRB is Rs.5 crore and the issued capital is a maximum Rs.1 crore.[60]

There are 196 Regional Rural Banks in all states of the country except Sikkim covering 392 of the total of 478 districts having a network of 14,539 branches. Up to March, 1992 these banks mobilized deposits of Rs.5,867.83 crore in 345.26 lakh deposit accounts. Rural banks extended loans worth Rs.4,090.86 crore to 123.99 lakh borrowers up to March, 1992.

Although Regional Rural Banks have achieved the basic objectives for which they were setup, they have not so far been able to achieve the economic viability. The accumulated losses of 194 banks amounted to Rs.101.04 crore as on 31st March, 1989. The reasons for the Regional Rural Banks incurring losses mainly are:

(i) impact of narrow spread,
(ii) restriction on the choice of clientele,
(iii) Area of operation as well as other restrictions on the profitability.

Other features of these banks are that out of the 115 districts identified under the Tribal Sub-plan area in whole of the country, as many as 94 districts have been covered by the Regional Rural Banks.

Regional Rural Banks can be made viable through a process of amalgamation. Merging them with the sponsoring banks is certainly not the solution as the latter have enough problems in their hands. Merger of RRBs at the state level into separate banks would be a more feasible proposition. The other alternative can be the takeover of these banks by

60 Indian Banks' Association, Indian Banking Year book 2012

NABARD. It would enable NABARD to have grass-root level presence as against its present city based structure. Instead of being only an apex refinancing agency, it can assert itself as the real rural bank with over 14,000 outlets.[61]

Performance of RRBs

The RRBs, over the years have made impressive strides on various business indicators. For instance, deposits of RRBs have grown by 18 times and advances by 13 times between 1980 and 1990. Between 1990 and 2004, deposits and advances grew by 14 times and 7 times, respectively. Between the year 2000 and 2004, loans disbursed by RRBs more than doubled reflecting the efforts taken by the banks to improve credit flow to the rural sector. The average per branch advances also increased from Rs.25 lakh in March 1990 to Rs.154 lakh in March 2003. When one considers the deployment of credit relative to the mobilization of resources, the credit-deposit (C-D) ratio of RRBs were more than 100 per cent during the first decade of their operations up to 1987. Though the C-D ratio subsequently became lower, of late, it has shown an improvement and went up from around 39 per cent in March 2000 to 44.5 per cent in March 2004.[62]

Regional Rural Banks (Amendment) Bill, 2012

The Union Cabinet gave its approval to the proposed amendments in the Regional Rural Banks (RRBs) Act, 1976 to enhance authorized and issued capital to strengthen their capital base. The term of the non-official directors appointed by the Central Government is proposed to be fixed not exceeding two years. The proposed amendments will ensure financial stability of RRBs which will enable them to play a greater role in financial inclusion and meet the credit requirements of rural areas and the Boards of RRBs will be strengthened. [63]

61 Banking Theory and Practice by Dr.P.K.Srivastava Himalaya Publishing House book
62 Banking Theory and Practice by Dr.P.K.Srivastava Himalaya Publishing House book
63 Indian Banks' Association, Indian Banking Year book 2012

3.4 UNIT TRUST OF INDIA (UTI)

The Unit Trust of India was established in 1964. It is a financial intermediary which pools the investible resources of numerous subscribers, particularly the small investors and invests these on their behalf, in a wide range of securities. The income from these investments and the realised capital appreciation are distributed to the unitholders after the expenses of running the Trust have been met. The Unit Trust is always to buyback units from investors at market value. This gives a high degree of liquidity to the unitholders. Besides, the Unit Trust minimises the risk involved in investment through diversification and offers the benefits of expert management. It was established with the objective of mobilising the savings of the community and channeling them into productive investments, and more importantly, for encouraging widespread and diffused ownership of industry by affording investors, particularly the small investors, a means of acquiring equity stock assured of a reasonable return with minimum risk.

