Banking - Introduction

- Banks are the important segment in Indian Financial System.
- An efficient banking system helps the nation's economic development.
- Various categories of stakeholders of the Society use the banks for their different requirements.
- Banks are financial intermediaries between the depositors and the borrowers.
- Apart from accepting deposits and lending money, banks in today's changed global business environment offer many more value added services to their clients.
- The Reserve Bank of India as the Central Bank of the country plays different roles like the regulator, supervisor and facilitator of the Indian Banking System.

Evolution of Banking

- Pre-Independence
  - Owdh Commercial Bank(1881)
  - Punjab National Bank (1895)
  - The Bank of India (1906), Bank of Baroda Ltd (1908), Central Bank of India Ltd (1911)
  - Reserve Bank of India (1935)
- Post-Independence
  - Nationalization of Banks
  - Imperial Bank of India brought under public ownership (1955)
  - Formation of State Bank Group (1955-59)
  - Emergence of New Private Sector Banks (1993)

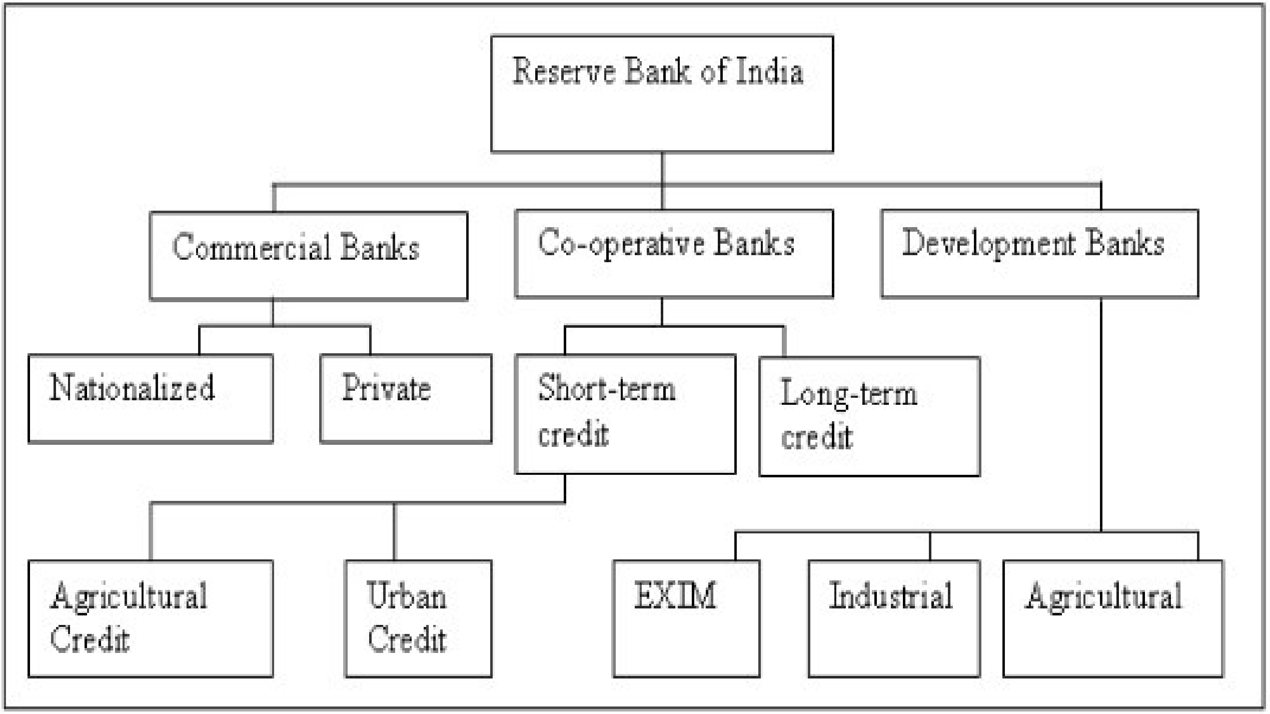
Origin of banking

- The term “BANK” derived from German word “Bancus”, “Banque” means bench.
- Jews were the early bankers
- Babylonian developed banking system in 2000BC
- In 14th century Royal exchangers did banking on behalf of kings
- Then goldsmith did the job of accepting money
- Bank of England was started in 1694
- 1708 Act provided the note issue power to them
- 1844 Act restricted power of note issue by private banks.
- Lack of increase in circulation of notes led to need for modern banking

