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PG AND RESEARCH DEPARTMENT OF COMMERCE

BANKING THEORY

UNIT-I

Introduction

Banking has played a very important role in the economic development of all the nations of the world. In fact, banking is the life blood of modern commerce. It may truly be said that modern commerce is o dependent upon banking that any cessation of banking activity, even for a day or two, would completely paralyze the economic life of a nation. Apart from their traditional business oriented functions, banks have come out to fulfill national responsibilities. Banks cater to the needs of agriculturalists, industrialists, traders and to all the other sections of the society. It naturally arouses out our interest in knowing more about the 'bank' and the various activities connected with it.

Evolution / Origin / Growth of Bank

The term bank is either derived from Old Italian word *'banca'* or French word '*banque'* both mean a bench or money exchange table. In olden days, European money lenders or money changes used to display (show) coins of different countries in big heaps (quantity) on benches or tables for the purpose of lending or exchanging when their business failed, the benches were broken and hence the word 'Bankrupt' came into usage.

Growth of commercial banks in India can be traced out in the following stages:

- The system of indigenous banking was in existence before Britishers came to India. British government found it difficult to use the indigenous bankers for their trading activities and encouraged the establishment of agency houses which undertook the banking operation in India. Then they set up the bank of Hindustan around 1770 which was the first bank established in India.
- The first bank if Indian origin was started in 1809, called presidency bank of Bengal, followed by the setting up of presidency bank in Bombay in 1840 and Presidency bank in Madras in 1843. In 1921, all these banks were amalgamated into the imperial bank of India. The business of which was taken over by the starting of State banks of India on 1st July 1955.
- During the first half of the 20th century, there was a mushroom growth of banks in India. But many have failed due to the banking crisis in 1913 to 1917.
- In 1935, the Reserve Bank of India was established as a Central Bank for regulating the controlling the banking business in the countries.
- After independence, the RBI was nationalized in January 1, 1949 under the Reserve Bank (Transfer to Public Ownership) Act of 1948.
- To have effective control over the banks and make them to serve better the needs of the developing economy in accordance with the national policy and objectives, 14 major commercial banks were nationalized on 19th July 1969. Again on 15th April, 1980, 6 more banks were also nationalized. As a result 91% of the banking system in India was brought under the public sector.
- The setting of the Regional Rural Banks (RRBs) as per the provisions of the Regional Rural Banks Act, 1976 is another milestone in the banking system of India.
- In additional, a number of industrial banks, called development banks of finance the capital requirements of small, medium and large scale industries were also started. They include, IDBI, NABARD, EXIM Banks, IFCI, ICICI, SFCs, GIC, LIC, UTI, etc.
- Besides a number of commercial banks working under public and private sector, cooperative banks and the branches of foreign banks are also carrying on their banking business in India.

Meaning of Bank

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.

Definitions of Bank

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

"A bank is an institution whose debts (bank deposits) are widely accepted in settlement of other peoples debts to each other."

-R.S. Sayers.

Definitions of Banking

*"**Under Section 5(c**) a 'Banking Company' is defined as any company which transact the business of banking in India."*

The word banking is defined as "accepting, for the purpose of lending or investment, deposits of money or otherwise and withdrawable by cheque, draft, order of otherwise: ***(Section 5b).***

Features / Characteristics of a Bank

The following are the main features of a bank:

1. Dealing in Money
2. Individual / Firm / Company
3. Acceptance of Deposit
4. Giving Advances
5. Payment and Withdrawal
6. Agency and Utility Services
7. Profit and Service Orientation
8. Ever Increasing Functions
9. Connecting Link
10. Banking Business
11. Name Identity

These features will be elaborately discussed below:

1. **Dealing with Money**

Bank is a financial institution which deals with other people's money i.e., money given by depositors.

2. **Individual / Firm / Company**

A bank may be a person, firm or a company. A banking company means a company which is in the business of banking.

3. **Acceptance of Deposit**

A bank accepts money from the people in the form of deposits which are usually repayable on demand or after the expiry of a fixed period. It gives safety to the deposits of its customers. It also acts as a custodian of funds of its customers.

4. **Giving Advances**

A bank lends out money in the form of loans to those who require it for different purposes.

5. **Payment and Withdrawal**

A bank provides easy payment and withdrawal facility to its customers in the form of cheques and drafts. It also brings bank money in circulation. This money is in the form of cheques, drafts, etc.

6. **Agency and Utility Services**

A bank provides various banking facilities to its customers. They include general utility sevices and agency services.

7. **Profit and Service Orientation**

A bank is a profit seeking institution having service oriented approach.

8. **Ever Increasing Functions**

Banking is an evolutionary concept. There is continuous expansion and diversification as regards the functions, services and activities of a bank.

9. **Connecting Link**

A bank act as a connecting link between borrowers and lenders of money. Banks collect money from those have surplus money and give the same to those who are in need of money.

10. **Banking Business**

A bank is main activity should be to do business of banking which should nor be subsidiary to any other business.

11. Name Identity

A bank should always add the word “bank” to its name to enable people to know that it is a bank and that it is dealing in money.

Banking system

The development of commercial banking institutions has taken place in different countries according to their economic, political, social and geographical conditions. The main banks have developed in different countries.

The banking system is classified on the basis of the lending practices adopted by them. From this point of view, the organizational system of banking takes the following forms.

(i) Deposit Banking
(ii) Investment Banking
(iii) Mixed Banking
(iv) Branch Banking
(v) Unit Banking
(vi) Chain Banking
(vii) Group Banking
(viii) Pure Banking
(ix) Correspondent Banking
(x) Universal Banking

These will discuss below in detail.

(i) Deposit Banking

Deposit banking is that system under which the commercial banks confine themselves to the financing of the short-term requirements of industry and commerce. In other words, the commercial banks under deposit banking do net give loans to industry and commerce for a long period. The system of deposit banking is very popular in U.K.

The system of deposit banking is highly conducive to the safety and liquidity of financial resources of the banks. The reason is that under funds in long-term loans to the industries. The loans are given for short-periods only. This keeps the banks resources in a liquid form to meet the requirements of the depositors.

(ii) Investment Banking

Investment banking implies collection of long-term deposits from the public and lending to industrial concerns on a long-term basis. In particular, the function of investment banks is to assist business corporations to raise resources for log-term capital requirements through sale of shares, stocks and bonds.

An investment banker is described as “the entrepreneur of entrepreneurs” because he performs the service of providing the necessary capital for the log-term capital needs on industries. Besides helping the industries, he is also of great service to the investing public. By making a detailed examination to the affairs of the industrial concern in whose issues he is interested, he ensures the safety of the investment.

(iii) Mixed Banking

In Germany, a system of banking known as mixed banking developed in which banks combined the functions of deposit banking and investment banking. Though in the beginning many of these banks started as industrial banks, latter they received large amounts of deposits from the public and carried on functioning simultaneously as investment banks and commercial banks.

(iv) Branch Banking

The typical commercial bank in most countries is a large institution having a network of branches scattered all over the country. This is the branch banking type. The best example of branch banking is to be found in the British system. The big four in Britain, Midland, Lloyds, Barclays and National Westminster have branches numbering 4400, 4200, 4800 respectively. These four giant banks control practically the whole business of banking in that country.

Special Features /Merits / Advantages of Branch Banking

The following are the main feature of branch banking.

1. Economies of Large Scale Operation

2. Economy of Reserves
3. Remittance Facilities
4. Spreading of Risks
5. Increasing Mobility of Capital
6. Clearing of Cheques made Easy
7. Service of Powerful and Affluent Banks
8. Good Social Relation with Customers.

These features will discus below in detail.

1. **Economies of Large Scale Operation**

Branch banks can introduce division of labour and put the right man on the right job. They can afford to employ experts for looking into intricate aspects of the banking business. They are efficient and provide abundant facilities to their customers.

2. **Economy of Reserves**

The branch bank can afford to hold a low cash reserve in cash office and feel safe since one office can draw on another. Maintenance of idle reserves is avoided.

3. **Remittance Facilities**

The branch bank can transact remittance business relatively cheaply because it is easy to adjust inter-office indebtedness.

4. **Spreading of Risks**

The branch bank finds it easy to spread its loan risks geographically. Losses from the branches functioning in depressed areas may be offset by profile earned by branches of the same bank operating in more prosperous areas.

5. **Increasing Mobility of Capital**

Branch banks help in transferring money from areas where demand is low to areas where demand is high. Thus equilibrium is brought about between demand and supply. This helps in establishing uniformity of interest rates.

6. **Clearing of Cheques made Easy**

Cheques deposited at a branch can be sent to the office in the city where there is a clearing house and cleared in the customary manner.

7. **Service of Powerful and Affluent Banks**

A branch bank is backed by assets of all the offices of the bank. It therefore enjoys great power and solvency. Customers can be proud of getting services from such a bank.

8. **Good Social Relation with Customers**

The branch bank managers can maintain good social relation with the customer. Even when a loan to a customer has to be refused, the branch manager can do it easily by throwing the blame on the head office.

Disadvantages / Demerits of Branch Banking

1. Need to Consult the Head Office
2. Transfer of Managers
3. Lack of Effective Control
4. Economic Repercussions of Failure
5. Lack of Initiative and Personal Touch

These will elaborately discuss below.

1. **Need to Consult the Head Office**

In the matter of granting loans, the branch manager may often have to consult the head office. Delay and inefficiency may creep in.

2. **Transfer of Managers**

Frequent transfer of manager results in the unsympathetic attitude of the head quarters to local needs.

3. **Lack of Effective Control**

As the number of branches increases, control and supervision become more and more difficult. As a result, mismanagement of branches may follow.

4. **Economic Repercussions of Failure**
   The failure of a branch bank will result in nation-wide calamity, because branches are spread throughout the country.
5. **Lack of Initiative and Personal Touch**
   Managers of branch banks lack the spirit of initiative and elasticity which is provided by the intimate personal contact of smaller banks with their clients.

(v) Unit Banking

This is a system of banking in which the bank's operations are in general confined to single office, though some are allowed to have their branches within a strictly limited area. The United States is the home of unit banking system. It is the outcome of the traditional fear of a money-trust in that country. Political prejudice and legal restrictions have stood in the way of development of branches in the United States.

Features / Merits / Advantages of Unit Banking

1. Catering to Local Needs
2. Knowledge of Local Industries and Conditions
3. Effective Management and Supervision
4. Elimination of Bad Debts

These will discuss in detail below.

1. **Catering to Local Needs**
   Unit banks are highly localized and hence the deposits collected in a particular place are utilized for the benefit of the same place.
2. **Knowledge of Local Industries and Conditions**
   The unit bank has specialized knowledge of the local industries and occupations. It is best fitted to serve the needs of the small communities.
3. **Effective Management and Supervision**
   Mismanagement and fraud can be easily checked in the staff do not offer any serious problem.
4. **Elimination of Bad Debts**
   The local bank can be expected to have personal knowledge of the borrowers. It can be discriminatory in its lending and protect itself from bad debts.

Disadvantages / Demerits

1. Limited Financial resources and Vulnerability to Failure
2. Limited Scope for offering Customer Services
3. Difficulty in Assessing Loan Applications

These will elaborately discuss below.

1. **Limited Financial resources and Vulnerability to Failure**
   Unit banks work with limited resources. They would find it difficult to overcome a crisis like run on the bank and business depression. Bank failures have been common occurrences among unit banks.
2. **Limited Scope for offering Customer Services**
   The services offered by unit banks cannot be wide and varied on account of the limitation in geographical area and in resources.