The Trust was established with an initial capital of Rs.5 crore, which was contributed by different institutions as follows:

i.	Scheduled banks and other financial institutions	Rs.1 crore
ii.	The Reserve Bank of India	Rs.2.5 crore
iii.	The Life Insurance Corporation	Rs.75 lakh
iv.	State Bank and its subsidiaries	Rs.75 lakh

Provision has also been made in the Act for refunding the whole or any part of the subscribed capital by the contributing institutions if the Trust finds that the capital is in excess of its requirements.
Unit Trust of India has formulated three schemes for selling 'units', namely, unit scheme 1964, unit scheme 1971, and unit scheme 1976. In order to cater to specific investment needs of different types of investors, UTI framed specific savings plans linked to the unit schemes, *viz.,* Reinvestment Plan 1966, Children's Gift Plan 1970 and Unit Linked Insurance Plan 1971. For the year ended 30 June, 1981, the Trust had declared a dividend of 11.5 per cent on the unit scheme of 1964.

The Unit Trust of India has so far introduced 72 different schemes to suit the preferences of various classes of investors. The main scheme of the UTI is the Unit Scheme, 1964. The UTI is at present managing "Two Country Funds of India". The first called "The India Fund" was launched abroad by the UTI and Merrill Lynch Capital Markets in July, 1986, for enabling Non-resident Indians and other persons outside India to invest in the securities markets of India. The shares of the fund are listed on the London Stock Exchange. The second fund called "The India Growth Fund Inc." was launched abroad by the UTI and Merrill Lynch in August, 1988. This fund is registered with the Securities and Exchange Commission (SEC) of the United States. The shares of the fund are listed on the New York Stock Exchange. The investible funds of the UTI up to 1990 were Rs.17,496 crore.

Apart from UTI there are six Mutual Funds operating at present in India. These funds have been set up by the Life Insurance Corporation of India, the State Bank of India, Canara Bank, Indian Bank, Punjab National Bank and Bank of India.

UTI manages funds of Rs.49,655.37 crore being market value of investments as on 28th June 2002 from 28.96 million investors. The bank has 79 branches, all computerized and networking through VSAT (Very Small Aperture Terminal).[64]

3.5 THE UTI BANK IS NOW AXIS BANK

Axis Bank was the first of the new private banks to have begun operations in 1994, after the Government of India allowed new private banks to be established. The Bank was promoted jointly by the Administrator of the specified undertaking of the Unit Trust of India (UTI-1), Life Insurance Corporation of India (LIC) and General Insurance Corporation Ltd., and other four PSU (Public Sector Unit) companies, *i.e.* National Insurance Company Ltd., The New India Assurance Company, The Oriental Insurance Corporation and United Insurance Company Ltd. The Bank today is capitalized to the extent of Rs.356.22 crore with the public holding (other than promoters) at 57.32%.[65]

64 Banking Theory and Practice by Dr.P.K.Srivastava Himalaya Publishing House book
65 Banking Theory and Practice by Dr.P.K.Srivastava Himalaya Publishing House book

The bank commenced operations in April 1994. The Bank's Registered Office is at Ahmedabad and its Central Office is located at Mumbai. The bank was renamed as “Axis Bank Limited" in July, 2007.Over the past 18 years, the Bank has grown both in terms of size of its assets base and its physical network of branches, extension counters and ATMs. The Bank has experienced significant growth while maintaining stable asset quality and enhancing its low-cost funding structure. The Bank has strengths in both and retail and corporate banking and is committed to adopting the best practices internationally in order to achieve excellence.

As at March 31, 2012, the Bank had a network of 1,622 branches and extension counters and 9,924 ATMs spread over 1,050 centres in India. The bank now is capitalized to the extent of Rs.42,082 crores with a public holding other than promoters of 62.70% as of June 30,2012.[66]

Developments

Profit after tax grew by 25.19 per cent to Rs.4,242.21 crores, Net interest income grew by 22.17 per cent to Rs.8,017.75 crores, Net interest margin stood at 3.59 percent for the financial year, Fee and other income grew by 22.33 per cent to Rs.5,058.66 crores, Total assets have grown by 17.68 per cent to Rs.2,85,628 crores, Deposits have grown by 16.31 per cent to Rs.2,20,104 crores, advances were up by 19.21 per cent toRs.1,69,760 crores, During the year, the bank added 232 branches thus taking the total branch network from 1,390 branches as on March 31, 2011 to 1,622 branches as on March 31, 2012, Total number of ATMs went up from 6,270 to 9,924. Net NPA ratio as a percentage of net customer assets was 0.25 per cent as on March 31, 2012 compared to 0.26 per cent as on March 31,2011, capital adequacy ratio (CAR) stood at 13.66 per cent as against the minimum regulatory norm at 9.0 per cent.[67]