HISTORY OF BANKING IN INDIA
Phase III (1991- Till date)

- M Narasimham committee worked for liberalization of banking
- Flooded with foreign banks and their ATM stations
- Introduction of Phone banking and net banking
- Digital banking
- Merger of SBI and its associates and BMB (1^{ST} April 2017)

Structure of Banks in India



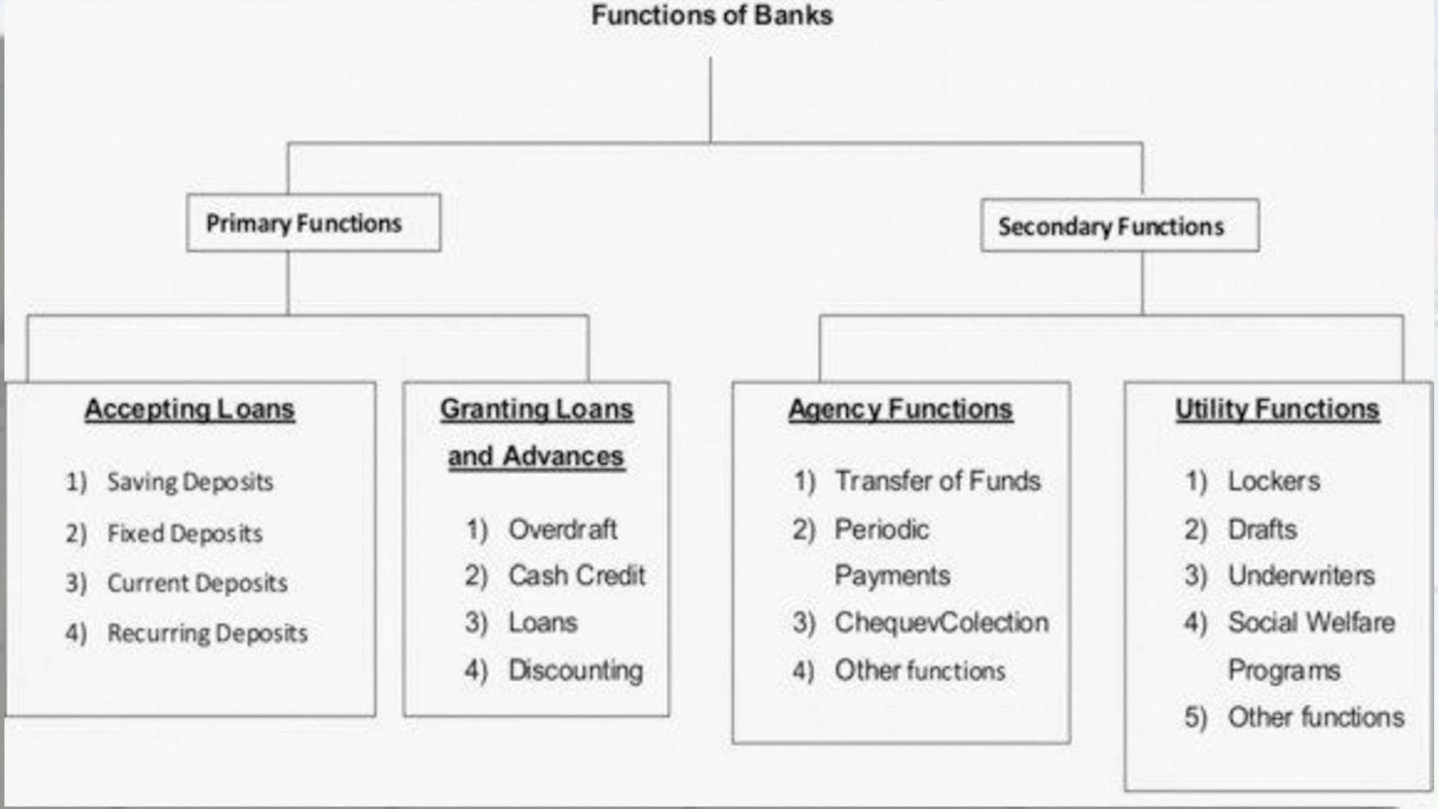
Role of Banks in the Economic Development of a Country

- 1. Banks promote capital formation
- 2. Investment in new enterprises.
- 3. Promotion of trade and industry
- 4. Development of agriculture
- 5. Balanced development of different regions
- 6. Influencing economic activity
- 7. Implementation of Monetary policy,
- 8. Monetization of the economy
- 9. Export promotion cells
- 10. Virtual Banking

Commercial Banks

- **The funds thus obtained from various classes of people are pooled together and lend to users of capital.**
- **Banks do not lend the entire sum of deposit. But a portion is kept in the form of cash.** This is called Cash Reserve Ratio(CRR) in order to meet the unforeseen demand of some depositors.
- **In its loans and advances, banks maintain a diversified portfolio** in order to seek a balance between liquidity and profitability.
- **Banks perform some other functions that enhance their yield. They keep valuables in their custody, collect chequable amounts, the purchase and sell of shares, debenture, they act as agents of their customers.** Besides they act as trustee and executors of wills, pay bills of customers.