3. **Difficulty in Assessing Loan Applications**
   A unit bank may not be able to refuse a loan to a local businessman who is influential for fear of incurring his displeasure. At the same time the bank manager may be aware of the risk of lending to the applicant. In such a situation the manager of a branch bank will find it easy to refuse the loan and throw the blame on the head office.

(vi) Chain Banking

The system of banking in which two of more banks are owned and controlled by one person of a group of persons is known as 'chain banking system'. Chain banking system was first developed in the USA towards the middle of the last century.

Merits of Chain Banking

1. Chain banking system ensured fuller utilization of financial resources
2. Better managerial services
3. Higher profits
4. Diversification of risks
5. Economy in operational costs
6. Centralized administrative control.

Demerits of Chain Banking

1. Lack of efficient management and supervision
2. Lack of flexibility
3. Corruptions on the part of the officers and the employees of the banks.

(vii) Group Banking

Where in a system of banking two or more banks are directly or indirectly controlled by an association, trust or corporation, it is case of a "group banking system". In other words, groups used to control the small number of member-banks.

Merits of Group Banking

1. Retentions of ones own identity and boards of directors
2. Possibility of enhancing the level of efficiency of working of the members of the group
3. Liquidity of financial resources
4. Easy transfer of funds from one member bank to another member banks.

Demerits of Group Banking

1. Fails due to the adoptions of unsound policies
2. Not possible for central administration
3. Possibilities for corruption at the centralized purchase organization.

(vii) Pure Banking

System of banking where the commercial banks confine themselves to the financing of the short-term requirements of industries and commerce is referred to as pure banking system. Under this system commercial banks provide loans and advances to industry and trade only for short-term purpose.

Pure banking system is popular in Britain as British banks specialized in giving in short-term loans.

(viii) Correspondent Bank

When the banks of different size fare linked by another bank, the bank which is linking them is called a correspondent bank. In India for many of the foreign banks certain Indian bank acts as correspondent banks.

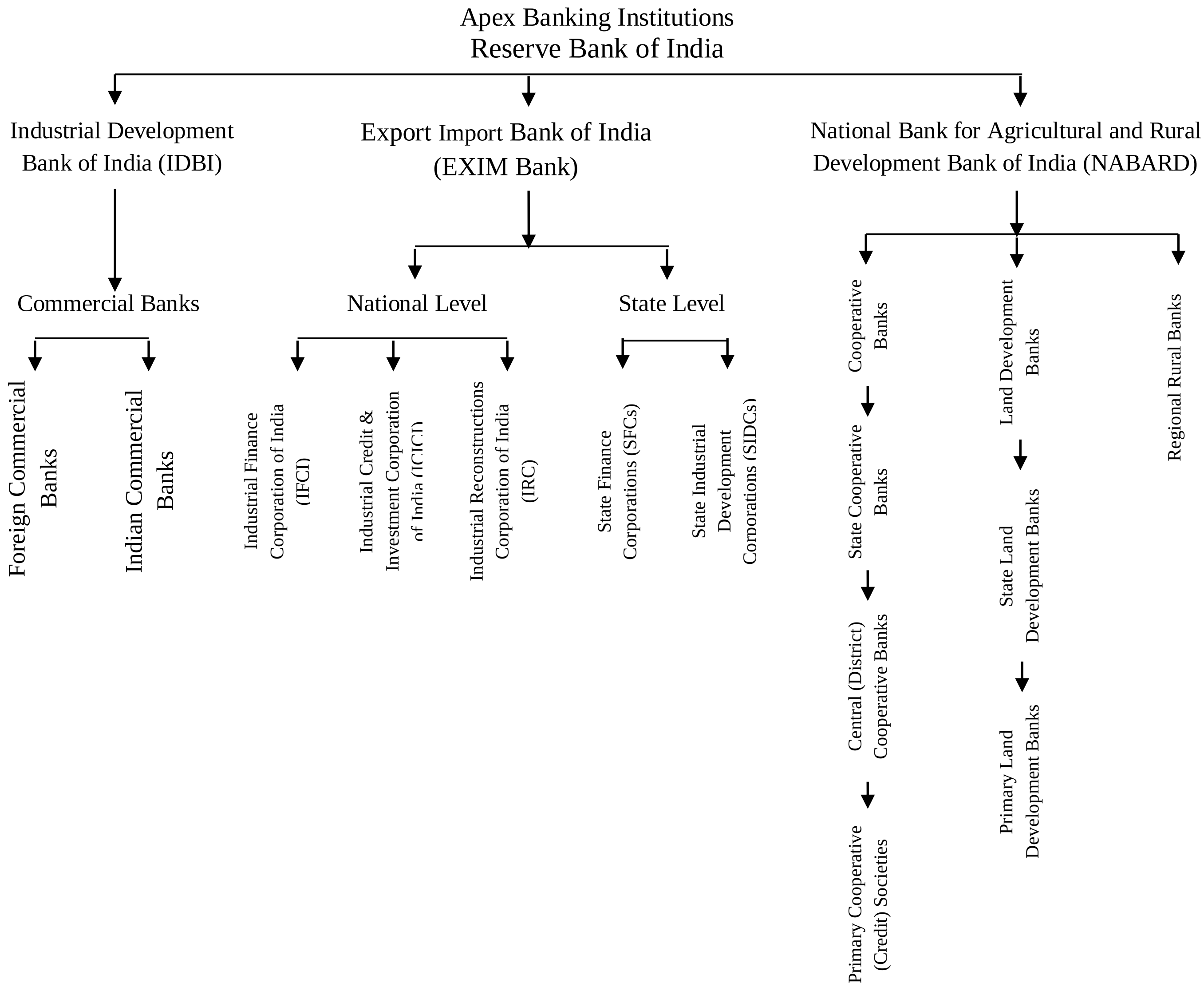
(ix) Universal Banking

Banks that are engaged in diverse kinds of banking business, which are generally handled by different types of banking entities, are known as "Universal banks". The concept of universal banking is of recent origin in India. At the global level, universal banks have been operating for quite sometime on Germany, Australia and Switzerland. Universal banking has its origin in Germany where it originated in 1850's. The universal banking system existed in US prior to 1920's.

Banking that includes investment services in addition to services related to savings and loans, is known as universal banking. Universal banks are financial conglomerates which function as part of financial supermarkets.

Banking System in India

The following chart expresses the existing banking system in India.



Types / Classification of Banks

The following are the major classification of banks.

A. Central Bank
B. Commercial Banks
C. Investment Banks
D. Co-Operative Banks
E. Foreign Banks

We briefly discuss about the various classification of banks below.

A. Central Bank

The central bank is also called the banker's bank in any country. In India, the Reserve Bank if India is the Central Bank. The Federal Reserve in USA and the Bank of England in UK function as central bank. This bank makes various monetary policies, decides the rates of interest, controlling the other banks in the country, managers the foreign exchange rate and the gold reserves and also issues paper currency in a country. The monetary control is the primary function of a central bank in most countries and so they are considered as the lender of last resort to various commercial banks.

B. Commercial Banks

Commercial banks function to help the entrepreneurs and businesses. They give financial services to these businessmen like debit cards, banks accounts, short-term deposits, etc., with the money people deposit in such banks. They also lend money to businessmen in the form of overdrafts, credit cards, secured loans, unsecured loans and mortgage loans to businessmen. In other words, commercial banks collect money from general public and give short-term loans to businessmen by way of cash credits, overdrafts, etc. commercial banks provide various services like collecting cheques, bill of exchange, remittance money from one place to another place.

Functions of Commercial Banks

Commercial banks being the financial institution perform diverse types of functions. It satisfies the financial needs of the sectors such as agriculture, industry, trade, communications, etc. That means they play very significant role in a process of economic social needs. The functions performed by banks are changing according to change in time and recently they are becoming customer centric and widening their functions. Generally the functions of commercial banks are divided into two categories viz, primary functions and the secondary functions. The following chart simplifies the functions of banks.

Functions of Commercial Banks

I. Primary Functions **II. Secondary Functions**

1. Accepting Deposits
2. Making Advances
3. Credit Creation

A. Agency Functions
B. General Utility Functions

I. Primary Functions

Commercial banks perform various primary functions. Some of them are given below:

1. Accepting Deposits

Commercial banks accept various deposits from the public especially from its client. It includes saving account deposits, recurring account deposits, etc. these deposits are payable after a certain time period.

2. Making Advances

The commercial banks provide loans and advances of various forms. It includes an over draft facility, cash credit, bill discounting, etc. They also give demand and term loans to all types of clients against proper security.

3. Credit Creation

It is most significant function of the commercial banks. While sanctioning a loan to a customer, a bank does not provide cash to the borrower instead it opens as deposit account from where the borrower can withdraw. In other words, while sanctioning a loan a bank automatically creates deposits. This is known as a credit creation from commercial bank.

II. Secondary Functions

Along with the primary functions each commercial bank has to perform several secondary functions too. It includes many agency functions or general utility functions. The secondary functions of commercial banks can be divided into agency functions and utility functions.

A. Agency Functions

Various agency functions of commercial banks are:

1. To collect and clear cheque, dividends and interest warrant.
2. To make payment of rent, insurance premium, etc.
3. To deal in foreign exchange transactions.
4. To purchase and sell securities.
5. To act as trusty, attorney, correspondent and executor.
6. To accept tax proceeds and tax returns.

B. General Utility Functions

The general utility functions of the commercial banks include;

1. To provide safety locker facility to customers.
2. To provide money transfer facility.
3. To issue traveller’s cheque.
4. To act as referees.
5. To accept various bills for payment e.g: phone bills, water bills, etc.
6. To provide merchant banking facility.
7. To provide various cards such as credit cards, debit cards, smart cards, etc.

C. Investment Banks

Investment banks are financial institutions that provide financial and advisory assistance to their customers. Their clients can be individuals, businesses or government organizations. They assist their customers to raise funds when required. These banks act as the underwriters for their customers when they want to raise capital by issuing securities. In some cases, they also help their customers to issue securities.

When there is a merger or an acquisition, they provide their customers, with the necessary support like marketing, foreign trading, foreign exchange, sale of equities, fixed income instruments etc. Apart from raising capital, these banks render valuable financial advice to heir customers and various kinds of business. Some examples of these banks include, bank of America, Barclays capital, Citi Bank, Deutsche Bank, etc.

D. Co-operative Banks

Co-operative banks are controlled, owned, managed and operated by cooperative societies and came into existence under the Co-operative Societies Act in 1912. These banks are located in the urban as well as in the rural areas. Although these banks have the same functions as the commercial banks, they provide finance to farmers, salaried people, small scale industries, etc., and their rates of interest are lower as compared to other banks.

E. Foreign Banks

Foreign Banks are foreign in origin and have their head offices in the country of origin. In simply, Foreign Banks are those banks whose branch offices are in India but they are incorporated outside India and have their head office in a foreign country. These banks were allowed to set their subsidiaries in India from the year 2002. There are 43 foreign banks (as on May 31, 2013) from 21 different countries operating in India. The business is conducted with the help of more than 205 branches. These branches are located in more than 15 states which includes Union Territories.

Other Types of Banks (Miscellaneous)

The following are the miscellaneous classification of banks.

1. Saving Banks
2. Industrial Banks / Development Banks
3. Land Mortgage / Land Development Banks
4. Indigenous Banks
5. Exchange Banks

6. Consumer Banks
7. Domestic and Foreign Banks (Basis of Domicile)
8. Scheduled and Non-Scheduled Banks
9. Public, Private Sector and Co-Operative Banks (Basis of Ownership)
10. Merchant Banks.

