UNIT - I

Indian Banking Structure, Origin, Evolution of Banking Institutions, Types and functions of banks, Banking companies in India, RBI; Constitution, Management and Functions, Banking Regulation Act, 1949, State Bank of India, UTI, IDBI, RRBs', Local banks, Non-Banking Financial Company (NBFC), BASEL Norms

The term '**Bank'** is derived from the Italian word 'banca', Latin word 'bancus' and Frenchword 'banque' which means bench or **Money exchange table**.

In olden days, European money lenders or money changers used to display (show) coins of different countries in big heaps (quantity) on benches or tables for the purpose of lending or exchanging. The meaning of it in English is a bench. The early bankers transacted their business at benches in a market place.

According to some authorities, the word bank was originally derived from German word bank. It means a joint stock fund. This word later on was called as 'banco' in Italy when a great part of Italy was ruled by the Germans.

A bank is a financial institution which deals with deposits and advances and other related services. It receives money from those who want to save in the form of deposits and it lends money to those who need it. A bank is a financial institution and a financial intermediary that accepts deposits and channels those deposits into lending activities, either directly by loaning or indirectly through capital markets. A bank is the connection between customers that have capital deficits and customers with capital surpluses.

Due to their influence within a financial system and an economy, banks are generally highly regulated in most countries. Most banks operate under a system known as fractional reserve banking where they hold only a small reserve of the funds deposited and lend out the rest for profit. They are generally subject to minimum capital requirements which are based on an international set of capital standards, known as the Basel Accords.

What is a Bank?

Oxford Dictionary defines a bank as "an establishment for custody of money, which it pays out on customer's order."

According to **Prof. Sayers**, "A bank is an institution whose debts are widely accepted in settlement of other people's debts to each other." In this definition

Sayers has emphasized the transactions from debts which are raised by a financial institution.
According to the Indian **Banking Company Act 1949**, "A banking company means any company which transacts the business of banking. Banking means accepting for the purpose of lending or investment, of deposits of money from the public, repayable on demand or other wise and withdrawable by cheque, draft or otherwise."This definition throws light on the three major functions of a bank. They are:
(i) Accepting of deposits and lending loans
(ii) Issue and pay cheques,
(iii) Collect cheques on behalf of the customers.
A bank is a financial institution that provides banking and other financial services to their customers. A bank is an institution which provides fundamental banking services such as accepting deposits and lending loans. As financial intermediaries, banks stand between depositors who supply capital and borrowers who demand capital. When banks accept deposits its liabilities increase and it becomes a debtor, but when it makes advances its assets increases and it becomes a creditor.
Banks are a subset of the financial services industry. The banks are the main participants of the financial system in India. All the banks safeguard the money and valuables and provide loans, credit, and payment services, such as money orders, and cheques. The banks also offer investment and insurance products.

Due to the emergence of integration among finance industries, some of the traditional distinctions between banks, insurance companies and securities firms have diminished and they have converted themselves into Universal Banks to offer a variety of services under one umbrella.

Example: IDBI Bank and ICICI. In spite of these changes, banks continue to maintain and perform their primary role—accepting deposits and lending funds from these deposits.

Evolution of Banking in India :

Modern banking as evolved in England was introduced by the British during their rule in India. Naturally, today's Indian banking is similar to British banking. However, it does not mean that banking was unknown to India. The essence of banking is lending for productive purposes. In fact, India was a major partner in international trading and was a big producer of steel, cloth, spices and luxurious articles. There are references to rate of interest, security of the loans in the Manusmrity. Kautilya in the ‘Artha Shastra’ mentions regulation of interest rates, deposits and even discounting of bills. They were called ‘Hundies’. The big merchants, traders and moneylenders called ‘Sresthis’ or “Nagarseths”occupied important positions in the Mughal and Maratha courts. They had efficient courier system, extensive branches all over India and they gave loans to the kings also. However, modern banking with its double-entry accounting system and insistence on deposit mobilisation was introduced bythe British. As the British rule extended all over the country, the stages in evolution in Banking in India. Modern banking also spread driving out the indigenous banking.

Stages in the Evolution of Banking in India :

Some important stages in the evolution of modern banking in India are as follows:

1) Agency Houses :

When the English traders came to India, they had problem of raising working capital due to the language barrier. Therefore, they established Agency Houses which combined trading with banking. One agency house established the first bank in India called the Bank of Hindustan in 1770. Later on, many banks were established. But they disappeared as fast as they were born. Anybody could then start a bank. The field was free for all.

2) Presidency Banks :

The East India Co., the ruler of India, took initiative in establishing Presidency Banks by contributing 20% of their share capital to meet its own demand for funds. Accordingly, Bank of Bengal, Bank of Bombay and Bank of Madras were established in 1806, 1840 and 1943 respectively.

3) Joint Stock Banks :

In 1884, banks were allowed to be established on the principle of limited liability. In due course, this encouraged establishment of banks. By the turn of the century, many banks with the initiative of Indians were established. Punjab National Bank, Allahabad Bank, Bank of Baroda are some of the banks then established. Many foreigners also came in the field of Indian banking.

4) Imperial Bank of India :

To meet the competition of foreign banks, the three Presidency Banks were amalgamated and a powerful Imperial Bank of India was established in 1921 with its network of branches all over the country. This bank was later nationalised in 1955 and it istoday's State Bank of India. This is a prestigious bank as the Government is its customer.