Functions Of A Commercial Bank



The Role of Commercial Banks in Economic Development

- Accelerating the Rate of Capital Formation
- Provision of Finance and Credit
- Monetisation of Economy (support to rural areas)
- Innovations
- Implementation of Monetary Policy
- Encouragement to Right Type of Industries
- Development of Agriculture
- Regional Development
- Fulfillment of socio-economic objectives

THE CENTRAL BANK INTRODUCTION

- Central bank is the most powerful economic institution of country. Central bank occupies an important place in the monetary & banking system of every country.
- It is the apex bank of a country's monetary and financial system.
- It was established on April 1,1935 under the RBI Act 1934.
- It was nationalised on Jan 1,1949.

Central Bank

- **Central Bank may be defined as an institution charged with the responsibility of managing the expansion and contraction of the volume of money** supply for general **Economic Welfare.**
- **The Central Bank is the Apex institution in the banking and financial structure** of the country.

Functions of Central Bank

(i) Monopoly of Note Issue :

The Central Bank enjoys the exclusive power of note issue. In India the RBI issues all notes except Re 1 notes and coins. Re 1 notes are issued by the Government of India under the guidance of RBI. **The currency notes issued by the Central Bank are declared unlimited legal tender throughout The country. The Central Bank has to keep reserve of Gold, Silver and foreign securities for issuing notes.**

(ii) Banker, Agent, Advisor To The Government :

The Banking A/c of the government both central and state are maintained by the Central Bank as the commercial bank does for its customers. As a banker and to the government it helps the government in **short term loans and advances for temporary requirements and floats public loans For the government.**

Functions of Central Bank

(iii) Banker's Bank :

- **All commercial banks keep part of their cash balances as deposits with the Central Bank of the country. This is either because of convention or legal compulsion.** The commercial banks regularly Draw currency during the busy season and paying in surplus during the slack season. Part of these balances are meant for clearing purposes i.e.; all commercial banks keep deposit account with the Central Bank. **The deposit balances of the Central Bank is considered as cash reserves for General purpose.**
- **Under the Banking Regulations Act of 1949, the Central Bank of India have been empowered with the right to supervise and control the activities of various scheduled commercial banks**. These powers are related to licensing, branch expansion, liquidity of assets and methods of working of The Bank.

Functions of Central Bank

(iv) Clearing House Facility :

- By virtue of its unique position in dealing with domestic and foreign funds the Central Bank has a Special position for conducting:
- **(a) Clearing house operation**
- **(b) Interbank transfer of funds**
- **(c) Settlement of accounts.**
- Clearing house facility means providing an opportunity to member commercial banks to settle Their claims on each other mutually E.g.: Indian Bank has to pay to SBI a sum of` 2 lakh and SBI has to pay to Indian bank`1,50,000.This can be settled with a check of `50,000 by Indian Bank On the RBI in-favour of SBI. As a result Indian Banks accounts will be debited and SBI's account will be credited.

Functions of Central Bank

(v) Custodian of Foreign Exchange Reserves :

- **Under this system the RBI controls both receipts and payments of foreign exchange. A country Have In its foreign trade favourable or unfavourable balance**.
- **Favourable balance helps to bring foreign exchange to the country while unfavourable balance means paying foreign exchange out.** As custodian of Foreign Exchange, Central Bank keeps a constant watch on the same so that the value of the home currency does not rise or fall adversely In relation to foreign currency.
- **During times of emergency the Central Bank may impose restrictions to control on buying or selling Of foreign currencies in the market.**

Functions of Central Bank

- **(vii) Lender OF Last Resort:** Central bank provides security to their cash reserves, gives them loan and accommodation at the times of emergency and thus act as the lender of the last resort. **The Reserve Bank provide financial assistance to the scheduled banks by rediscounting their eligible bill, and through loans and advances against approved securities**

Credit Control

(vii) Credit Control

- **In order to ensure price stability and Economic growth of a country, the Central Bank undertakes The responsibility of controlling credit.**
- The Central Bank ensures price stability and avoids inflationary And deflationary tendencies by several monetary methods such as regulation of Bank rate, open Market operation, change invariable reservation, etc.