These will discuss in briefly in following ways:

1. Saving Banks

Saving banks are established to create saving habit among the people. These banks are helpful for salaried people and low income groups. The deposits collected from customers are invested in bonds, securities, etc. At present most of the commercial banks carry the functions of saving banks. Postal department also performs the functions of saving bank.

2. Industrial Banks / Development Banks

Industrial / Development banks collect cash by issuing shares & debentures are providing long-term loans to industries. The main objectives of these banks are to provide long-term loans for expansion and modernization of industries. In India such banks are established on a large scale after independence. They are Industrial Finance Corporation of India (IFCI), Industrial Credit and Finance Corporation of India (ICICI) and Industrial Development Bank of India (IDBI).

3. Land Mortgage / Land Development Banks

Land mortgage / Land Development Banks are also known as Agricultural Banks because these are formed to finance agricultural sector. They also help in land development.

In India, government has come forward to assist these banks. The govt. has guaranteed the debentures issued by such banks. There is a great risk involved in the financing of agriculture and generally commercial banks do not take much interest in financing agricultural sector.

4. Indigenous Banks

Indigenous banks mean Money Lenders and Sahukars. They collect deposits from general public and grant loans to needy persons out of their own funds as well as from deposits. These indigenous banks are popular in villages and small towns. They perform combined functions of trading and banking activities. Certain well-known Indian communities like Marwadies and Multani even today run specialized indigenous banks.

5. Exchange Banks

Hong Kong Banks, Bank of Tokyo, Bank of America are the examples of Foreign Banks working in India. These banks are mainly concerned with financing foreign trade. Following are the various functions of Exchange Banks:

1. Remitting money one country to another country.
2. Discounting of foreign bills.
3. Buying and selling Gold, Silver and
4. Helping import and export trade.

6. Consumers Banks

Consumer bank is a new addition to the existing type of banks. Such banks are usually found only in advanced countries like USA and Germany. The main objective of this bank is to give loans to consumers for purchase of the durables like Motor car, television set, washing machine, furniture, etc. The consumers have to repay the loans in easy installments.

7. Domestic and Foreign Banks (Basis of Domicile)

On the basis of domicile, the banks are divided into two categories, namely (i) Domestic and (ii) Foreign Banks.

Domestic banks are registered and incorporated within the country.

Foreign banks are foreign in origin and have their head offices, in the country of origin.

8. Scheduled and Non-Scheduled Banks

In India, banks have been broadly classified into scheduled and non-scheduled banks. A scheduled bank is that which has been included in the Second Schedule of the RBI Act, 1934 and fulfills the three conditions: (a) it has paid up capital and reserves of at least Rs. 5 lakhs (b) it ensures the Reserve Bank that its operations are not determined to the interest of the depositors (c) it is a cooperation or a cooperative society and not a partnership or a single owner firm.

The banks which are not included in the Second Schedule of the Reserve Bank of India Act are non-scheduled banks.

9. Public, Private Sector and Co-Operative Banks (Basis of Ownership)

On the basis of ownership, banks can be classified into three categories, namely public sector, private and cooperative banks.

The public sector banks are owned and controlled by the government of India, the nationalized banks and the Regional Rural Banks come under these categories.

The Private sector banks are owned by the private individuals or corporations and not by the government or cooperative societies.

Co-operative banks are operated on the cooperative lines. In India, cooperative credit institutions are organized under the cooperative societies law and play an important role in meeting financial needs in the rural areas.

10. Merchant Banks

Merchant bank is defined as a kind of financial institution that provides variety of services, including investment banking, management of customers, portfolios, insurance, acceptance of bills, etc. Merchant banks are neither merchant nor are they necessarily banks. Merchant banking originated through the entering of London merchants in financing of foreign trade through acceptance of bills. Over a period merchant banks extended their activities to domestic business of syndication of short-term and long-term finance, underwriting of new issues, acting as registrars and share transfer agents, debenture trustees, portfolio managers, negotiating agents for mergers and take-overs, etc.

The post-war period has witnessed the rapid growth of merchant banking through the innovation of instruments such as “Euro-Dollars” and the growth of various financial centres like Singapore, Hong Kong, Bahamas and more recently Bahrain, Kuwait, Dubai, etc.

Procedure to Set up Foreign Banks and its Role in Indian Economy.

Procedure to set up

Foreign banks who wish to open up branches in India have to apply to the RBI. These banks should be able to satisfy the RBI regulations. The banks should also get permission from their home country to set up branches in India. Other factors that are considered while approving the application of the presence of foreign banks in India are as follows:

1. Financial soundness of the foreign banks.
2. Economic and political relations between the home country of the foreign banks and India.
3. International ranking of the bank.
4. Home country ranking of the bank.
5. International presence of the bank.
6. Rating given to the bank by international rating agencies.

Role of Foreign Banks

Foreign banks have played an important role in the Indian economy, especially in the priority sectors. Globalization has compelled the baking sector to reach out to more customers in order to expand their business. This meant opening banking businesses even in the foreign countries. Many of the private banks were interested in expanding their business all over the world. They opened up branches across the globe to serve large number of customers and also improve service to the existing customers. This change was a blessing for India. Currently, the foreign banks are growing tremendously in India.

The services provided by these banks are very impressive. The presence of these banks in India brought a lot of technical development. Banks of all categories, be it a domestic bank or an international bank, started using the latest technologies to provide better service to the customers. The technological development saved a lot of time of the customers as well as the bankers. They introduced innovative and unique banking practices in India.

The previous years witnessed out throat competition in the banking sector with the presence of foreign banks. The competition has compelled banks to come up with something new that no other bank can provide to the customers. Banks are partially a part of the service industry. The main objective of all the banks was to provide a better service to a large number of customers and look after their financial requirements. Customer satisfaction was a priority for domestic banks as well as the foreign banks.

Role of Commercial Banks in Economic Development of a Country.

The commercial banks play an important part of economy when they are involved in bidding process of government securities. Various services and products provided by commercial banks such as car leasing, mortgage financing, credit cards etc., provide easy accessibility of funds to the customers. Hence great deal of money circulated in the economy is contributed by the commercial banks. Commercial banks are also an important element in implementing the monetary and fiscal policy by the central bank. When a central bank decides in introduce concretionary monetary policy, commercial banks have to increase their interest rates to comply with the central bank. Therefore commercial banks play an important in bringing economic development in a country.

Commercial banks play an important and active role in the economic development of a country. If the banking system in a country is effective, efficient and disciplined it brings about a rapid growth in the various sectors of the economy.

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 economy activity
7. Implementation of monetary policy
8. Monetization of the economy
9. Export promotion cells.

UNIT – I Completed.

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2. *Banking Theory, Law and Practices* – ***P.Saravanavel.***

UNIT – II
Central Banking

Introduction

Central bank is having the power to control the banking industry in any country. In the earlier of 20th century, central banks were under the control of private parties for a long time. But therefore, especially in beginning of the 20th century, central banks were came under the government control and owned by the government almost in all countries of the world. Now- a-days Central Bank's role is very essential and very much need to every country.

Origin

Prior to the 17th century most money was commodity money, typically gold or silver. However, promises to pay were widely circulated and accepted as value at least five hundred years earlier in both Europe and Asia. The *Song Dynasty* was the first to issue generally circulating paper currency, while the

Yuan Dynasty was the first to use notes as the predominant circulating medium, in 1455, in an effort to control inflation, the succeeding Ming Dynasty ended the use of paper money and closed much of Chinese trade. The medieval European Knights Templar ran an early prototype of a central banking system, as their promises to pay were widely respected and many regard their activities as having laid the basis for the modern banking system.

As the first public bank to "offer accounts not directly convertible to coin", the *'Bank of Amsterdam'* established in 1609 is considered to be the precursor to modern Central Banks.

Definitions

R.G. Hawtrey defines central bank as "the lender of last resort."

Sayers R.S. claimed as *"the business of a central bank is to control the commercial banks in such a way as to promote the general monetary policy of the state."*

Vera Smith holds that *"the primary definition of central banking is a banking system in which a single bank has either a complete or a residual monopoly of note issue,"*

Shaw believes that the Central Bank is that *which controls credit*.

Nature / Features of Central Banking

Central bank has the following features:

1. It has more service-motive than profit motive.
2. Central bank is owned by the government and managed by persons appointed by the govt.
3. It controls the complete banking industry.
4. It is responsible for maintaining the value of the currency which it alone issues.
5. Central bank undertakes activities in consultation with the govt.
6. It helps the govt. in fulfilling their economic policies such as raising funds for five year plans and development of priority sector.

Need for Central Bank

When a country undertakes monetary, fiscal and trade activities, it acquires a proper guide and control by a recognized institution. Monetary activity consists of issue of currency, maintenance of price level, maintaining the value of currency, controlling credit through commercial banks, etc. Thus, need for central bank arises as follows:

1. To regulate monetary, fiscal and trade activities.
2. To control the commercial banks against credit expansion.
3. For maintaining the value of currency both within and outside the country.
4. To protect the interest of the depositors and to maintain confidence in the banking industry.
5. To help the government by providing finance in both domestic and foreign currency for meeting its various requirements.
6. The central bank does not aim at profits, through it may actually secure large profits, while commercial banks aim at securing maximum profit for their shareholders, the central bank aims at controlling the banking system and supporting the economic policy of the govt.
7. The central bank has a special relation with the commercial banking system of the country. It is given special power to control and regulate the working of the latter.
8. The central bank is generally an organ of the govt. and forms part of the govt. machinery. Its actions are closely coordinated with those of the other departments of the government particularly with the department of finance or the treasury.

Principles of Central Banking

Following are the three main principles of central banking:

1. National Welfare
2. Monetary and Financial Stability
3. Freedom from Political Influence
4. Co-operation with Central Government
5. Co-operation with Member Banks.

These will discuss below in detail.

1. **National Welfare**

The central bank is always inspired by the spirit National Welfare. The commercial banks are generally guided almost exclusively by the profit-motive. According to the ***De Kock,*** the directive principles of central bank are that it should work exclusively in the interest of public welfare. It should not consider profit as the primary motive. This however, does not mean that central bank should suffer losses while working in national interest. What it implies is that the profit-motive for the central bank should only be a secondary consideration.

2. **Monetary and Functional Stability**

Another important principle of central banking is that the central bank should help in the maintenance of monetary and financial stability in the country. There are several functions in the armoury of the Central Bank which it can utilize for the achievement of this objective.

3. **Freedom from Political Influence**

The central bank should remain free from all political influences. In other words, it should not allow itself to be dominated by the ideology of a particular political party. On the contrary, it should work strictly in accordance with the well-known principles of central banking. At the same time it is also necessary that there should be perfect co-operation between the central bank and govt. of the country, the reason is that the economic problems of the country cannot be satisfactorily solved without the fullest co-operation between the central bank.

4. **Co-operation with Central Government**

The central bank should strive to function in perfect harmony with the govt. This helps in proper formulation and efficient implementation of policies relating to monetary management of the economy.

5. **Co-operation with member Banks**

As a parent bank, the central bank is not supposed to complete with the member banks. This will contribute for the strong financial system.

Functions of Central Bank

The following are the main functions of the central bank.

1. Bank of Issue
2. Banker, Agent, Advisor to the Govt.
3. Banker's Bank and Custodian of the Cash Reserves of Commercial Banks
4. Custodian of Nation's Foreign Currency Reserves
5. Lender of the Last Resort
6. Bank of Central Clearance, Settlement and Transfer
7. Controller of Credit

These will discuss below in detail.