5) Establishment of the Reserve Bank of India :

Though there was boom in banking, due to absence of any regulation and facility of timely assistance there were recurrent bank failures. This resulted in suspicion about banks in theminds of the people. They stayed away from banks. The need for a separate Central Bank was emphasised by the Hilton Young Commission. Accordingly, the RBI was established in 1935 to perform all the functions of a Central Bank. It was modeled on the pattern of the Bank of England. But it did not have much power of regulation. The period was also critical one due to the great depression and the subsequent Second World War. The RBI could not do much about banking.

6) Nationalisation of the RBI and the Banking Regulation Act :

These two important steps were taken in 1949. Immediately after independence wide powers of regulation and control were given to the RBI and by making use of those powers the RBI was successful in making Indian banking trustworthy. Soon, bank failures became a thing of the past and India's banks progressed under the guidance of the RBI. Many malpractices, deficiencies and drawbacks were sought to be removed by the RBI.

7) Nationalisation of Banks in 1969 and 1980 :

Another significant step was taken in 1969 by nationalising 14 big Indian banks. Then six more banks were nationalised in 1980. The nationalisation of banks brought about a sea-change in the policies, attitudes, procedures, functions and coverage of banks. Indian banks are now being prepared to become international players. These are the stages through which Indian banking developed.

Till the year1980 approximately 80% of the banking segment in India was under government's ownership. In the early 1990s, the then Narsimha Rao government embarked on a policy of liberalisation, licensing a small number of private banks. These came to be known as ***New Generation tech-savvy banks***, and included Global Trust Bank (the first of such new generation banks to be set up), which later amalgamated with Oriental Bank of Commerce, Axis Bank(earlier as UTI Bank), ICICI Bank and HDFC Bank. Later on, in the year 1993, the government merged New Bank of India with Punjab National Bank. It was the only merger between nationalized banks and resulted in the reduction of the number of nationalized banks from 20 to 19.

Characteristics of Banker/Banking

1. Banker deals with others' money
2. Banks repay deposits either on demand or after the expiry of specified period
3. They utilise deposits for lending/investment
4. They perform subsidiary services and innovative functions
5. Banking should be dominant part of business of bank
6. A bank should hold itself out as a bank

Importance of banks

Bankers play very important role in the economic development of the nation. The health of the economy is closely related to the growth and soundness of its banking system. Although banks create no new wealth but their fund collection, lending and related activities facilitate the process of production, distribution, exchange and consumption of wealth. In this way, they become very effective partners in the process of economic development.

1. Banks mobilise small, scattered and idle savings of the people, and make them available for productive purposes
2. By offering attractive interests, Banks promote the habit of thrift and savings
3. By accepting savings, Banks provide safety and security to the surplus money
4. Banks provide convenient and economical means of payments
5. Banks provide convenient and economical means of transfer of funds
6. Banks facilitate the movement of funds from unused regions to useful regions
7. Banking help trade, commerce, industry and agriculture by meeting their financial requirements
8. Banking connect saving people and investing people.
9. Through their control over the supply of money, Banks influence the economic activities, employment, income level and price level in the economy.

Structure of Indian Banking System :
The Indian Banking System is classified into four categories as follows :

Reserve Bank of India :
The Reserve Bank of India is the supreme monetary and banking authority in India and this bank bears the responsibility to control and regulate the functioning of the banking system in India. As the Reserve Bank keeps the reserves of all commercial banks, it is known as the "Reserve Bank". The Reserve Bank performs all the typical functions of a Central Bank. Its main function is to regulate the monetary mechanism comprising of the currency.
For this the Bank is given the monopoly of note issue and has wide powers over the commercial banks. At the same time the bank is taking active part in fostering an adequate banking structure capable of meeting the needs of trade, industry, agriculture and commerce.
A) Commercial Banks :
Commercial banks are those banks which started mainly to earn profit as well as to render different types of services to their depositors. It enables large payments to be made over a long distances with minimum expenses. It constitutes the very life blood of an advanced economic society. Commercial banks have a long history of their existence for many decades.
Mobilisation of urban savings is done by the commercial banks and they make availability of these accumulated savings for providing credits to the working capital requirements of different categories of industries and trading units. Due to nationalisation of big commercial banks in 1969, commercial banks are broadly classified as :
1) Public Sector Banks :
In 1999, Indian banking system had 27 public sector banks. The public sector banks have wider objectives of rapid economic development. They have been successful in quantitative expansion of banking through more branches,higher deposits and credit distribution. The public sector banks undertake social responsibilities in a big way.
a) SBI and Its Associate Banks :
The State Bank of India is the founder and the flagship member of the State Bank group. The seven associate banks of SBI are :
1) State Bank of Bikaner and Jaipur.
2) State Bank of Hyderabad.
3) State Bank of Indore.

4) State Bank of Mysore.
5) State Bank of Patiala.
6) State Bank of Saugashtra.
7) State Bank of Travancore.

The SBI and its seven associates as group accounts nearly 34% of aggregate banking business.

b) Nationalised Banks :

Under the Banking Companies (Acquisition of Undertakings) Act, 1970, the Central Government acquired the undertakings of the 14 major Indian banks.These banks are then recognised as Nationalised Banks. These are :

1) The Central Bank of India.
2) The Bank of India.
3) The Punjab National Bank.
4) The Bank of Baroda.
5) The United Commercial bank.
6) Canara Bank.
7) The United Bank of India.
8) Dena Bank.
9) Syndicate Bank.
10) The Union Bank of India.
11) Allahabad Bank.
12) The Indian Bank.
13) Bank of Maharashtra
14) The Indian Overseas Bank.

