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Banking Awareness

COURSE BOOK

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SECTION-1

Introduction to Banking

INTRODUCTION

In the history of banking, there is no unanimous opinion regarding the beginning of banks. Some trace its origin to French word BANGUI and some to Italian word 'BANCA'. According to one viewpoint, in good old days, Italian money lenders were known as " Banechi" or Banacheri" because people kept a special type of table to transact their business called "Banchi". The practice of safekeeping and saving was found in the temple of Bobylon. Chankya in his Arthashastra has also mentioned about existence of powerful guilds of merchant bankers who received deposits, advanced loans and issued hundis.

First Bank in India : The first bank in India was started in 1770 as 'Bank of Hindustan'

First Bank in modern sense : 'Bank of Bengal' was the first bank in modern sense in 1806.

ANCESTORS IN THE HISTORY OF BANKING

1. The Merchants
2. The Gold Smiths
3. The Money Lenders

1. The Merchants : It was the 'merchant' who first evolved the system of banking by trading activities which needed remittance of money. They issued 'hundis' to remit funds and here merchant bankers were known as 'Seths'.

2. The Gold Smiths : Another stage was of goldsmith, who had to take special precautions against theft of gold and jewellery. People nearby his place started leaving thier bullion, money and ornaments in his care. He charged some nominal amount for taking this care and also issued a receipt. Here he also started lending of such gold coins and silver coins provided that they were payable on demand.

3. The Money Lenders : In the third stage of money lending when the withdrawls were less, the Goldsmith thought of investing or lending on interest. He also used to keep some money as reserve and hence the business of accepting and lending flourished so the Goldsmith turned into money lender.

PRE INDEPENDENCE

The largest bank, and the oldest still in existence, is the State Bank of India (S.B.I). It originated as the Bank of Calcutta in June 1806. In 1809, it was renamed as the Bank of Bengal. This was one of the three banks funded by a presidency government; the other two were the Bank of Bombay in 1840 and the Bank of Madras in 1843. The three banks were merged in 1921 to form the Imperial Bank of India, which upon India's independence, became the State Bank of India in 1955.

In 1881 first bank with limited liability to be managed by Indian Board is "Oudh Commercial Bank". First bank wholly managed and owned by Indians is "Central Bank of India" (1911 on the recommendation of Hilton Young Commission). For many years the presidency banks had acted as quasi-central banks, as did their successors, until the Reserve Bank of India was established in 1935, under the Reserve Bank of India Act, 1934.

POST INDEPENDENCE

The Government of India initiated measures to play an active role in the economic life of the nation, and the Industrial Policy Resolution adopted by the government in 1948 envisaged a mixed economy. This resulted in greater involvement of the state in different segments of the economy including banking and finance. The major steps to regulate banking included:

- The Reserve Bank of India, India's central banking authority, was established in April 1935, but was nationalized on 1 January 1949 under the terms of the Reserve Bank of India (Transfer to Public Ownership) Act, 1948 (RBI, 2005).
- In 1949, the Banking Regulation Act was enacted, which empowered the Reserve Bank of India (RBI) "...to regulate, control, and inspect the banks in India."
- The Banking Regulation Act also provided that no new bank or branch of an existing bank could be opened without a license from the RBI, and no two banks could have common directors.

NATIONALISATION IN THE 1960s

Despite the provisions, control and regulations of the Reserve Bank of India, banks in India except the State Bank of India (SBI), remain owned and operated by private persons. By the 1960s, the Indian banking industry had become an important tool to facilitate the development of the Indian economy. At the same time, it had emerged as a large employer, and a debate had ensued about the nationalisation of the banking industry.

The Government of India issued an ordinance ('Banking Companies (Acquisition and Transfer of Undertakings) Ordinance, 1969') and nationalised the 14 largest commercial banks with effect from the midnight of 19 July 1969. These banks contained 85 percent of bank deposits in the country.

A second dose of nationalisation of 6 more commercial banks followed in 1980. The stated reason for the nationalisation was to give the government more control of credit delivery. Later on, in the year 1993, the government merged New Bank of India with Punjab National Bank. It was the only merger between nationalised banks and resulted in the reduction of the number of nationalised banks from 20 to 19.