1. **Bank of Issue**

The monopoly enjoyed by the central bank is the most important function of the central bank. The privilege of note-issue was almost everywhere associated with the origin and development of central banks, initially they were generally known as bank of issue. Now-a-days the central banks everywhere enjoy the exclusive monopoly of note issue and the currency notes issued by the central banks are declared unlimited legal tender throughout the country. This aspect brings about.

(a) Uniformity in note-issue.
(b) Facilities trade and exchange within the country.
(c) Attaches distinctive prestige to the currency notes.
(d) Enables the central bank to influence and control the credit creation of commercial banks.
(e) Avoids the over-issue of notes and
(f) Enables the govt. to appropriate partly or fully the profits of note-issue. The central bank keeps three considerations in view as regards issue of notes-uniformity, elasticity and safety. The govt. has the power to supervise and control the issue of currency notes by the central bank but not the authority to print the notes. This is mainly to avoid over issue due to political influence.

It is on account of the above advantages that the right to issue notes has been granted to the central banks in all the countries of the world.

2. **Banker, Agent, Advisor to the Govt.**

Central banks in all countries act as the fiscal agent, banker and advisor on all important financial matters. Adam Smith tells us that the earliest banks of Italy were the finance companies. Marshall also writes that banks like the Bank of Amsterdam acted as Fiscal agents for the governments.

As a Banker, the central bank accepts deposits from the govt. it undertakes the collection of cheques and drafts deposited from one place to another or from one account to another account. In addition, the central bank also provides to the govt. foreign exchange resources to enable it to meet its external debts or for the purchase of foreign goods or for making other payments, etc.

The central bank, in its capacity as agent to the govt. accepts loans and manages the public debt on behalf of the govt. In fact, the new loans and treasury bills are issued by the central bank on behalf of the government. The central bank receives taxes and other payments from the public on behalf of the govt. as its fiscal agent.

As financial Advisor, the central bank tenders useful advice to the govt. on important economic problems like that devaluation of currency, commercial policy, foreign exchange policy and the budgetary policy, etc. Since the central bank possesses full information about the working of the economy, it is in a position to offer useful advice to the govt. on economic and financial problems.

3. **Banker's Bank and Custodian of the Cash Reserves of Commercial Banks**

As banker's bank the central bank holds the cash reserves of commercial and other banks in the economy and thus acts as the guardian of the ultimate reserves of the country. The other banks also hold deposits in the books of the central bank. The central bank rediscounts bills of the commercial banks. It provides leadership, guidance and direction in regulating their policies. The centralization of cash reserves in the central bank is a source of great strength to the banking system of any country and this can be enjoyed most effectively during the periods of seasonal strain and financial crisis. This is the main reason for the central banks to be called "Reserve Banks".

4. **Custodian of Nation's Foreign Currency Reserves**

Unlike Gold Standard System after the World War I, the central banks have been maintaining both gold as well as foreign currencies as a reserve against note-issue and also to meet any adverse Balance of Payment. Another vital point is the maintenance of stability of external value of the currency and it has to operate efficiently the exchange control measures and other restrictions imposed by the state.

5. **Lender of the Last Resort**

This function developed the special position of the central bank. The authority to monopolise the note-issue and the centralization of metallic reserves added strength to the capacity of central bank to perform its function as lender of last resort. In this capacity of the lender of last resort it assumes responsibility of meeting directly or indirectly all reasonable demands for financial accommodation from the commercial banks, discount houses and other credit institutions subject to certain terms and conditions which constitute the discount rate policy. This function has come to be regarded as the sine quanon of central banking.

6. **Bank of Central Clearance, Settlement and Transfer**

This function evolved as a method of practice, became in course of time as accepted normal function of the central bank as Banker's bank. This function found place in their laws or Articles of Association and Memorandum. This is today regarded as a necessary function of a central bank. Shaw asserts that a "central bank will operate as the clearing house for ail its member banks as a mere matter of mechanism or book-keeping. Much of the labour and inconvenience that is experienced in the individual system of clearance and settlement is done away with when central bank enters into the picture as a central clearing agency. Willis highlights the significance of clearing and settlement function performed by the central banks in these words. "it is not only a means of economizing cash and capital nut is also a means of testing at any time the degree of liquidity which the community is maintaining - a matter which is essential for the central bank to know from day-to-day."

7. **Controller of Credit**

Controlling credit is the vital function of the central bank in streamlining the economic pace of the economy. Unwarranted fluctuations in the volume of credit by causing wide fluctuations in the purchasing poser of money unit cause great social and economic upheavals. The experience of last fifty years bears ample testimony to the need of controlling credit in the interest of maintaining the economic and political stability in the system. The stability of the money market depends largely on the careful manipulation of credit and the central bank with the monopoly of note-issue can effectively regulate the quantity of credit.

Important Roles Played by Central Bank in Developing Countries

In the developing countries, the central bank has to play a much wider role. Besides performing the traditional functions, the central bank has to undertake responsibility of economic growth with stability in these economies. Moreover, since the developing countries do have well-organised money and capital markets, the central bank has a crucial function to develop the banking and financial system of the country. The central bank performs the following developmental and promotional functions in the developing countries.

1. Traditional Functions
2. Economic Growth
3. Internal Stability
4. Development of Banking System
5. Branch Expansion
6. Development of Financial Institutions
7. Development of Banking Habits
8. Training Facilities
9. Proper Interest Rate Structure
10. Other Promotional Roles

These will be elaborately discussed below.

1. **Traditional Functions**

The central banks in developing countries perform both traditional and non-traditional functions. The traditional functions of the central bank are: having the monopoly of note-issue, acting as banker of the govt., serving as bankers' bank functioning as the lender of last resort, controlling and regulating the credit and maintaining the external stability.

2. **Economic Growth**

The central banks in the developing countries should aim at promoting the process of economic growth requires sufficient financial resources. The central bank can ensure adequate monetary expansion in the country. Moreover, as a banker to the govt., the central bank can provide funds for initiating investment in the public sector.

3. **Internal Stability**

Along with the objective of economic growth, the central bank should also attempt to maintain internal price stability. The developing countries are susceptible to inflationary pressures mainly due to supply inelasticities in the short-period. The central bank should adopt such a monetary policy that can control inflationary tendencies and ensure price stability.

4. **Development of Banking System**

The developing and underdeveloped countries do not have well-developed banking system. In such an economy, the central bank should not only take measures to develop an integrated commercial banking system, but also should not hesitate undertaking directly the commercial banking system.

5. **Branch Expansion**

In developing countries, the commercial banks generally concentrate their branches in the urban areas. In order to extend credit facilities to the agricultural sector, the central bank should prepare programme for branch expansion in the rural areas.

6. **Development of Financial Institutions**

Development of the leading sectors of the economy such as agriculture, industry, foreign trade, etc., requires long-term finances. For this, the specialized financial institutions should be established which provide term-loans to these sectors.

7. **Development of Banking Habits**

Through its various credit control instruments (i.e., bank rate, variable cash reserve ratio, etc.) and by providing discounting facilities to the commercial banks, the central bank exercises full control over the activities of commercial banks. This creates public confidence in the banking system and helps in the development of banking habits of the people.

8. **Training Facilities**

A major difficulty in developing the banking system in developing countries is the lack of trained staff. The central bank can provide training facilities to meet the personnel requirements of the banks.

9. **Proper Interest Rate Structure**

The central bank can help in establishing a suitable interest rate structure to influence the direction of investment in the country. In underdeveloped countries a policy of low interest rate is necessary for encouraging investment and promoting development activities. Again, by adopting different interest rates, the central bank can increase productive investment and discourage unproductive investment.

10. **Other Promotional Roles**

The central bank can provide a number of other promotional facilities. For example, (a) it can adopt policies to provide help to the various priority sectors, such as agriculture, co-operative sector, small scale sector, export sector, etc., (b) it can provide guidelines to be followed by the planners about some definite patterns of economic and investment policies, (c) it can publish information regarding the state of the economy and promote research in money and banking.

Comparison between Central Bank and Commercial Banks

There are various similarities as well as dissimilarities between central bank and commercial banks. The similarities are as follows:

Similarities between Central Bank and Commercial Banks

1. Both Deal in Money
2. Both Create Credit
3. Non-Acceptance of Immovable Properties as Securities
4. Both Extend Short-term Credits

These will discuss below in detail.

1. **Both deal with Money**

Both the central bank as well as the commercial banks are basically monetary institutions. They deal in money in some form or the other. The central bank creates money (currency) whereas the commercial banks deal in money.

2. **Both Create Credit**

The central bank as well as the commercial banks are both engaged in the creation of credit. The central bank, in reality, creates credits when it issues paper currency without keeping equivalent securities in the reserves. Likewise, the commercial banks also create on the basis of their derivative deposits.

3. **Non-Acceptance of Immovable Properties as Securities**

Both the central bank as well as the commercial banks decline to extend loans against immovable properties because this results in creating non-liquidity in their assets.

4. Both Extend Short-term Credits

Both the central bank as well as commercial banks extend short-term loans only because this helps them in maintaining liquidity in their resources. The central bank should, under no circumstances, extend long-term loans because this will make its assts non-liquid.

Dissimilarities / Differences between Central Bank and Commercial Banks

Sl. No	Purpose	Central Bank	Commercial Bank
1	Position of the bank	It is the apex bank in the banking system of the country.	It is part of the banking system.
2	Ownership	It is government owned bank	Commercial bank includes public sector banks. Also foreign owned banks.
3	Basis motive	It aims at economic growth and price stability and has no profit motive.	The aim of maximization of profit.
4	Dealing with the public	Central bank does not deal directly with the public.	They deal directly with the general public.
5	Competition	Central bank does not compete with commercial banks.	Commercial bank competes among themselves.
6	Relationship	The relationship between the central bank and commercial bank is unique. The central bank has power to exercise control over the banks.	Commercial banks are functioning at the same level. They cannot exercise control over others except on their subsidiaries.
7	Government transactions	Central bank usually acts as advisor to the government and also conducts government transactions.	Public sector banks partially undertake government transactions. However, other commercial banks are precluded from such functions.
8	Power of note issue	The central bank has the sole authority to issue currency notes.	Commercial bank cannot issue currency notes.
9	Dealing with foreign exchange.	Central bank has the responsibility to maintain the stability of foreign exchange rates.	They do not have any such responsibility.
10	Role of banking	Central bank functions as the banker to the government.	They are functioning as the banker to the general public.
11	Basic functions	Central bank acts as the bankers' bank and lender of last resort to the commercial banks.	They do not have such roles and status.
12	Clearing house	The central bank acts as national clearing house for inter bank settlements.	The commercial banks do not function as clearing house. In India SBI conducts clearing

			operations.
13	Responsibility.	Central bank is responsible to hold the price line and inflation rate.	Commercial banks do not have responsibility.

Reserve Bank of India

Introduction

The Reserve Bank of India is at the heart of the banking system. Being a central bank, it occupies a pivotal position in the Indian money market. It is an 'Apex' institution and hence acts as a guardian of the Indian money market. It was started on April 1, 1935. Originally the Bank was constituted as shareholders' bank with a share capital of Rs. 5 crores. This capital has remained unchanged upto this day. The Reserve Bank of India came to be nationalized on January 1, 1949 under the Reserve Bank (Transfer to Public Ownership) Act of 1948.