2) Private Sector Banks :

In a mixed economy of India, the private sector also occupies an important place and is expected to play an important role in economic development. The existence of private sector banks has enlarged consumer's choice. These banks are giving tough competition to the public sector banks by introducing various innovation like ATM facility, 24 hours banking, home banking. Private sector banks again can be divided between **:**

a) Indian Banks :

The banks which have their head office in India and which are owned, controlled and managed by the Reserve Bank of India are known as Indian Bank.

b) Foreign Banks :

Banks which have their head office overseas and which are owned, controlled and managed from other countries are foreign banks.

Nationalised or public sector banks and private sector banks. The public sector banks consist of the State Bank of India and its associate banks alongwith another 21 banks which were nationalised. Small number of Indian scheduled banks which have not been nationalised and branches of foreign banks operating in India belong to the private sector banks. Foreign banks are commonly known as "foreign exchange banks."

B) Regional Rural Banks :

Since the middle of 1970's, the Regional Rural Banks came into existence in India. These banks were set up with the specific objective of providing credit and facilities of deposits especially to small and marginal farmers, agricultural labour and artisans and small enterprises. The rural development in respect of agriculture, trade, commerce and industry is the Prime responsibility of Regional Rural Banks (RRBs) of India.

These banks are essentially commercial banks. However, their area of operation is restricted to a district.

C) Co-operative Banks :

Co-operative banks are an important component of the Indian banking system. It is originated with the enactment of the Cooperative Credit Societies Act of 1904. These banks are classified as Urban Co-operative Banks and Rural Co-operative Credit Institutions.

1) Urban Co-operative Banks :

The urban areas are served by the urban co-operative banks. These banks are registered under Co-operative Societies Act of the respective State Governments. The RBI is the regulatory and supervisory authority of these banks for their banking related operations. The RBI extends refinance to these banks at Bank Rate against their advances to tiny and cottage industrial units. These banks are required to channelise 60% of total loans and advances towards priority sectors. There are urban co-operative credit societies working in the urban areas to supply credit at low rate of interest to the semi-urban weaker sections of society. These are the societies registered under Co-operative Societies Act. Theyplay an important role in providing credit in urban areas.

2) Rural Co-operative Credit Institutions :

The rural areas are largely served by the rural co-operative credit institutions. There is a three tire structure consisting of :

a) The State Co-operative Banks at the apex level exist a the state level.

b) The District Co-operative banks at the intermediate level existing at District level.

c) The Primary Co-operative credit societies at the grassroots level.
The State Co-operative Banks and the District Central Cooperative Banks provide financial support to Primary Cooperative Credit Societies. The funds of the Reserve Bank are provided to agricultural sector through the State Cooperative Banks and the Central Co-operative Banks.

Types of banks

Functional classification

1. Commercial banks/Deposit banks

Banks accept deposits from public and lend them mainly for commercial purposes for comparatively shorter periods are called Commercial Banks. They provide services to the general public, organisations and to the corporate community. They are oldest banking institution in the organised sector. Commercial banks make their profits by taking small, short-term, relatively liquid deposits and transforming these into larger, longer maturity loans. This process of asset transformation generates net income for the commercial bank. Many commercial banks do investment banking business although the latter is not considered the main business area. The commercial banking system consists of scheduled banks (registered in the second schedule of RBI) and non scheduled banks. Features of Commercial banks are;

- They accepts deposits on various accounts.
- Lend funds to organisations, trade, commerce, industry, small business, agriculture etc by way of loans, overdrafts and cash credits.
- They are the manufacturers of money.
- The perform many subsidiary services to the customer.
- They perform many innovative services to the customers.

2. Industrial banks/Investment banks

Industrial banks are those banks which provide fixed capital to industries. They are also called investment banks, as they invest their funds in subscribing to the shares and debentures of industrial concerns. They are seen in countries like US, Canada, Japan, Finland, and Germany. In India industrial banks are not found. Instead, special industrial finance corporations like IFC and SFC have been set up to cater to the needs of industries. Features of Industrial Banks are:

- Participate in management.
- Advise industries in making right investment
- Advise govt. on matters relating to industries

3. Agricultural banks

Agricultural banks are banks which provide finance to agriculture and allied sectors. It is found in almost all the countries. They are organised generally on co-operative basis. In India, Cooperative banks are registered under the Co-operative Societies Act, 1912. They generally give credit facilities to small farmers, salaried employees, small-scale industries, etc. Co-operative Banks are available in rural as well as in urban areas. Agricultural banks are of two types;

- **Agricultural co-operative banks:** They provide short term finance to farmers for purchasing fertilizers, pesticides and seeds and for the payment of wages.
- **Land Development Banks:** They provide long term finance for making permanent improvement on land. They assist to purchase machinery, equipments, installation of pump sets, construction of irrigation works etc.

4. Exchange banks

Exchange banks finances foreign exchange business (export, import business) of a country. Special exchange banks are found only in some countries. The main functions of exchange banks are remitting money from one country to another country, discounting of foreign bills, buying and selling gold and silver, helping import and export trade etc.

5. Savings bank

Savings banks are those banks which specialise in the mobilisation of small savings of the middle and low income group. In India, saving bank activities are done by commercial banks and post offices.

Features of savings banks are:

- Mobilise small and scattered savings
- Promote habit of thrift & savings
- Keep only small portion in hand and invest major part in govt. securities
- They do not lend to general public.

6. Central / National banks

It is the highest banking & monetary institution in a country. It is the leader of all other banks. Since it is occupying a central position, it’s known as Central Bank. It is operating under state's control and is not a profit motive organisation. Reserve Bank of India (India), Bank of Canada (Canada), Federal Reserve System(USA) etc are the examples of Central Banks.