LIST OF NATIONALISED BANKS IN INDIA

Allahabad Bank	Andhra Bank
Bank of Baroda	Bank of India
Bank of Maharashtra	Canara Bank
Central Bank of India	Corporation Bank
Dena Bank	Indian Bank
Indian Overseas Bank	Oriental Bank of Commerce
Punjab and Sind Bank	Punjab National Bank
Syndicate Bank	UCO Bank
Union Bank of India	United Bank of India
Vijaya Bank	

PHASES OF INDIAN BANKING

Indian banking system over the years has gone through various phases. The evolution of banking since last 5 decades after independence can be divided into following 5 phases.

Foundation Phase : It be gained from 1950s extending from nationalization of banks in 1969. Focus was to lay foundation for a sound banking system.

Expansion Phase : It gained momentum after nationalisation of banks and continued till 1984. Effort was made to make banking facilities available to masses by creating a branch network covering rural and semi-urban areas.

Consolidation Phase : It started in 1985 initiatives were taken by RBI to imporve house keeping, customer service, credit management, staff productivity.

Reforms Phase : After 1991 there were extensive financial sector reforms. Reforms brought deregulation of interest rates, more competition, technological changes, prudential guidelines on asset classification and income recognition, capital adequacy, autonomy packages etc. It was during this phase that Narsimham Committee report was prepared and submitted.

Post Reforms Phase : During this era there are developments in banking system. The focus is on bigger size, new innovative products, and global standards of serving.

RETAIL BANKING CONCEPT

One of the major development in the banking sector is the introduction of retail Banking in the country. At present, banks are focusing more on retail banking by proving various loan facilities to depositors. The banking sector is facing increased competition from non-banking institution. The Retail Banking encompasses various financial products (different type of deposit accounts, home loan, auto loan, credit cards, demate facilities, Insurance mutual funds, credit and debit cards, ATM, Stock broking, payment of utility bills) catering to diverse customer groups, offering a host of financial services, mostly to individuals. Simply speaking, it takes care of the diverse banking needs of an individual. (Kaur, Bhandri and Gupt, 2009).

Now a days, banks are focusing more on individual needs through retail banking which increased the other income of the banks significantly

PROBLEMS OF INDIAN BANKING SYSTEM

Despite of progress made by Indian Commercial banks during last two decades, there are still many problems faced by these banks. Some of them are listed below :

1. Indian banks are facing low profitability.

2. The NPA s of Indian banks have been growing rapidly.

3. The capital base of Indian banks was very low and not uniform.

4. Many bank involve in window dressing of their balance sheets. They artificially increase their deposits in last weeks of the financial year.

5. Some bank favour certain companies in advancing loans without following rigrous process, often these loans turn bad.

6. The quality of loan portfolios of many banks is very bad usually they advance loans under political pressures.

7. Many banks misutilise public deposits by indulging in share speculation. There have been various scams which revealed the negative role of public and private sector banks.

8. There have been reported many irregularities in maintaining accounts by the banks.

This shows that Indian commercial banks are not operating properly. Therefore number of committees have suggested measures to improve this workings. One of the major committee and its recommendations are explained here under.

NARSIMHAM COMMITTEE REPORT

Narasimham Committee Report Part I (1991) :

The committee on Financial system under the chairmanship of Sri M. Narasimham laid down the blue print of financial sector reforms. The committee assumed that the financial resources of commercial banks came from general public therefore these funds should be deployed for maximum benefit of the depositors.

Narasimham Committee on Banking Sector Reforms Part II (1998) :

The committee was constituted to review the progress of banking sector reforms and suggest reforms necessary to strengthen India's financial system and make it internationally competitve. The committee gave its Report on April 23, 1998.