66 Indian Banks’ Association, Indian Banking Year book 2012
67 Indian Banks’ Association, Indian Banking Year book 2012

3.6 CORE BANKING SOLUTION (CBS) SYSTEM

Core Banking Solution refers to networking of all branches of a bank which enables a customer to operate their accounts from anywhere. Before introduction of this system a customer could withdraw/deposit money only in the account he had opened in a particular branch of a bank and from nowhere else, e.g., a person who had an account with the Connaught Place Branch of a bank could operate it only from that branch. But with the CBS system a customer is not hampered by any geographical limitation and can operate from any branch of his bank whether local or national. Though there is no limitation on the deposits which can be made but usually a maximum limit of Rs.50,000 is imposed on withdrawals which can be made from any other branch of the bank.[68]

3.7 PRIME LENDING RATE (PLR)

The interest rates on advances granted by scheduled commercial banks were prescribed by Reserve Bank of India and revised by it from time to time. With effect from 18th October, 1994 Reserve Bank of India has abolished the minimum lending rate for advances of over 2 lakh. Banks are now free to fix their own Prime Lending Rate which will be their Minimum Lending Rate.

In October, 1996, Reserve Bank asked the banks to announce the maximum spread over the Prime Lending Rate for all advances other than consumer credit. While announcing their Prime Lending Rate, banks have been permitted to prescribe their spreads over prime lending rate separately for the loan component and cash credit component. This was intended to encourage borrowers to prefer loan component over cash credit component because of a higher spread in case of the latter. In pursuance of this directive, State Bank of India has recently prescribed maximum interest spread of 3.5% on loans and 3.75% on cash credits.

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68 Elements of Banking and Insurance book by Jyotsna Sethi and Nishwan Bhatia Book

In April 1999, Reserve Bank of India permitted the banks to offer tenor-linked prime lending rates, *i.e.* they can offer different Prime Lending Rates on loans for different maturities.

In October, 1999, Reserve Bank of India permitted the banks to charge interest rates without reference to their Prime Lending Rate in respect of the following categories of loans:

(i) Loans covered by refinancing schemes of term lending institutions
(ii) Lending to intermediary agencies
(iii) Discounting of bills
(iv) Advances/overdrafts against domestic/NRE (Non-Resident External)/FCNR (Foreign Currency Non-resident) deposits

The permission granted to banks to grant fixed rate loans for project finance was extended by Reserve Bank to all loans in April, 2000. Now banks are free to offer all loans on fixed or floating rate basis. But they have to ensure that PLR stipulations as applicable are complied with.

To provide further flexibility to commercial banks to decide their lending rates in April, 2001 Reserve Bank of India permitted them to offer loans at below Prime Lending Rates to exporters or other creditworthy borrowers including public enterprises on the lines of a transparent and objective policy approved by their Boards.

Small loans up to Rs.2 lakhs still continue to be granted at rates not exceeding the Prime Lending Rate of relevant maturity.[69]

Keeping in view the international practice and to provide operational flexibility to commercial banks in deciding their lending rates, banks can offer loans at below BPLR (Benchmark Prime Lending Rate) to exporters or other creditworthy borrowers, including public enterprises, on the basis of a transparent and objective policy approved by their respective Boards. Banks will continue to declare the maximum spread of interest rates over BPLR.

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69 Banking Theory and Practice by Dr.P.K.Srivastava Himalaya Publishing House book

Given the prevailing credit market in India and the need to continue with concessionality for small borrowers, the practice of treating BPLR as the ceiling for loans up to Rs.2 lakhs will continue.

Banks are free to determine the rates of interest without reference to BPLR and regardless of the size in respect of loans for purchase of consumer durables, loans to individuals against shares and debentures/bonds, other non-priority sector personal loans, etc.