The main functions of a Central Bank are:

- Monopoly of currency issue
- Acts as banker to the govt.
- Serves as bankers' bank
- Act as controller of credit
- Custodian of nation's gold and foreign exchange reserve.

Functions of commercial banks

Functions of a Commercial Bank can be classified into three.

1. Principal/ Primary/ Fundamental functions
2. Subsidiary/ Secondary/ Supplementary functions
3. Innovative functions.

Principal functions

Commercial banks perform many functions. They satisfy the financial needs of the sectors such as agriculture, industry, trade, communication, so they play very significant role in a process of economic social needs. The functions performed by banks, since recently, are becoming customer-centred and are widening their functions. Generally, the functions of commercial banks are divided into two categories; primary functions and the secondary functions. Two 'acid test' functions of commercial banks are Accepting deposits and Lending loans. These functions along with credit creation, promotion of cheque system and investment in Government securities form basic functions of commercial banks. The secondary functions of commercial banks include agency services, general utility services and innovative services.

1. Receiving deposits

Most important function of a commercial bank is to accept deposit from those who can save but cannot profitably utilise this savings themselves. By making deposits in bank, savers can earn something in the form of interest and avoid the danger of theft. To attract savings from all sorts of customers, banks maintain different types of accounts such as current account, Savings bank account, Fixed Deposit account, Recurring deposit account and Derivative Deposit account.

Features of Current Accounts

- It is generally opened by trading & industrial concerns.
- It is opened not for profit or savings but for convenience in payments
- Introduction is necessary to open the account.

- Any number of transactions permitted in the account.
- Withdrawals are generally allowed by cheque
- Deposit is repayable on demand
- No interest is allowed but incidental charges claimed.
- Minimum balance requirement varies from bank to bank.

Features of Saving Bank (SB) accounts

- It is generally opened by middle/low income group who save a part of their income for future needs
- Introduction is necessary to open the account if cheque facility is allowed.
- There are some restrictions on number of withdrawals.
- Fair interest (less than FD) is offered on the deposits of this account.

Features of Fixed Deposit accounts

- It is generally Opened by small investors who do not want to invest money in risky industrial securities like shares.
- No introduction is necessary to open the account.
- No maximum limit for investing.
- Minimum period of investment is 15 days
- Withdrawal is allowed only after the expiry of a fixed period.
- Withdrawal is generally allowed by surrendering FD Receipt
- Higher rate of interest is offered on the deposits of this account,

Features of Recurring Deposit accounts / Cumulative Deposit account.

- This account is meant for fixed income group, who can deposit a fixed sum regularly.
- The amount is paid back along with interest after a specified period.
- High rate of interest is offered on recurring deposits.
- Passbook is the means through which deposits and withdrawals are made

2. Lending of funds

The second important function of commercial banks is to advance loans to its customers. Banks charge interest from the borrowers and this is the main source of their income. Modern banks give mostly secured loans for productive purposes. In other words, at the time of advancing loans, they demand proper security or collateral. Generally, the value of security or collateral is equal to the amount of loan. This is done mainly with a view to recover the loan money by selling the security in the event of non-refund of the loan. Commercial banks lend money to the needy people in the form of Cash credits, Term loans, Overdrafts (OD), Discounting of bills, Money at call or short notice etc.

(i) Cash Credit: In this type of credit scheme, banks advance loans to its customers on the basis of bonds, inventories and other approved securities. Under this scheme, banks enter into an agreement with its customers to which money can be withdrawn many times during a year. Under this set upbanks open accounts of their customers and deposit the loan money. With this type of loan, credit is created.

(ii) Term loans: A term loan is a monetary loan that is repaid in regular payments over a set period of time. In other words, a loan from a bank for a specific amount that has a specified repayment schedule and a floating interest rate is called Term loan. Term loans usually last between one and ten years, but may last as long as 30 years in some cases. It may be classified as short term, medium term and long term loans.

(iii) Over-Drafts: It is the extension of credit from a bank when the account balance reaches zero level. Banks advance loans to its customer's up to a certain amount through over-drafts, if there are no deposits in the current account. For this, banks demand a security from the customers and charge very high rate of interest. Overdraft facility will be allowed only for current account holders.

(iv) Discounting of Bills of Exchange: This is the most prevalent and important method of advancing loans to the traders for short-term purposes. Under this system, banks advance loans to the traders and business firms by discounting their bills. While discounting a bill, the Bank buys the bill (i.e. Bill of Exchange or Promissory Note) before it is due and credits the value of the bill after a discount charge to the customer's account. The transaction is practically an advance against the security of the bill and the discount represents the interest on the advance from the date of purchase of the bill until it is due for payment. In this way, businessmen get loans on the basis of their bills of exchange before the time of their maturity.

(v) Money at Call and Short notice: Money at call and short notice is a very short-term loan that does not have a set repayment schedule, but is payable immediately and in full upon demand. Money-at-call loans give banks a way to earn interest while retaining liquidity. These are generally lent to other institutions such as discount houses, money brokers, the stock exchange, bullion brokers, corporate customers, and increasingly to other banks. 'At call' means the money is repayable on demand whereas ' At short notice' implies the money is to be repayable on a short notice up to 14 days.