1991 Recommendations	1998 Recommendations
More strong Banks (Cautioned merger of strong and weak banks)	Merger weak banks to reduce number
Free bank boards from interference	Free bank boards from interference
Move to three-tier structure	Move to three-tier structure
Review capital adequacy norm	Fix capital adequacy at 8%
Consider whether autonomy is consistent with public ownership	Ensure autonomy of banks. Wind up banking division of Finance Ministry

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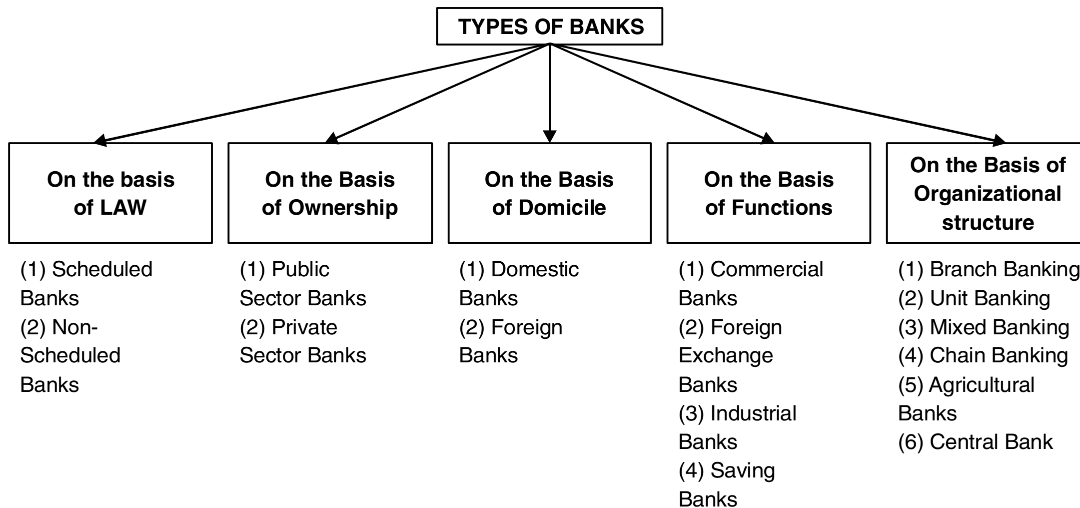
Classification and Functions of Banks

CLASSIFICATION OF BANKS



1) On the Basis of Law

Banks can classify into two categories on the basis of second schedule of the Reserve Bank of India, 1934.

A) Scheduled Banks: A Scheduled bank has been included in the second schedule of the Reserve Bank, and fulfills the following three criteria:

- It must have a paid up capital of at least Rs. 5 lakhs.
- It must fulfill the RBI norms about no activity that may be detrimental to the depositor's interests.
- It must be a Corporation (not a partnership or a single ownership firm).

B) Non-Scheduled Banks: Non-Scheduled Banks are excluded from the Second schedule of RBI. The Reserve Bank does not exercise much control over them, but they report monthly to RBI.

2) On the Basis of Ownership

A) Public Sector Banks: These are banks where majority stake is held by the Government of India or Reserve Bank of India. Examples of public sector banks are: State Bank of India, Corporation Bank, Bank of Baroda and Dena Bank, etc

B) Private Sectors Banks: In case of private sector banks majority of share capital of the bank is held by private individuals. These banks are registered as companies with limited liability. For example: The Jammu and Kashmir Bank Ltd., Bank of Rajasthan Ltd., Development Credit Bank Ltd, Lord Krishna Bank Ltd., Bharat Overseas Bank Ltd., Global Trust Bank, Vysya Bank, etc.

C) Co-operative Banks: People who come together to jointly serve their common interest often form a co-operative society under the Co-operative Societies Act. When a co-operative society engages itself in banking business it is called a Co-operative Bank. The society has to obtain a licence from the Reserve Bank of India before starting banking business. Any co-operative bank as a society is to function under the overall supervision of the Registrar, Co-operative Societies of the State.

As regards banking business, the society must follow the guidelines set and issued by the Reserve Bank of India.

Types of Co-operative Banks:

There are three types of co-operative banks operating in our country. They are primary credit societies, central co-operative banks and state co-operative banks. These banks are organized at three levels, village or town level, district level and state level.

(i) Primary Credit Societies: These are formed at the village or town level with borrower and non-borrower members residing in one locality. The operations of each society are restricted to a small area so that the members know each other and are able to watch over the activities of all members to prevent frauds.