Administrative Machinery of RBI

Governor

Dy.Governor Dy.Governor Dy.Governor Dy.Governor

Executive Director Executive Director Executive Director

Chief Manager

Chief Accountant

Management of RBI

The management of RBI 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 offices of the bank by the central govt. for a team not exceeding five years.
(b) Four directors nominated by the central govt. one from each of the four Local Boards constituted as given below:
(c) Ten Directors nominated by the central govt., for a term of four years; these directors are experts in business, industry, finance and cooperation.
(d) One official nominated by the govt. of India (Secretary, Finance Ministry, Govt. of India)
All 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 head quarters at Bombay, Calcutta, New Delhi and Madras respectively.

For each of these four areas, there is a Local Boards consisting of the five members appointed by the central govt. 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 prefer such duties as the Central Board may delegate to it.

Various Departments of RBI

The Reserve Bank of India contains the following departments.

1. Banking Department
2. Issue Department
3. Exchange Control Department
4. Secretary's Department
5. Department of Banking Operations and Development
6. Department of Accounts and Expenditure
7. Legal Department
8. Administration and Personnel
9. Agricultural Credit Department
10. Industrial Finance Department
11. Department of Non-Banking Companies
12. Economic Department
13. Department of Statistics
14. Planning and Re-Organization Department
15. The Premises Department
16. Reserve Bank of India Service Board.

Functions of RBI

Reserve Bank of India, being the central bank if our country, perform all the central banking functions. Since ours is a developing economy, the Bank also performs promotional functions. The main functions of the Bank are explained in following pages.

1. Bank of Issue
2. Banker to the Government
3. Banker's Bank
4. Custodian of Foreign Exchange Reserves
5. Lender of Last Resort
6. Controller of Credit
7. Promotional Functions

These will discuss below in detail.

1. **Bank of Issue**

Reserve Bank of India in the first instance acts as a 'Bank of Issue'. Under section 22 of the RBI of the Act, the bank has the sole right to issue the bank notes in India. The Reserve Bank of India issues notes of denominations except one rupee notes. The one rupee note is considered to be a coin printed on a paper and hence is issued by the Ministry of Finance, Government of India. For performing this function more efficiently, the Reserve Bank has a separate department known as the 'Issue Department'. The assets and liabilities of the Issue Department are kept separate from that of the Banking Department.

2. **Banker to the Government**

The Reserve Bank if India also acts as a banker to the Government. Under Sections 20, 21 and 21-A of the RBI Act, the bank performs this function. It acts as an agent, advisor and a banker to the govt. The central as well as the State Governments maintain their accounts with the RBI. In the absence of the Reserve Bank's office, the Governments maintain their accounts with its agent the State Bank of India and its subsidiaries. As a banker, the Reserve Bank accepts money on behalf of the Government, makes payments and also arranges for the remittances of the govt. The management to the public debt is also entrusted to the RBI. The Reserve Bank of India also acts as an agent of the govt. in respect of its membership to various international monetary institutions. Governments seek advice from the bank from time to time on all banking and financial matters.

3. **Banker's Bank**

The Reserve Bank of India, like all other central banks also acts as the Bankers Bank. The development of an adequate and sound banking system to cater to the needs of trade, commerce, industry and agriculture is an additional responsibility of the Reserve Bank of India besides the performance of its traditional functions. The RBI Act of 1934 and the Banking Regulation Act of 1949 have the extensive and sweeping power to the RBI to supervise and control the commercial and co-operative banks in India. In brief, the RBI acts as a friend, philosopher and guide to other commercial banks.

As bankers' bank, RBI performs the following functions.

(a) It receives the cash reserves of the commercial banks, protects them and rescues them in time of difficulties.
(b) It rediscounts bills of commercial banks. It acts as a clearing house for them.
(c) It provides good and ample leadership to the commercial banks.
(d) It effects centralization of the cash reserves of the commercial banks in the country.

4. **Custodian of Foreign Exchange Reserves**

The RBI acts as a custodian of our foreign exchange reserves. It is entrusted with the task of maintaining the external value of the rupee. The bank exercises a very strict control over the foreign receipts and payments and maintains the parity value of the rupee as per the provisions of the International Monetary Fund. The Banks has a separate 'Exchange Control Programme to supervise and control the scarce foreign exchange.

5. **Lender of the Last Resort**

The scheduled commercial banks get financial accommodation from the RBI during emergencies to overcome temporary financial stringencies. Such financial accommodation is provided by RBI against the rediscounting of the Bills of exchange or govt. securities. This function of the bank is called 'lender of the last resort' function of the bank.

6. **Controller of the Credit**

The most outstanding of the RBI is to control the credit made available by the entire banking system. This function and execution of the monetary policy. The bank controls the volume and direction of credit by using both quantitative as well as qualitative measures. The quantitative measures include the Bank Rate, Open Market Operations, Variable Reserve Requirements and the Net Liquidity Ratio. These measures act upon the cost and availability of credit, whereas selective credit measures place restrictions over the quality or purposes of credit. The Reserve Bank has put to extensive use all these measures.

Objectives of Credit Control

The following are the main objectives of the credit control of Reserve Bank of India.

1. To obtain stability in the internal price level.
2. To attain stability in exchange rate.
3. To stabilize money market of a country.
4. To culminate business cycles-inflation and depression-by controlling supply of credit.
5. To maximize income, employment and output in a country.
6. To meet the financial requirements of an economy not only during normal times but also during emergency or war.
7. To help the economic growth of a country within specified period of time. The objective has become particularly necessary far the less developed countries of present day world.

Methods of Credit Control

There are two methods of credit control namely Quantitative and Qualitative methods.

Quantitative Credit Control Method

1. **Bank Rate Policy**

Commercial banks rediscount their bills of exchange with the central bank in terms of need. Similarly they borrow from the central bank against approved securities for this service the central bank charges a rate, which is called bank rate.

Thus, the bank rate or discount rate is the rate which at which the central bank is prepared to discount the first class bills of exchange and govt. securities held by the commercial banks. The bank of England was the first to develop the bank rate as a weapon of credit control.

2. **Open Market Operations**

Open market operations refer to the sale and purchase of a variety of assets by the central bank. In practice, they are mainly concerned the purchase and sale of govt. securities. The central bank results are in an increase or decrease in the cash resources of the commercial banks.

This in turn affects the credit creation of the commercial banks. Open market operations tend immediately to increase or decrease the quality of money in circulation and the cash resources of commercial banks.

3. **Variable Reserve Ratio**

Variable reserve ratio as a method of credit control was suggested by Keynes in 1930. This method was introduced by Federal Reserve System of USA in 1935. Now ion almost all countries of the world the central bank adopts this instrument as an effective credit control.

The commercial banks have to keep a minimum cash reserve with the central bank. When the central bank wants to reduce credit, it will increase the cash ratio to be kept by the commercial banks. This reduces the capacity of each commercial bank to lend and thus, the credit creation is controlled.

When the liquidity is available with banks the CRR is hiked to impound excess cash. Similarly, this rate is also used to stables exchange rate of rupee. Suppose, the central rises the cash reserve ratio from 3 to 10 %.

Qualitative Credit Control Method

Following are the selective credit control methods.

1. Fixation of Margin Requirements
2. Rationing of Credit
3. Regulation of Consumer Credit
4. Controls through Directives
5. Moral Suasion
6. Publicity
7. Direct Action
8. Promotional Functions

These will be elaborately discussed below.

1. **Fixation of Margin Requirements**

This method was adopted in USA in 1934 to control speculative activities in securities. Under this method the central bank prescribes the margin to be kept for loans against stock exchange securities. When the central bank prescribes higher margin the borrower can obtain less amount of credit on his stock.

2. **Rationing of Credit**

This is oldest method of credit control. It aims to control and regulate the purposes for which credit is granted by commercial banks credit rationing is generally of two types. The first is the variable portfolio ceiling. According to this the central bank advances beyond the particular limit.

This method is known as the variable capital asset ratio. This is the ratio which the central bank fixes in relation to the capital of a bank to its total assets.

3. **Regulation of Consumer Credit**

Regulation of consumer credit as a selective control method was first adopted in USA in 1941. Under this method credit granted to customers for purchase of durable goods is regulated. In developed countries, largest portion of national income is spent on consumer durable goods such as cars, refrigerators, costly furniture, etc.

Many countries have adopted this weapon to control credit allowed to the customer. It is essential to regulate consumer expenditure on such durable goods to control inflations.

4. **Controls through Directives**

The central bank issues directives to control the credit created by commercial banks. The directives may be in the form of written orders, warnings or appeals, etc.

5. **Moral Suasion**

Moral suasion implies persuasion and request made by the central bank to the commercial banks calls to follow certain policy in the interest of the economy.

During depression, it may request banks to extent credit liberally. Further the central banks calls a meeting of the needs of commercial banks where in it explain the need for the adoption of a particular policy and appeal to them to follow it.

6. **Publicity**

Quite a number of central banks use publicity as an instrument of credit control. They regularly publish statements of assets and liabilities of commercial banks for the information to the public. They are also public reports of general money market and banking conditions. This method is useful for highly industrialized countries. It has been quite extensively used in USA.

7. **Direct Action**

The method of direct action is the most effective weapon of central bank to control credit creation. The central bank uses this method to enforce both quantitative and selective credit controls. Direct action refers to each directions and controls which the central bank may enforce on all banks or a particular bank concerning their lending and investment.

8. **Promotional Functions**

The RBI, being the central bank of developing nation, also performs certain promotional functions. Since its inception the bank has played a vital role by discharging such functions as the promotion of banking habits among people, expansion of banking facilities and the established of new specialized agencies have been brought into existence in our country specially after the independence of the country. Perhaps, the bank has been instrumental in starting such agencies. The agencies include: the Deposit Insurance Corporation, Unit Trust of India, Industrial Development Bank of India and the Central and State-Sponsored financial corporations to provide long-term credit industries. To cater to the needs of agriculture, the bank has a special department called the Agricultural Credit Department. There is also an Industrial Finance Department in the Bank. To ensure sound banking system for India, the Economics and Research Department of the RBI disseminates necessary information on banking and also conducts research. Thus, in all possible ways the Reserve Bank of India is striving hard to promote economic growth of the nation.

Reserve Bank of India is thus a supreme banking authority in India. It is like an axle-wheel on which the whole money market revolves.

Role and Importance of RBI in Economic Development

The following are the main role and importance of RBI in economic development of our country.