3. Investment of funds in securities

Banks invest a considerable amount of their funds in government and industrial securities. In India, commercial banks are required by statute to invest a good portion of their funds in government and other approved securities. The banks invest their funds in three types of securities—Government securities, other approved securities and other securities. Government securities include both, central and state governments, such as treasury bills, national savings certificate etc. Other securities include securities of state associated bodies like electricity boards, housing boards, debentures of Land Development Banks, units of UTI, shares of Regional Rural banks etc.

4**. Credit Creation**

When a bank advances a loan, it does not lend cash but opens an account in the borrower's name and credits the amount of loan to this account. Thus a loan creates an equal amount of deposit. Creation of such deposit is called credit creation. Banks have the ability to create credit many times more than their actual deposit. (The process of credit creation is explained in the last part of the module in detail)

5. **Promoting cheque system**

Banks also render a very useful medium of exchange in the form of cheques. Through a cheque, the depositor directs the banker to make payment to the payee. In the modern business transactions by cheques have become much more convenient method of settling debts than the useof cash. Through promoting cheque system, the banks ensure the exchange of accounted cash. At

present, CTS (Cheque Truncation System) cheques are used by Indian Banks to ensure speedy settlement of transactions in between banks. In contrast to the declining importance of cheques, the use of electronic payment instruments at the retail level has been growing rapidly.

Subsidiary functions

1. Agency services : Banks act as an agent on behalf of the individual or organisations. Banks, as an agent can work for people, businesses, and other banks, providing a variety of services depending on the nature of the agreement they make with their clients. Following are the important agency services provided by commercial banks in India.

- Commercial Banks collect cheques, drafts, Bill of Exchange, interest and dividend on securities, rents etc. on behalf of customers and credit the proceeds to the customer's account.
- Pay LIC premium, rent, newspaper bills, telephone bills etc
- Buying and selling of securities

- Advise on right type of investment
- Act as trustees (undertake management of money and property), executors (carry out the wishes of deceased customers according to will) & attorneys (collect interest & dividend and issue valid receipt) of their customers.
- Serve as correspondents and representatives of their customers. In this capacity, banks prepare I-Tax returns of their customers, correspond with IT authorities and pay IT of their customers.

2. General Utility Services : In addition to agency services, modern banks performs many general utility services for the community. Following are the important general utility services offered by Commercial Banks-

- *Locker facility:* Bank provide locker facility to their customers. The customers can keep their valuables such as gold, silver, important documents, securities etc. in these lockers for safe custody.
- *Issue travellers' cheques:* Banks issue traveller's cheques to help their customers to travel without the fear of theft or loss of money. It enable tourists to get fund in all places they visit without carrying actual cash with them.
- *Issue Letter of Credits:* Banks issue letter of credit for importers certifying their credit worthiness. It is a letter issued by importer's banker in favour of exporter informing him that issuing banker undertakes to accept the bills drawn in respect of exports made to the importer specified therein.
- *Act as referee:* Banks act as referees and supply information about the financial standing of their customers on enquiries made by other businessmen.
- *Collect information:* Banks collect information about other businessmen through the fellow bankers and supply information to their customers.
- *Collection of statistics:* Banks collect statistics for giving important information about industry, trade and commerce, money and banking. They also publish journals and bulletins containing research articles on economic and financial matters.
- *Underwriting securities:* Banks underwrite securities issued by government, public or private bodies.
- *Merchant banking:* Some bank provide merchant banking services such as capital to companies, advice on corporate matters, underwriting etc.

Innovative Functions

The adoption of Information and Communication technology enable banks to provide many innovative services to the customers such as;

1. ATM services

Automated Teller Machine (ATM) is an electronic telecommunications device that enables the clients of banks to perform financial transactions by using a plastic card. Automated Teller Machines are established by banks to enable its customers to have anytime money. It is used to withdraw money, check balance, transfer funds, get mini statement, make payments etc. It is available at 24 hours a day and 7 days a week.

2. Debit card and credit card facility

Debit card is an electronic card issued by a bank which allows bank clients access to their account to withdraw cash or pay for goods and services. It can be used in ATMs, Point of Sale terminals, e-commerce sites etc. Debit card removes the need for cheques as it immediately transfers money from the client's account to the business account. Credit card is a card issued by a financial institution giving the holder an option to borrow funds, usually at point of sale. Credit cards charge interest and are primarily used for shortterm financing.

3. Tele-banking :

Telephone banking is a service provided by a bank or other financial institution, that enables customers to perform financial transactions over the telephone, without the need to visit a bank branch or automated teller machine

4. Internet Banking:

Online banking (or Internet banking or E-banking) is a facility that allows customers of a financial institution to conduct financial transactions on a secured website operated by the institution. To access a financial institution's online banking facility, a customer must register with the institution for the service,
and set up some password for customer verification. Online banking can be used to check balances, transfer money, shop onlline, pay bills etc.

5. Bancassurance:

It means the delivery of insurance products through banking channels. It can be done by making an arrangement in which a bank and an insurance company form a partnership so that the insurance company can sell its products to the bank's client base. Banks can earn additional revenue by selling the insurance products, while insurance companies are able to expand their customer base without having to expand their sales forces

6. Mobile Banking:

Mobile banking is a system that allows customers of a financial institution to conduct a number of financial transactions through a mobile device such as a mobile phone or personal digital assistant. It allows the customers to bank anytime anywhere through their mobile phone. Customers can access their banking information and make transactions on Savings Accounts, Demat Accounts, Loan Accounts and Credit Cards at absolutely no cost.