Credit Control by Central Bank

- **Credit money created by commercial banks and other non-banking financial institutions constitutes A significant portion of total money supply In an economy.**
- Their shortages and excesses may have profound impact upon an economy.
- The flow of credit should be regulated in such a way that they may raise or fall according to the Needs of an economy. This is what we generally means by credit control.
- **This is done by the central bank in its role of a banker's bank.**
- **The objective of credit control is generally two fold.**
- A central bank may encourage member banks to expand credit, known as expansionary monetary policy, which is adopted to lift an economy out of depression and unemployment.
- **It may restrict credit-creating power of banks and non-banks which is known as restrictive policy to fight inflation and to achieve financial stability** In the context of growth with stability a central bank is to deal with both aspects-increasing credit Flow for more investment and, at the same time, restrict flow of credit so that it may not generate inflation.

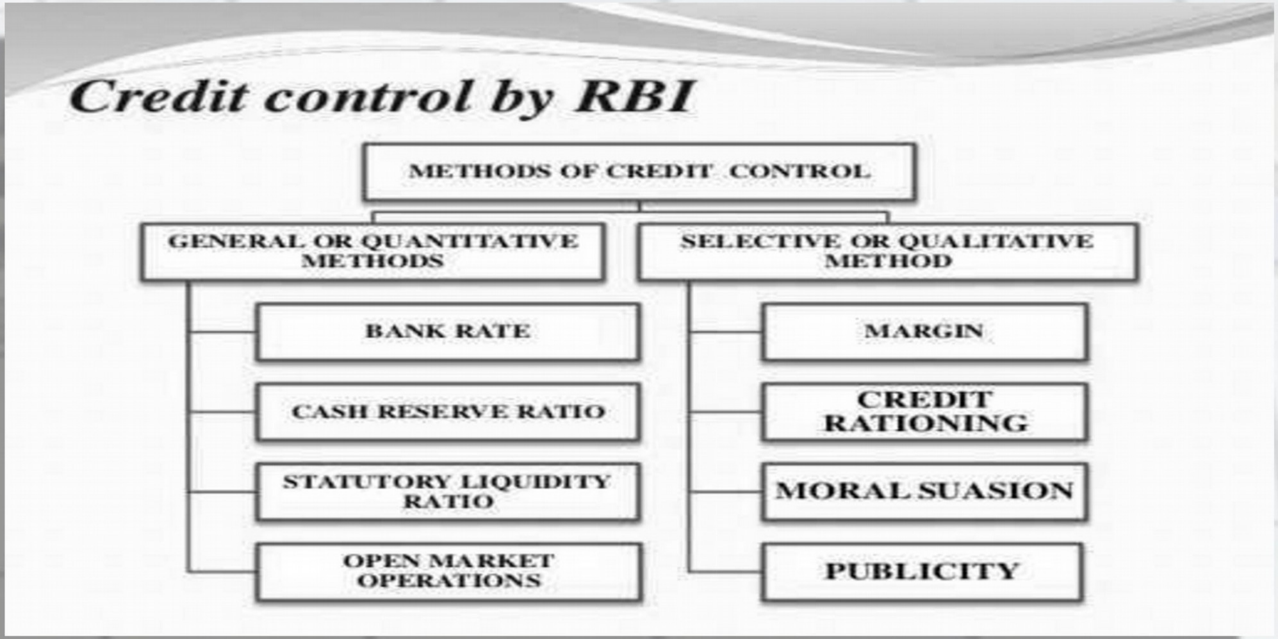
RESERVE BANK OF INDIA
AN INTRODUCTION

- RBI is the central bank of the country
- It is the apex institution of country's monetary and financial system
- It was established on the recommendations of hilton young commission as a body corporate under the RBI act 1934
- It plays a leading role in organising, running, supervising, regulation and developing the monetary and financial system

Functions of RBI

- To regulate the issue of banknotes. It has sole right to issue banknotes of all denominations.
- To maintain reserves with a view to securing monetary stability.
- To operate the credit and currency system of the country to its advantage.
- Banker, agent and adviser to the government.
- RBI is the banker's bank and also the lender of the last resort.
- Regulator and supervisor of financial system.
- Manager of exchange control i.e. to facilitate external trade and payment and maintenance of foreign exchange market in India.