1. The Reserve Bank of India was established on April 1, 1935 in accordance with the provisions of the RBI Act 1934. The central office of the Reserve Bank was initially established in Calcutta but was permanently moved to Mumbai in 1937. Though originally privately owned, since nationalization in 1949, the Reserve Bank is fully owned by the Government of India.
2. The Preamble of the RBI describes the basic functions of the Reserve Bank as "…. to regulate the issue of Bank Notes and keeping of reserves with a view to securing of reserves stability in India and generally to operate the currency and credit system of the country to its advantage."
3. Head quarters Maharastra established April 1, 1935 Governor Duvvuvi Subbarao central bank of India currency Indian Rupee ISO 4217 code Reserves US$287.37 billion (2009) Base borrowing rate 5.2% Base deposit rate 9.5%.
4. Issue of currency, Banker and Debt Manager to govt., Banker to Banks Regulator of the Banking system, Manager of Foreign Exchange, Regulator and Supervisor of the payment and Settlement systems Development Role.
5. Monetary policy refers to the use of instruments under the control of the central bank to regulate the availability cost and use of money and credit, goal; achieving specific economic objectives, such as low and stable inflation and promoting growth.
6. Maintaining price stability ensuring adequate flow of credit to the productive sectors of the economy to support economic growth financial stability.
7. The Reserve Bank is the nation's sole note-issuing authority. Along with the govt. of India, RBI is responsible for the design and production and overall management of the nation's currency, with the goal of ensuring an adequate supply of clean and genuine notes. The Reserve Bank also makes sure there is an adequate supply of coins, produced by the govt.
8. The role as banker and debt manager to government includes several distinct functions undertaking banking transactions for the central and state governments to facilitate receipts and payments and maintaining their accounts. Managing the governments' domestic debt with the objective of raising the required amount if public debt in a cost-effective and timely manner.
9. As the banker to banks, we focus on: Enabling smooth, swift and seamless clearing and settlement of inter-bank obligations. Providing an efficient means of funds transfer for banks. Enabling banks to maintain their accounts with us for purpose of statutory reverse requirements and maintain transaction balances. Acting as lender of the last resort.
10. The Reserve Bank regulates and supervises the nation's financial system. Different departments of the Reserve Bank oversee the various entities that comprise-India's financial infrastructure. Commercial banks and all-India development financial institutions. Urban co-operative banks. Reserve Rural Banks (RRBs), District Central Co-operative Banks and State Co-operative Bank, Non-Banking Financial Companies (NBFC).
11. The Reserve Bank plays a key role in the regulation and development of the foreign exchange market and assumes three broad-roles relating to foreign exchange. Regulating transactions related to the external sector and facilitating the development of the foreign exchange market. Ensuring smooth conduct and orderly conditions in the domestic-foreign exchange market managing the foreign currency assets and gold reserves of the country.
12. The Payment and Settlement Systems Act of 2007 (PSS Act) gives the Reserve Bank oversight authority, including regulation and supervision, for the payment and settlement systems in the country. In this role, we focus on the development and functioning of safe, secure and efficient payment and settlement mechanisms.
13. The role is, perhaps the most unheralded aspect of RBI's activities, yet it remains among the most critical. This includes: Ensuring that credit is available to the productive sections of the economy. Establishing institutions designed to build the country's financial infrastructure. Expanding access to affordable financial service and promoting financial education and literacy.
14. The Reserve Bank has a rich tradition of generating sound economic research, data collection and knowledge-sharing. It's economic research focuses: on study and analysis of domestic and international issues affecting the Indian economy. This is mainly done by the Department of Economic Analysis and Policy and Department of Statistics and Information Management.

15. This important work is designed to: Educate the public, provide reliable, data-driven information for policy and decision-making. Supply accurate and timely data for academic research as well as the general public.
16. RBI emphasis on communication involves a range of activities, all aimed at sharing knowledge about the financial arena. The Reserve Bank's web site (www.rbi.org.in) provides a full range of information about RBI's activities. RBI's publications, it's history or organization.
17. The Reserve Bank's willingness to use conventional and unconventional measure help buffer the nation from severe crisis. Here are some examples of our responses during- the 2008-09 global financial crisis: carefully considered and calibrated reduction of interest rates situation has stabilized loosened restrictions on access to foreign currency creation of a rupee-dollar swap facility to manage short-term funding requirements.
18. Establishment of a refinancing window and special-purpose vehicle for non-banking financial companies. Expansion of funding sources for umbrella financial to keep credit flowing to small business, housing and export businesses.

Monetary Policy of RBI

Monetary policy is the process by which monetary authority of a country, generally a central bank controls the supply of money in the economy by exercising its control over interest rates in order to maintain price stability and achieve high economic growth. In India, the central monetary authority is the Reserve Bank of India (RBI), is so designed as to maintain the price stability in the economy. Other objectives of the monetary policy of India, as stated by RBI, are:

1. Price Stability
2. Controlled Expansion of Bank Credit
3. Promotion of Fixed Investment
4. Restriction of Inventories
5. Promotion of Exports and Food Procurement Operations
6. Desired Distribution of Credit
7. Equitable Distribution of Credit
8. To Promote Efficiency
9. Reducing the Rigidity

These objectives of monetary policy of RBI are elaborately discussed below.

1. Price Stability

Price stability implies promoting economic development with considerable emphasis on price stability. The centre of focus is to facilitate the environment which is favour to the architecture that enables the development projects to run swiftly while also maintaining reasonable price stability.

2. Controlled Expansion of Bank Credit

One of the important functions of RBI is the controlled expansion of bank credit and money supply with special attention to seasonal requirement for credit without affecting the output.

3. Promotion of Fixed Investment

The aim here is to increase the productivity of investment by restraining non-essential fixes investment.

4. Restriction of Inventories

Overfilling of stocks and products becoming outdated due to excess of stock often results is sickness of the unit. To avoid this problem the central monetary authority carries out this essential function of restricting the inventories. The main objective of this policy is to avoid over-stocking and idle money in the organization.

5. Promotion of Exports and Food Procurement Operations

Monetary policy pays special attention in order to boost exports and facilitate the trade. It is an independent objective of monetary policy.

6. Desired Distribution of Credit

Monetary authority has control over the decisions regarding the allocation of credit to priority sector and small borrowers. This policy decides over the specified percentage of credit that is to be allocated to priority sector and small borrowers.

7. **Equitable Distribution of Credit**

The policy of Reserve Bank aims equitable distribution to all sectors of the economy and all social and economic class of people.

8. **To Promote Efficiency**

It is another essential aspect where the central bank pays a lot of attention. It tries to increase the efficiency in the financial system and tries to incorporate structural changes such as deregulating interest rates, ease operational constrains in the credit delivery system, to introduce new money market instruments etc.

9. **Reducing the Rigidity**

RBI tries to bring about the flexibilities in the operations which provide a considerable autonomy. It encourages more competitive environment and diversification. It maintains its control over financial system whenever and wherever to maintain the discipline and prudence in operations of the financial system.

UNIT – II Completed.

Reference:

1. *Banking Theory, Law and Practices* – ***Prem Kumar Srivastava.***
2. *Banking Theory, Law and Practices* – ***P.Saravanavel.***

Unit- III
E – Banking

Meaning

E-Banking refers to electronic banking. It is like e-business in banking industry. E-Banking is also called as “Virtual Banking” or “Online Banking”.

E-Banking is a result of the growing expectations of bank’s customers. E-banking involves information technology based banking. Under this I.T. system, the banking services are delivered by way of a computer-controlled system. This system does involve direct interface with the customers. The customers do not have to visit the bank’s premises. For instance, may offer unlimited bill pay options while others restrict online activity.

Important Services Provided by E-Banking

E-Banking provides the following services:

1. Round- the- clock Banking
2. Direct Deposit
3. Phone Payment
4. PC (personal computer) Banking
5. Point-of- sale Transfers
6. Electronic Cheque Conversion

These services will be discussed below in detailed.

1. **Round- the- clock Banking**

Automatic Teller Machines are the electronic terminals that allow round- the- clock access to banking services. It allows the customer to withdraw cash, make deposit (or) transfer funds between accounts by simply inserting an ATM card and entering the PIN.

2. **Direct Deposit**

Electronic Banking (E-Banking) makes possible direct deposit of cheques to the account on a regular basis. It also facilitates pre-authorized direct withdrawals to make payment of recurring bills, such as insurance premiums, mortgages and utility bills.

3. **Phone Payment**

A pay-by-phone system enables banks and financial institutions to pay certain bills (or) to transfer funds between accounts. For this purpose an agreement with the institution concerned is to be written.

4. **PC (personal computer) Banking**

PC banking allows the customer to handle many banking transactions through the personal computer. For instance, one may use the computer to view the account balance, request transfers between accounts, and pay bills electronically.

5. Point-of- sale Transfers

Point-of-sale Transfers facilitates payment for purchases with a debit card. The process is similar to using a credit card, but there is some important exceptions. While the process is fast and easy, a debit card purchase transfers money, fairly quickly from the customer's bank account to he merchants account. The very important thing the customer has adequate funds in the account.

6. Electronic Cheque Conversion

Electronic cheque conversion converts a paper cheque into an electronic payment. At the time of point-of-sale where a cheque is issued and sent to the shop cashier, it is processed through an electronic system. The system compares the customer's banking information and the amount of the cheque. Once the cheque is processed, the customer signs a receipt authorizing the shopkeeper to present the cheque of the customer's bank electronically. Issue of receipt marks the completion of the electronic transaction.

Benefits / Advantages E-Banking

E-Banking has the following advantages:

1. Round the clock Banking
2. Convenient Banking
3. Low cost Banking
4. Profitable Banking
5. Quality Banking
6. Speed Banking
7. Service Banking

These will discuss below in detail.

1. Round the clock Banking

E-Banking facilitates performing of basic banking transactions by customers round the clock globally. World-wide 24 hours and 7days a week banking services are made possible. There is no restricted office hour for E-Banking.

2. Convenient Banking

E-Banking increases the customer's convenience. No personal visit to the branch are required customers can perform basic banking transactions by simply sitting at their office (or) at home through PC (or) Laptop. Customers can get drafts and their door step through E-Main call.So E-Banking facilitates Home Banking.

3. Low cost Banking

The operational costs have come down due to technology adoption. The cost of transactions through internet banking is much less than any other traditional mode.

4. Profitable Banking

The increased speed of response to customer requirements under E-Banking vis-à-vis branch banking can enhance customer satisfaction and consequently can lead to higher profits. Banks can also offer many cash management products for the existing customers without any additional cost.

5. Quality Banking

E-Banking opens new vistas for providing efficient, economic and quality service to the customers. E-Banking allows the possibility of improved quality and an enlarged range of services being made available to customers.

6. Speed Banking

The increased speed of response to customer requirements under E-Banking will lead to greater customer satisfaction and handling a large number of transactions at a lesser time and also it facilitates to retain the customers.

7. Service Banking

E-Banking creates strong basic infrastructure for the banks to embark upon many cash management products and to venture in the new fields like E-Commerce, EDI etc. Instant credit, one day credit, immediate payment of utility bills, instant transfer of funds etc. would be made possible under E-Banking.

Disadvantages / Limitations of E-Banking

Though there are many advantages of E-Banking, following are said that the disadvantages of E-Banking.

1. Start-up cost
2. Training and Maintenance
3. Lack of skilled personnel
4. Security
5. Legal issues
6. Restricted clientele and technical problems
7. Restricted Business
8. Destruction of Pricing Mechanism

1. Start-up cost

Many banks have expressed their concern about the huge initial start-up cost for venturing into E-Banking

a) The connection cost to the internet (or) any other mode of electronic communication.
b) The cost of sophisticated hardware, software and other related components including modem, routers, Bridges etc.
c) The cost of maintenance of all equipments, websites, skills level of employees etc.
d) The cost of setting up organizational activities to implement E-Banking.

2. Training and Maintenance

The introduction of E-Banking involves 24 hours support environment, quality service to end users, which would necessitate a qualified people to meet external and internal commitments. The training and retaining of skilled manpower is a major cause of concern

3. Lack of Skilled personnel

It is a well known fact that there is an acute scarcity of web developers, content providers and knowledgeable professionals to route the banking transactions through internet.

4. Security

In paperless banking transaction, many problems of security are involved. Problems are in the form of destruction, disclosure, modification of data, denial of services, fraud, waste and abuse. There are chances that documents such as cheques, pass book etc. can be modified without leaving any visible trace. Providing appropriate security may require a major initial investment in the form of application encryption Techniques, implementation of firewalls etc.

5. Legal issues

Legal framework for recognizing the validity of banking transactions conducted through the **'Net'** is till being put in place. The legal issues should cover unauthorized access, and unauthorized modification data, wrongful communication, punishment to be meted out to combat computer crimes. To prevent computer crimes, the country's banking legislation needs to make suitable provisions with a thorough consultation and discussion among the legal as well as technical experts.