7. Electronic Clearing Services :

It is a mode of electronic funds transfer from one bank account to another bank account using the services of a Clearing House. This is normally for bulk transfers from one account to many accounts or viceversa. This can be used both for making payments like distribution of dividend, interest, salary, pension, etc.
by institutions or for collection of amounts for purposes such as payments to utility companies like telephone, electricity, or charges such as house tax, water tax etc

8. Electronic Fund Transfer/National Electronic Fund Transfer(NEFT):

National Electronic Funds Transfer (NEFT) is a nation-wide payment system facilitating one-to-one funds transfer. Under this Scheme, individuals, firms and corporate can electronically transfer funds from any bank branch to any individual, firm or corporate having an account with any other bank branch in the country participating in the Scheme. In NEFT, the funds are transferred based on a deferred net settlement in which there are 11 settlements in week days and 5 settlements in Saturdays.

9. Real Time Gross Settlement System(RTGS):

It can be defined as the continuous (real-time) settlement of funds transfers individually on an order by order basis . 'Real Time' means the processing of instructions at the time they are received rather than at some later time. It is the fastest possible money transfer system in the country.

Role of commercial banks in a developing economy

A well developed banking system is necessary pre-condition for economic development of any economy. Apart from providing resources for growth of industrialisation, banks also influence direction in which these resources are utilised. In underdeveloped and developing nations banking facilities are limited to few developed cities and their activities are focussed on trade & commerce paying little attention to industry & agriculture. Commercial banks contribute to a country’s economic development in the following ways.

1.Capital formation

Most important determinant of economic development is capital formation. It has 3 distinctive stages

- Generation of savings
- Mobilisation of savings
- Canalisation of saving

Banks promote capital formation in all these stages. They promote habit of savings by offering attractive rate of return for savers. Banks are maintaining different types of accounts to mobilise savings aiming different types of customers. They make widespread arrangements to collect savings by opening branches even in remote villages. Moreover, banks offer their resources for productive activities only.

2. Encouragement to entrepreneurial innovations

Entrepreneurs in developing economies, generally hesitate to invest & undertake innovations due to lack of fund. Bank loan facilities enable them to introduce innovative ideas and increase productive capacity of the economy.

3. Monetisation of economy

Monetisation means allow money to play an active role in the economy. Banks, which are creators and distributors of money, help the monetisation in two ways

- They monetise debt i.e., buy debts (securities) which are not as acceptable as money and convert them to demand deposits which are acceptable as money.
- By spreading branches in rural areas they convert non-monetised sectors of the economy to monetised sectors.

4. Influencing economic activity

They can directly influence the economic activity & pace of economic development through its influence on

(a) The rate of interest (reduction in rates make investment more profitable and stimulates economic activity)

(b) Availability of credit. (Through Credit creation banks helps in increasing supply of purchasing power)

5. Implementation of monetary policy

Well developed banking system is necessary for effective implementation of monetary policy. Control and regulation of credit is not possible without active co-operation of banks.

6. Promotion of trade and industry

Economic progress of industrialised countries in last 2 centuries is mainly due to expansion in trade & industrialisation which could not have been made possible without development of good banking system. Use of cheques, drafts and BoE as a medium of exchange has revolutionalised the internal and international trade which in turn accelerated the pace of industrialisation.

7. Encouraging right type of industries

In a planned economy it is necessary that banks should formulate their loan policies in accordance with the broad objectives and strategy of industrialisation as adopted in the plan.

8. Regional development

Banks can play role in achieving balanced development in different regions of the economy. They can transfer surplus funds from developed region to less developed regions, where there is shortage of funds.

9. Development of agricultural & other neglected sectors

Under developed economies primarily agricultural economies and majority of the population live in rural areas. So far banks were paying more attention to trade and commerce and have almost neglected agriculture and industry. Banks must diversify their activities not only to extend credit to trade, but also to provide medium and long term loans to industry and agriculture.

Credit Creation

('Loans create deposits' and 'deposits create loans')

Banks, unlike other financial institutions, have a peculiar ability to create credit i.e., to expand their demand deposits as a multiple of their cash reserves. This is because of the fact that demand deposits of the banks serve as the principal medium of exchange, and in this way, the banks manage the payment system of the country. In short multiple expansion of deposits is called credit creation.

When a bank extends loans it is not directly paid to the borrower, but is only credited to his account and a cheque book is given. Thus every bank loan creates an equivalent amount of derivative deposit. By using this deposit, banker can again extend loan to some other parties after keeping a specified amount as reserve. Thus with a little cash in hand the banks can create additional purchasing power to a considerable degree. Credit can be created by a single bank or by more than one banker. When it is created by more than one banker, it is called multiple credit creation.

Imagine that the CRR maintained by the bank is 20%. Now, Mr. A deposits Rs.10,000 with Federal Bank. The bank need not keep the entire cash in reserve to meet its day to day demand for cash. After keeping a 20% (Rs.2,000) in hand,

bank extends a credit of Rs.8,000 (initial excess) to Mr. B by opening a credit account in his name. This creates another derivative deposit of Rs.8,000
in the bank. By keeping 20% (Rs.1,600) of this in hand bank again advances Rs.6,400 to Mr.C and he deposits the same in his bank, SBT. This creates a primary deposit to SBT, and it extend a credit of Rs.5120 to Mr.D after keeping 1,280 (20%) in the bank. This process continues until the initial primary deposit of Rs.10,000 with Federal Bank lead to the creation of total deposits (both primary
and derivative) of Rs.50,000 or initial excess reserve of Rs. 8,000 creates a total derivative deposit of Rs.40,000 (8,000+6,400+5120+4096+……. = 40,000)
From the above illustration, it is clear that the initial primary deposit of Rs.10,000 in Federal Bank leads to the expansion of total deposit of Rs. 50,000. Initial excess reserve of Rs.8,000 creates multiple derivative deposits of Rs. 40,000. Credit creation is 5 times (Rs.40,000) of the initial excess reserve (Rs.8,000)
Credit multiplier (5) is =
Total derivative deposits
Initial excess reserve
4000
800
Or 1/ CRR i.e., 1/20%

Destruction of credit:

Banks create credit by advancing loans. Similarly banks can destroy credit by reducing loans. Extend of destruction depends on CRR. Higher the CRR greater will be the destruction of credit.