RPLR will be made uniformly applicable at all branches of a bank.[70]

Determination of Benchmark Prime Lending Rate (BPLR)

In order to enhance transparency in banks' pricing of their loan products as also to ensure that the BPLR truly reflects the actual costs, banks should be guided by the following considerations while determining their Benchmark PLR:

a) Banks should take into account their (i) actual cost of funds, (ii) operating expenses and (iii) a minimum margin to cover regulatory requirement of provisioning/capital charge and profit margin, while arriving at the benchmark PLR. Banks should announce a Benchmark PLR with the approval of their Boards.

b) The Benchmark PLR will be the ceiling rate for credit limit up to Rs. 2 lakhs.

c) All other lending rates can be determined with reference to the Benchmark PLR arrived at as above by taking into account term premia and/or risk premia.

In the interest of customer protection and to have greater degree of transparency in regard to actual interest rates charged to borrowers, banks should continue to provide information on maximum and minimum interest rates charged together with the Benchmark PLR.[71]

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70 Banking Product and Services By Indian Institution of Banking and Finance Publishing Taxmann

71 Banking Product and Services By Indian Institution of Banking and Finance Publishing Taxmann

Freedom to fix Lending Rates

Banks are free to determine the rates of interest without reference to BPLR and regardless of the size in respect of the following loans:

(i) Loans for purchase of consumer durables;
(ii) Loans to individuals against shares and debentures/bonds;
(iii) Other non-priority sector personal loans including credit card dues;
(iv) Advances/overdrafts against domestic/NRE/FCNR(B) deposits with the bank, provided that the deposit/s stands/stand either in the name(s) of the borrower himself/borrowers themselves, or in the names of the borrower jointly with another person;
(v) Finance granted to intermediary agencies including housing finance intermediary agencies for on-lending to ultimate beneficiaries and agencies providing input support;
(vi) Discounting of Bills;
(vii) Loans/Advances/Cash Credit/Overdrafts against commodities subject to Selective Credit Control;
(viii) To a co-operative bank or to any other banking institution;
(ix) To its own employees;
(x) Loans covered by refinance schemes of term lending institutions.[72]

Explanatory Note on Data for Quarter ended September 2010 onwards

The Reserve Bank vide its circular DBOD.No.Dir.BC88/13.03.0/2009-10 dated April 9, 2010 introduced the Base Rate system with effect from July 1, 2010, which replaced the Benchmark Prime Lending Rate(BPLR) system. The Base Rate includes all those elements of the lending rate that are common across all categories of borrowers. Banks are allowed to determine their actual lending rates on loans and advances with reference to the Base Rate and by including such other customer specific charges as considered appropriate. All categories of loans are required to be priced only with reference to the Base Rate.

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The Base Rate system is applicable for all new loans and for those old loans that come up for renewal. Since the Base Rate is the minimum rate for all loans, banks are not permitted to resort to any lending below the Base Rate. Banks are required to review the Base Rate at least once in a quarter.[73]

India Prime Lending Rate

Bank Lending Rate in India remained unchanged at 10.25 percent in March of 2014 from 10.25 percent in February of 2014. Bank Lending Rate in India is reported by the Reserve Bank of India. Bank Lending Rate in India averaged 14.09 per cent from 1978 until 2014, reaching an all-time high of 20 per cent in October of 1991 and a record low of 8 per cent in July of 2010. In India, the prime lending rate is the average rate of interest charged on loans by commercial banks to private individuals and companies.[74]

3.8 REVERSE REPO RATE

Reverse repo rate is the rate at which the central bank of a country (RBI in case of India) borrows money from commercial banks within the country.

Definition

Reverse repo rate is the rate at which the central bank of a country (Reserve Bank of India in case of India) borrows money from commercial banks within the country. It is a monetary policy instrument which can be used to control the money supply in the country.[75]

73 www.rbi.org

74 www.rbi.org

75 www. economictimes.indiatimes. com

Description

An increase in the reverse repo rate will decrease the money supply and vice-versa, other things remaining constant. An increase in reverse repo rate means that commercial banks will get more incentives to park their funds with the RBI, thereby decreasing the supply of money in the market.

Reverse Repo rate is the rate at which Reserve Bank of India (RBI) borrows money from banks. Banks are always happy to lend money to RBI since their money are in safe hands with a good interest. An increase in Reverse repo rate can cause the banks to transfer more funds to RBI due to these attractive interest rates. It can cause the money to be drawn out of the banking system. Due to this fine tuning of RBI using its tools of CRR, Bank Rate, Repo Rate and Reverse Repo rate our banks adjust their lending or investment rates for common man. [76]

76 www.economictimes.indiatimes.com