6. Restricted Clientele and Technical Problems

The user of E-Banking needs a computer and time to log on to the site. It means that the target clientele is restricted to those who have a home PC (or) can access the net through the office (or) cyber cafes. Moreover, phone connections are not always perfect and, on a home PC, the modem connection often breaks off, requiring another seditious log-on.

7. Restricted Business

Not all transactions can be carried out electronically. Many deposits and some withdrawals require the use of postal services. Some banks have automated their front-end process for the customers, but still largely depend upon manual processes at the back-end.

8. Destruction of Pricing Mechanism

The internet may also destroy the basic business pricing models. Internet creates prefect market conditions where prospective consumers have access to more information and can more readily compare rates and financial products offerings. New players in the field have lower costs than ole banks. Hence, they can under cut the prices and provide stiff competition to established banks.

Traditional Banking Vs E-Banking

The following are distinction between traditional banking and E-Banking:

- In traditional Banking, the customer has to visit the branch of the bank in person to perform the basic banking operations viz., account enquiry, funds transfer, cash withdrawals etc.

But, E-Banking enables the customers to perform the basic banking transactions by sitting at their office (or) homes through PC (or) Laptop. The customers can access the banks website for viewing their account details and perform the transactions on account as per their requirements.

- Today's banking is no longer confined to branches customers are being provide with additional delivery channels which are more convenient to customers and are cost effective to the banks. These delivery channels include ATM, Tele-Banking, Internet Banking, Mobile Banking, Home Banking etc.
- E-Banking is more of a science that art. E-Banking is knowledge based and mostly scientific in using the electronic devices of the computer revolution. When most corporate tend to become internet working organizations, banking has to be E-banking in the new century.

Mobile Banking (M-Banking)

Introduction & Meaning

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. Mobile banking differs from mobile payments, which involve the use of a mobile device to pay for goods or services either at the point of sale or remotely, analogously to the use of a debit or credit card to effect an EFTPOS payments.

The earliest mobile banking services were offered over SMS, a service known as SMS banking. With the introduction of smart phones with WAP support enabling the use of the mobile web in 1999, the first European banks started to offer mobile banking on this platform to their customers.

Then mobile banking refers to provision and availment of banking and financial services with the help of mobile telecommunication devices.

Features of Mobile Banking

The following are main features of Mobile Banking:

1. Mobile Customer
2. M-Commerce
3. Technology-Based
4. Types of Services
5. Eligibility
6. Application

1. Mobile Customer

Those who use '**Mobile Telephony'** use mobile banking services. Mobile telephony is used through mobile phones.

2. M-Commerce

Mobile banking is a part of M-Commerce whereby business and trade takes place through mobile on-line. Those mobile users who become on-line internet users do M-Commerce.

3. Technology-Based

Happening in the realm of mobile banking are based on technology development. Mobile Banking makes use of the internet for transmission, transaction, and delivery of banking services.

4. Types of Services

Mobile Banking offers the entire Internet-based banking services such as on-line account opening, account verification, Funds transfer etc.

5. Eligibility

Mobile Banking is extended only to individual customers having account with any branch of a particular bank that offers internet banking facility. It is also required that the customer is registered as an internet banking customer.

6. **Application**

In order to avail the facility of mobile banking, an application duly filled in is to be submitted to the bank. The application is invariably made available in the official website of the bank.

Services Provided by Mobile Banking

Mobile banking can offer services such as the following:

1. Mini-statements and checking of account history.
2. Alerts on account activity or passing of set thresholds.
3. Monitoring of term deposits
4. Access to loan statements
5. Access to card statements
6. Mutual funds/equity statements
7. Insurance policy management
8. Pension plan management
9. Status on cheque, stop payment
10. Ordering of cheque books
11. Balance checking in the account
12. Recent transactions
13. Due date of payment (functionality for stop, change and deleting of payments)
14. PIN provision, change of PIN and reminder over the interest
15. Blocking of (lost, stolen) cards
16. Domestic and international fund transfer
17. Micro-payment handling
18. Mobile recharging
19. Commercial payment processing
20. Bill payment processing
21. Peer to peer payments
22. Withdrawal at banking agent
23. Deposit at banking agent.

Advantages of Mobile Banking

The following are advantages of M-Banking:

1. Reduce cost
2. Save time
3. Increase revenue
4. Helps to maintain trust factor
5. Getting high level of customer satisfaction

Challenges of Mobile Banking

The following are the challenges of mobile banking:

1. Improper privacy maintenance
2. Many phones are not compatible with anti-virus software
3. Lesser preference for M-Banking rather than net banking by bankers
4. Running awareness programmes to educate the public is the difficult task.

UNIT – III Completed.

Reference:

1. *Banking Theory, Law and Practices* – ***P.Saravanavel.***
2. *Banking Theory, Law and Practices* – ***Prem Kumar Srivastava.***

Unit- IV
Internet Banking

Introduction

Banking is no longer confined in the branches, as customers are being provided with additional delivery channels viz., ATMs, Internet Banking channels. Internet banking is taking the lead and has become the most popular and convenient mode of banking amongst the customers.

Meaning

Internet banking refers financial services accessed via the Internet's World Wide Web. An internet bank exists only on the internet, the global network of computer networks without any "brick and mortar" branch offices. Internet banking sites offer the prospect of more convenient ways to manage personal finances and such services as paying bills on-line, finding mortgage or auto loans, applying for credit cards and locating the nearest ATM or branch office. Some internet banks also offer 24 – hours telephone support, so customers can discuss their needs with bank service representatives directly.

Services provided by Internet Banking

1. Accounts transaction details
2. Viewing / printing of account statement
3. Transfer of funds to other bank accounts in India through NEFT / RTGS
4. Transfer of funds on own / third party accounts with our bank.
5. Direct / indirect tax payments
6. Utility bill payments like electricity bills, telephone bills, insurance premium payments, mutual fund payments, credit card payments, etc.
7. Online air ticket and railway ticket booking, etc.
8. Notification of change of address so as to update the records.
9. Updating of foreign currency exchange rates.
10. Intimating on-line about a stop payment.
11. Notification of lost / stolen ATM card.

Thus, internet banking has no time zones and is accelerate round the clock without restricting it to any geographical boundary.

Advantages of Internet Banking

Internet banking has several advantages over traditional banking which makes operating a bank account simple and convenient. Internet banking allows you to conduct various transactions using the bank's website and offers several advantages. Some of the advantages of internet banking are:

1. Simple
2. Convenient
3. 24 X 7 service
4. Fast and Efficient
5. Safe
6. Great Medium for Banks.

These advantages are elaborately discussed below.

1. **Simple**

   Internet banking account is simple to open and easy to operate.

2. **Convenient**

   Internet banking is quite convenient as we can easily pay our bills, can transfer funds between accounts, etc. Now we do not have to stand in a queue to pay off our bills; also we do not have to keep receipts of all the bills as we can now easily view our transactions.

3. **24 X 7 Service**

Internet banking is available all the time, i.e., 24 X 7. We can perform our tasks from anywhere and anytime; even in night when the bank is closed or holidays. The only thing we need to have is an internet connection.

4. **Safe**

Through internet banking, we can keep an eye on our transactions and account balance all the time. This facility also keeps our accounts safe. This means that by the case of monitoring our account at anytime, we can get to know about any fundamental activity or threat to our account before it can pose our account to severe damage.

5. **Fast and Efficient**

Internet banking is fast and efficient. Funds get transferred from one account to the other very fast. We can also manage several accounts easily through internet banking.

6. **Great Medium for Banks**

Internet banking is also a great medium for the banks to endorse their products and services. The services include loans, investment options and many others.

Major Issues and Drawbacks / Disadvantages of Internet Banking

Though there are many advantages of internet banking, but nothing comes without disadvantages and everything has its pros and cons; same is with internet banking. It is also has some disadvantages which much be taken care off. The disadvantages of internet banking include the following:

1. Needs a Computer
2. Difficult to understand
3. Essential of Internet Connection
4. Lack of Trust / Security Transactions
5. Password Security
6. Depending Server's Capacity
7. Slow Browsing
8. Restricted to use

The disadvantages of internet banking are discussed below in detail.

1. **Needs a Computer**

To use the internet banking services, the user needs a computer, and time to log on to the website of the bank. This money that the target clientele is restricted to those who have a home PC or can access the net through the office (or) cyber-cafes.

2. **Difficult to Understand**

Understanding the usage of internet banking might be difficult for a beginner at the first go. Though there are some sites which offer a demo on how to use internet banking, but all does not offer this facility. So a person who is new to internet banking might face some difficulty.

3. **Essential of Internet Connection**

We cannot have access to internet banking if we don't have an internet connection; thus without the availability of internet access, internet may not be useful.

4. **Lack of Trust**

The use of internet banking services depends much on the trust reposed by the customers of a bank on the internet banking initiative of the bank. It therefore becomes an imperative that internet start-ups gain the trust of depositors before they will make deposits. Customers may get less protection than with established banks. It is a big issue. Because, our account information might be hacked by unauthorized people over the internet.

5. **Password Security**

Password security is must. After getting our net banking password, do change it and memorize it otherwise our account may be misused by someone who gets to know our password inadvertently.

6. **Depending Server's Capacity**

We cannot use internet banking, in case the bank's server is down.

7. **Slow Browsing**

Another issue is that sometimes it becomes difficult to note whether our transaction was successful or not. It may be due to the loss of internet connectivity in between, or due to a slow connection, or the bank's server is down.

8. **Restricted Use:**

It is not possible that all transactions can be carried out electronically. Many deposits and some withdrawals require the use of postal service, which can be slow and unreliable even in developed economies.

Indian Scenario of Internet Banking

Indian banks and financial service organizations are making use of the internet for delivering innovative and traditional financial products as follows.

1. Explicit Security Plan
2. Access Control
3. Firewalls
4. Security Infrastructure
5. Backup Recovery
6. Monitoring Against Threats
7. Education and Review
8. Log of Messages
9. Certified Products
10. Maintenance of Infrastructure
11. Approval for Internet Banking
12. Legal Issues

These will be discussed below in detail.

1. **Explicit Security Plan**

Banking organizations should make explicit security plan and document it. There should be a separate security Office/Group dealing exclusively with information systems security. The information technology division will actually implement the computer systems while the computer security officer will deal with its security.

2. **Access Control**

Logical access controls should be implemented on data, systems, application software, utilities, telecommunication lines, libraries, system software etc. Logical access control techniques may include User-IDs, Passwords, Smart Cards (or) other biometric technologies.

3. **Firewalls**

Banks should use the proxy server type of firewall so as to ensure that there is no direct connection between the internet and the bank's system. It facilitates a high level of control and in depth monitoring using logging and audition tools.

4. **Security Infrastructure**

PKI (**Public Key Infrastructure**) is the most favoured technology for secure internet banking services. But it is not commonly available. PKI infrastructure is strongly recommended, during the transition period, until IDRBT (or) government puts in place the PKI infrastructure, the following options are recommended.

(a) Security Log (Audit Trail)

All computer access and security violations should be reported and follow up action taken as the organization's security policy.

(b) Penetration Testing:

The information security officer and the information system auditor should undertake periodic penetration tests of the system, which includes:

- Attempting to guess passwords using password-cracking tools.
- Search for back door traps in the program
- Attempt to overload the system using **DDOS (Distributed Denial Of Service**) and **DOS (Denial Of Service)**
- Check if commonly known holes in the software.
- The penetration testing may also be carried out by engaging outside experts **(called Ethical Hackers**)

5. Backup Recovery

The bank should have a proper infrastructure and schedules for backing up data. The backed-up data should be periodically tested to ensure recovery without loss of transactions in a time frame as given out in the bank's security policy. Business continuity should be ensured by having disaster recovery sites, where backed-up data is stored. These also should be tested periodically.