Various ways of creating money

- by advancing loans
- by allowing Overdrafts
- by providing Cash Credits
- by discounting bill of exchange
- by purchasing securities

Limitations of credit creation

Bank cannot expand deposits to an unlimited extent by granting loans and advances even though this process of granting loans and advances is profitable to them. Their power to create credit is subject to the following limitations:

- ***Amount of Cash available with the Bank:*** Credit creation depends on the amount of cash available with bank. Larger the amount of cash with the banking system, greater will be the credit creation and vice versa.

- ***Cash Reserve Ratio:*** CRR is the minimum cash required to be maintained by a bank with RBI.CRR sets the limit for the creation of credit. Higher the CRR smaller will be the credit creation and vice versa.
- ***Leakages:*** The credit creation by the banks is subject to certain conditions. If there is any leakage in this process the credit creation by the banks will be limited. In credit creation, it is expected that the banks lend the entire amount of excess deposits over the minimum statutory reserve. If there is any down fall in such lending, it will affect the creation of credit to that extent. Leakage may occur either because of unwillingness of banks to utilise their surplus funds for granting loans or unwillingness of borrower to keep whole amount of loan in the bank. Both will lead to lesser credit creation.
- ***Security for loans:*** The securities acceptable to bank places a limit on credit creation by the banks. While lending, the banks insist upon the securities from the customers. All type of assets are not acceptable to banks as securities. If borrower is not able to provide sufficient security, credit creation is not possible.
- ***Credit policy of banks:*** If banks want to create excess reserves, the credit creation will be limited to that extent.

Meaning:

According to Sec. 5 of the Banking Regulation Act, 1949, a banking company means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise and withdrawn by Cheque, Draft, Order, or otherwise.

In short, a banking company means and includes any company which carries on the business or which transacts the business of banking in India. Therefore, any company which is engaged in trade or manufacture, which accepts deposits of money from the public for the purpose of financing its business only, shall not be deemed to carry on the business of banking.

No company can use as part of its name any of the words bank, banker or banking other than a banking company and, at the same time, no company can carry on business of banking in India unless and until it uses at least one of such words as part of its name.

Licensing of Banking Companies:

According to Sec. 22, no company shall carry on banking business in India unless it holds a license issued by the Reserve Bank of India

If the following conditions are satisfied, the Reserve Bank of India may grant a license:

(i) "That the company is or will be in a position to pay its present and future depositors in full as their claims accrue;

(ii) That the affairs of the company are not being or are not likely to be conducted in a manner detrimental to the interests of its present or future depositor;

(iii) That, in the case of a foreign banking company, the carrying on of a banking business by such company in India will be in the public interest, that the Government or law of the country of its origin does not discriminate against Indian banking companies carrying on business in that country, and that it complies with all the requirements of law applicable to it".

Cancellation of License:

The Reserve Bank of India may cancel a license if:

(i) The company ceases to carry on banking business in India;

(ii) The company at any time fails to comply with any of the conditions on which the license was granted; or

(iii) At any time, any of the conditions, on the satisfaction of which the Reserve Bank of India granted the license, has not been fulfilled.

Area of Business of Banking Companies:

Sec. 6 of the Banking Regulation Act, 1949, lays down that the following business may also be carried on by a banking company, in addition to the usual banking business:

(a) Acting as agents for any government or local authority or any other person or persons; the carrying on of agency business of any description including the clearing and forwarding of goods, giving of receipts and discharges and otherwise acting as an attorney on behalf of customers, but excluding the business of a managing agent of a company;

(b) Contracting for public and private loans and negotiating and issuing the same;

(c) Selecting, insuring, guaranteeing, underwriting, participating, in managing and carrying out of any issue, public or private, of state, municipal or other loans or of shares, stock, debentures or debenture stock of any company, corporation or association and of lending of money for the purpose of any such issue;

(d) Carrying on and transacting every kind of guarantee and indemnity business;

(e) Managing, selling and realizing any property which may come into the possession of the company in satisfaction or part satisfaction of any of its claims;

(f) Acquiring or holding and generally dealing with any property, or title or interest in any such property which may form the security or part of the security for any loans or advances or which may be connected with any such security;

(g) Undertaking and executing trusts;

(h) Undertaking the administration of estates as executor, trustee or otherwise;

(i) Establishing and supporting associations, institutions, funds, trusts, and convenience for the benefit of employees, ex-employees, their dependents and the general public;

(j) Acquiring, constructing, maintaining and altering any building or works necessary for the purpose of the banking company;

(k) Selling, improving, managing, developing, exchanging, leasing, mortgaging, disposing-off or turning into account or otherwise dealing with all or any part of the property and rights of the company;

(l) Acquiring and undertaking the whole or any part of the business of any person or company when such business is of a nature enumerated or described in Sec. 6.

(m) Doing such other things as are necessary for the efficient conduct of the above-named business, such as acquisition, construction, alteration etc. of any building or works necessary or convenient for the purpose of the company; and

(n) Any other form' of business which the Central Government may notify in the Official Gazette.