Credit Control



Credit Control

- Central bank of a country can control credit by following two methods such as
- Quantitative Credit Control
- Qualitative Credit Control.
- **Quantitative /General Credit Controls:**

  regulate (expand or contract) the total quantity of credit (vis-à-vis derivative demand deposits) created by commercial banks in an economy.
- **Qualitative /Selective Credit Controls:**

  do not regulate the total amount of credit created by commercial banks but certain particular (selective) credit which creates economic instability.

Quantitative /Genera Credit Controls

- **Bank Rate (or Discount Rate) Policy :** The bank rate is the rate at which the central bank lends funds to commercial banks a lender of last resort against approved securities or eligible bills of exchange.
- **During inflationary tendencies, the central bank may increase bank rate lending rates by bank on loans and advances also move up, borrowing from banks becomes expensive and is discouraged and, monetary expansion** decreases During deflationary tendencies, bank rate may be decreased.

Qualitative /Selective Credit Controls

- **Fixation of Margin Requirements:** Margin Requirements is the difference between the value of the securities and the loan.
- **When the Central Bank prescribes higher margin the borrowers can obtain less amount** of credit on his stock and vice-versa.
- **Rationing of Credit: Under the rationing of credit, the Central Bank fixes a maximum limit** for loans that a commercial bank can provide to different sectors of the economy.

Qualitative /Selective Credit Controls

- **Directives : The Central Bank issues directives from time to time to follow its credit policy** and the commercial banks abide. The directives may be in the form of written orders, warnings or appeals, etc.
- **Moral Suasion: Under this method, the Central Bank merely uses its moral influence on the commercial banks.** It includes the advice, suggestion request and persuasion with the commercial banks to co-operate with the Central Bank. If the commercial banks do not follow the advice extended by the Central Bank, no penal action is taken against them.

Qualitative /Selective Credit Controls

- **Publicity:** the **Central Bank gives wide publicity to its credit policy through its bulletins.**
- educates the general public regarding the monetary policy and its objectives.
- **The commercial banks are guided as well.**

- **Direct Action: The Central Bank uses direct action against the banks which does not comply with its instructions.**
- No commercial bank can afford to go against the wishes of the central bank with regard to policy matters, as the central bank has wide powers even to stop banks' operations.

Recent Trends in the Banking System

Electronic Payment Services – e – Cheques: In the recent days we are aware of e-governance, e-mail, e-commerce, e-tail etc. In the same manner, a new technology is being developed in US for introduction of e-cheque, which will eventually replace the conventional paper cheque.

Real Time Gross Settlement (RTGS): Real Time Gross Settlement system, introduced in India since March 2004.

Electronic Funds Transfer (EFT): It is a system whereby anyone who wants to make payment to another person/company etc. can approach his bank and make cash payment or give instructions/authorization to transfer funds directly from his own account to the bank account of the receiver/beneficiary.

Electronic Clearing Service (ECS): It is a retail payment system that can be used to make bulk payments/receipts

Automatic Teller Machine (ATM): It is the most popular devise in India, which enables the customers to withdraw their money 24 hours a day 7 days a week.

Point of Sale Terminal: It is a computer terminal that is linked online to the computerized customer information files in a bank and magnetically encoded plastic transaction card that identifies the customer to the computer.

Recent Trends in the Banking System

- **Tele - Banking:** It facilitates the customer to do entire non-cash related banking on telephone. Under this devise Automatic Voice Recorder is used for simpler queries and transactions. For complicated queries and transactions, manned phone terminals are used.
- **Electronic Data Interchange (EDI):** It is the electronic exchange of business documents like purchase order, invoices, shipping notices, receiving advices etc. in a standard, computer processed, universally accepted format between trading partners.
- **Net Banking:** It is used for transfer of funds, booking rail tickets, shopping, purchasing cinema tickets, purchasing shares etc.
- **Mobile Banking:** Mobile banking is a service provided by a bank or other financial institution that allows its customers to conduct a range of financial transactions remotely using a mobile device such as a mobile phone or tablet, and using software, usually called an app, provided by the financial institution for the purpose.
- **Amalgamation of Banks:** The consolidation of banks is known as amalgamation of banks. Recently the Union Cabinet on 15-02-2017 approved the merger of State Bank of India with five of its associate banks for efficient enhanced operational efficiency and reduced cost of funds.