As such, other types of business are prohibited by a banking company.

RBI

The Reserve Bank of India Act, 1934 sets out the objectives of the Reserve Bank:

"to regulate the issue of Bank notes and keeping of 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; to have a modern monetary policy framework to meet the challenge of an increasingly complex economy, to maintain price stability while keeping in mind the objective of growth."

The formulation, framework and institutional architecture of monetary policy in India have evolved around these objectives – maintaining price stability, ensuring adequate flow of credit to sustain the growth momentum, and securing financial stability.

The responsibility for ensuring financial stability has entailed the vesting of extensive powers in and operational objectives for the Reserve Bank for regulation and supervision of the financial system and its constituents, the money, debt and foreign exchange segments of the financial markets in India and the payment and settlement system. The endeavour of the Reserve Bank has been to develop a robust, efficient and diversified financial system so as to anchor financial stability and to facilitate effective transmission of monetary policy. In addition, the Reserve Bank pursues operational objectives in the context of its core function of issuance of bank notes and currency management as well as its agency functions such as banker to Government (Centre and States) and management of public debt; banker to the banking system including regulation of bank reserves and the lender of the last resort.

The specific features of the Indian economy, including its socio-economic characteristics, make it necessary for the Reserve Bank to operate with multiple objectives. Regulation, supervision and development of the financial system remain within the legitimate ambit of monetary policy broadly interpreted in India. The role of communication policy, therefore, lies in articulating the hierarchy of objectives in a given context in a **transparent** manner, emphasising a **consultative**

approach as well as **autonomy** in policy operations and **harmony** with other elements of macroeconomic policies.

The Reserve Bank of India was established on April 1, 1935 in accordance with the provisions of the **Reserve Bank of India Act, 1934**.

The Central Office of the Reserve Bank was initially established in Calcutta but was permanently moved to Mumbai in 1937. The Central Office is where the Governor sits and where policies are formulated.

Though originally privately owned, since nationalisation in 1949, the Reserve Bank is fully owned by the Government of India.

Central Board

The Reserve Bank's affairs are governed by a central board of directors. The board is appointed by the Government of India in keeping with the Reserve Bank of India Act.

- Appointed/nominated for a period of four years
- Constitution:
  - **Official Directors**
    - Full-time : Governor and not more than four Deputy Governors
  - **Non-Official Directors**
    - Nominated by Government: ten Directors from various fields and two government Official
    - Others: four Directors - one each from four local boards

Legal Framework

I. Acts administered by Reserve Bank of India

- **Reserve Bank of India Act, 1934**
- Public Debt Act, 1944/**Government Securities Act, 2006**
- **Government Securities Regulations, 2007**
- **Banking Regulation Act, 1949**
- **Foreign Exchange Management Act, 1999**
- Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (Chapter II)
- Credit Information Companies(Regulation) Act, 2005
- **Payment and Settlement Systems Act, 2007**
  - **Payment and Settlement Systems Regulations, 2008 and Amended up to 2011 and BPSS Regulations, 2008**
  - **The Payment and Settlement Systems (Amendment) Act, 2015 - No. 18 of 2015**
- Factoring Regulation Act, 2011

II. Other relevant Acts

- Negotiable Instruments Act, 1881
- Bankers' Books Evidence Act, 1891
- State Bank of India Act, 1955
- Companies Act, 1956/ Companies Act, 2013
- Securities Contract (Regulation) Act, 1956
- State Bank of India Subsidiary Banks) Act, 1959
- Deposit Insurance and Credit Guarantee Corporation Act, 1961
- Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970
- Regional Rural Banks Act, 1976
- Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980
- National Bank for Agriculture and Rural Development Act, 1981
- National Housing Bank Act, 1987
- Recovery of Debts Due to Banks and Financial Institutions Act, 1993
- Competition Act, 2002
- **Indian Coinage Act, 2011** : Governs currency and coins
- Banking Secrecy Act
- The Industrial Development Bank (Transfer of Undertaking and Repeal) Act, 2003
- The Industrial Finance Corporation (Transfer of Undertaking and Repeal) Act, 1993

Main Functions

Monetary Authority:

- Formulates, implements and monitors the monetary policy.
- Objective: maintaining price stability while keeping in mind the objective of growth.

Regulator and supervisor of the financial system:

- Prescribes broad parameters of banking operations within which the country's banking and financial system functions.
- Objective: maintain public confidence in the system, protect depositors' interest and provide cost-effective banking services to the public.

Manager of Foreign Exchange

- Manages the Foreign Exchange Management Act, 1999.
- Objective: to facilitate external trade and payment and promote orderly development and maintenance of foreign exchange market in India.

Issuer of currency:

- Issues and exchanges or destroys currency and coins not fit for circulation.

- Objective: to give the public adequate quantity of supplies of currency notes and coins and in good quality.

Developmental role

- Performs a wide range of promotional functions to support national objectives.

Related Functions

- Banker to the Government: performs merchant banking function for the central and the state governments; also acts as their banker.
- Banker to banks: maintains banking accounts of all scheduled banks.

Offices

- Has **20 regional offices, most of them in state capitals and 11 Sub-offices**.

Training Establishments

Has five training establishments

- Two, namely, College of Agricultural Banking and Reserve Bank of India Staff College are part of the Reserve Bank
- Others are autonomous, such as, National Institute for Bank Management, Indira Gandhi Institute for Development Research (IGIDR), Institute for Development and Research in Banking Technology (IDRBT)