6. **Monitoring Against Threats**

The banks should acquire tools for monitoring systems and the networks against intrusions and attacks. These tools should be used regularly to avoid security breaches.

7. Education and Review

The banks should review their security infrastructure and security policies regularly and optimize them in the light of their own experiences and changing technologies.

8. Log of Messages

The banking applications run by the bank should have proper record keeping facilities for legal purposes. It may be necessary to keep all received and sent messages both in encrypted and decrypted form.

9. Certified Products

The banks should use only those security solutions products which are properly certified for security and for record keeping by independent agencies.

10. Maintenance of Infrastructure

Security infrastructure should be properly tested before using the systems and applications for normal operations.

The bank should upgrade the systems by installing patches released by developers to remove bugs and loopholes, and upgrade to newer versions which give better security and control.

11. Approval for Internet Banking

All banks having operations in India and intending to offer internet banking services to public must obtain an approval for the same from RBI.

The application for approval should clearly cover the systems and products that the bank plans to use as well as the security plans and infrastructure.

It should include sufficient details for RBI to evaluate security, reliability, availability, auditability, recoverability, and other important aspects of the services.

12. Legal Issues

So far as the Indian banking scenario is concerned the various legal issues that emanate from internet banking.

(a) Negotiable Instruments Act, 1881

Section 131 of the Negotiable Instrument Act 1881, and different case laws, there is an obligation on the banks not only to establish the identity but also to make enquiries about integrity and reputation of the prospective customer.

(b) Information Technology Act, 2000

In India, the information Technology Act, 2000 in section 3(2) provides for a particular technology as a means of authenticating electronic record.

(c) Income Tax Act, 1961

Section 40 A(3) of the Income Tax Act, 1961 recognizes only payments through a crossed cheque (or) crossed bank draft, where such payment exceeds Rs.20,000/- for the purpose of deductible expenses. This act needs to be amended suitably, under the present regime there is an obligation on banks to maintain secrecy and confidentiality of customers account.

(d) Prevention of Money Launching Bill, 1999

The proposed prevention of money launching bill 1999 imposes obligation on every banking company to maintain records of transactions for certain prescribed period. The banking companies rules,1985 also require banks to preserve certain records for a period ranging between 5 to 8 years.

(e) Consumer Protection Act, 1986

The Consumer Protection Act, 1986 defines the rights of consumers in India and is applicable to banking services as well. The IT Act, 2000 has provided for penalty for denial of access to a computer system (sec. 43) and hacking (sec. 66). The IT Act, 2000 in sec 72 has provided for penalty for breach of privacy and confidentiality. Sec. 79 of the act has also provided for exclusion of liability of a network service provider for data traveling through their network subject to certain conditions.

Automated Teller Machine (ATM)

Introduction

The most visible, and perhaps most revolutionary, element of the virtual banking revolution is the cash machine (or) the Automated Teller Machine (ATM), as it is more popularly known ATMs are known for their speed and convenience giving 24 hours access to bank customers to operate their bank account in the physical environment with the help of machines ATMs have given an edge to the banks and financial institutions in efficiently carrying out their operations. ATMs provide the advantage of accessing the account of customers any time anywhere.

Concept of ATM

Electronic equipment that allows cardholding customers to perform routine banking transactions without interacting with a human teller is called ***'Automated Teller Machine'*** also called ***'Cash Machine'***, it offers a range of services of modern banking.

The machine is used to render certain essential banking functions such as deposit taking, cash withdrawal, account balance verification etc, with the help of a Personal Identification Number (PIN) system.

Services Provided by ATM

The following services are provided by ATM.

1. Anywhere Banking
2. Anytime Banking
3. Anything Banking
4. Safety
5. User Interface
6. Visual Messages
7. Swallowed Card
8. ATMs Security

These services will be explained below in detail.

1. Anywhere Banking

Automatic Teller Machines can be installed at any place where public congregate in large numbers for transacting business (or) availing services. Accordingly besides banks, ATM can be installed at banks, shopping centers, Offices, Airports, Railway Stations etc.

2. Anytime Banking

Automatic Teller Machines offer round-the-clock banking services to customers. This comes as boon to those who cannot access banking services on normal working hours due to their nature of work. The benefits are innumerable where the banker is part of the common sharing facility, called **'Shared ATM'**

3. Anything Banking

Automatic Teller Machines offer an amazing range of banking services such as cash withdrawal, balance enquiry, deposits, funds transfer, etc., at the convenience of customers.

4. Safety

From the technical perspective, an ATM is simply a safe with an electro-mechanical input and output system which is itself controlled by a fully electronic user interface.

5. User Interface

Organizations that manufacture ATMs are Fujistu, IBM, NCR, Siemens, etc. Those organizations spend great effort on the user interface aimed at maximizing the speed of the entire customer interaction and keeping the language used for the interaction process as clear and straightforward as feasible. Most ATMs nowadays use a Cathode-Ray Tube (CRT) for the visual interface.

6. Visual Messages

The '**User interface'** of an ATM is designed to ensure that the minimal required activities such as obtaining cash; obtaining receipt and retrieving the card etc. are performed.

To facilitate the process of ATMs, the machine is provided with a touch-screen with user-friendly commands. Some machines also provide visual messages to remind the customer to retrieve the card, especially if the function is one where the customer is not going to be lingering by the machine until the cash has been dispensed.

7. Swallowed Card

Many a time it happens that the customer forgets to retrieve the card within a certain seconds of time. In such cases, the machine **'swallows'** the card after a short period, normally about 30 seconds.

This would require that the customer applies to the bank's central office in order to have the card returned. However, it is quite possible that a customer may be in a position to get back the **'swallowed card'** from the branch manager of the bank, where the ATM is located in the same premises where the banks branch also functions.

8. ATMs Security

The overriding objective of operating an ATM is that it should provide for dispensing the required functions to the bonafide and authorized user. The mechanism should therefore prevent an unauthorized of the card from gaining access to the machines functions.

Mechanism of ATM / Method of Using ATM

Using of ATM facility is to go through the following steps:

- Customer of a bank making application for the ATM card.
- Manager of the bank-branch issuing the ATM card, fixing the maximum cash withdrawal limits, etc.
- Customer to gain access to the ATM by swiping the card through a card-swipe located outside.

- Verification of the card and opening of the lobby door, the entrance lobbies are particularly useful for security reasons as they let the customer complete the transaction without any potential mugger (or) thief being in the immediate vicinity.
- Customer to insert the ATM card in the insertion point of the ATM. After reading the information embedded in the magnetic stripe on the card, the accountholder will be prompted to key in his PIN.
- If the accountholder and PIN are matched, the accountholder will be prompted successively to indicate the nature of account and the amount to be withdrawn.
- The ATM to depict the list of functions waiting to be carried out for the customer, such as cash withdrawal etc.,
- The machine will give out through different slots (a) Cash, (b) the ATM card and (c) Printout indicating the transaction carried out. The screen will prompt the user to indicate if another transaction is to be executed. If the answer is no the ATM card will be rejected and collected by the accountholder. The transact ion is complete.
- In case the PIN entered by the user is wrong, a warning is indicated. If wrong entries are made continuously for a specified number of times, the card will be retained by the machine.
- In some machines, instead of inserting the card which will be retained by the machine transaction is completed, the card has to be swiped, i.e., inserted and taken out immediately.

Functions of ATM

There are two types of functions:

1. Basic Functions and
2. Additional Functions

1. Basic Functions

Basic functions are also classified into two categories. They are:

a. Cash Withdrawal
b. Balance Enquiry, Statement Ordering Facility

2. Additional Functions

Additional functions also classified into following categories.

- Cheque book request facility
- Deposit, the facility being confined to customers of the financial institutions running the ATM in question which is not usually available via a shared ATM network.
- Funds transfer facility, which usually involves a customer-initiated transfer of funds, to a prearranged destination, such as utilities company account to pay a bill (or) to another customer account.
- Mini-statement facility, which is usually available as a print-out, and typically covers the last 10 transactions.
- PIN change facility.
- Dispensing traveler’s cheque, although a fairly uncommon facility available at international airports.

ATM can also be used to provide far more functions. For instance, they could be used for a wide range of communication purposes as emergency measures to alert police, ambulance (or) fire service. Similarly sharing of ATMs might be possible in future among banks and other service providers too such as to obtain tickets and other important documents via ATMs.

Strategic Importance of ATM

- The use of ATMs has a strategic importance for the banker who operates it in as many a number as possible and in as many a place as possible. For instance, it is possible for a banker to encompass more access of banking for business purposes, which would help to expand and diversify the banking operations. ATMs have the potential to be exciting, dynamic delivery systems which could greatly extend an institution’s operating base and give it a real competitive edge over its rivals.

ꕥ Modern commercial banks heavily depend on the ATMs to carry out routine transactions. ATM are capable of reducing the pressure on branches for undertaking routine transactions and there by reducing costs of operations. Even virtual banking institutions that have set up primarily telephone-based organizations naturally need some way of delivering cash to their customers and the ATM is the only virtual means available for doing this.

ꕥ There is a clear case for customers having to carry out all their banking functions with the help of the ATMs, although it is possible that customers might be reluctant and feel less comfortable to make deposits of money fearing theft. This would also help to reduce the queue for the ATM and this would ultimately maximize the customer satisfaction.

UNIT – IV Completed.

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UNIT – V

AGRICULTURAL BANKING

Introduction

Being a primary sector, agricultural sector is attracts everyone's attention in the world. Because it has provides food grains not only for human beings but also fodder for cattle. Due to that reasons every country wants to strengthen their agricultural sector especially the developing countries like India. So they are wants to establish various banking institutions which are provide financial assistance particularly for agricultural sector. Though there are various banking institutions available for agricultural credit, the following banks namely co-operative banks, RRB and NABARD are well functioning in India to develop agricultural sector and concentrate on agricultural farmers and labours.

Agricultural Finance Commission

Introduction

The agricultural Finance Commission plays an important role in providing loans to agricultural sector. It was promoted by the Indian Banks Association in April 1968 under the Companies Act with an authorized share capital of Rs.100 crores subscribed capital of Rs.10 crores and paid up share capital of Rs.5 crores. The main object of the AFC is to help the nationalized and commercial banks to participate activity and extensively in agricultural and rural development.

Objectives

The objects of the AFC are wide enough to enable it finance or assist in the financing of activities connected with the production supply transport and distribution of inputs for agricultural production, marketing, transport and storage of agricultural produce farm mechanization, animal husbandry, forestry and all other activities and operation incidental to or connected with agriculture, agricultural produce or agricultural operations.

Co-operative Banks

The Indian agriculturists require the provision of credit facilities according to time limit in three ways: (i) short-term credit to finance current and day to day forming requirements generally for a harvest or a year (ii) medium-term credit ranging from one to five years for buying cattle and other agricultural inputs

(iii) log-term credit to purchase costly machinery and implements like tractor, thresher, etc., to buy land to make permanent improvements on land ranging from five to twenty-five years. These type of credit facilities has provided by co-operative banks.

Co-operative is the idea of a voluntary association of individuals for the achievement of the common goal. It stands for the principle of "All for each and each for all." Theory of co-operation is that an isolated and weak individual can, by association with others and by mutual support, obtain the material advantage available to wealthy or powerful persons and thereby develop himself to the fullest extent of his natural abilities.

The credit co-operative is a voluntary association of members for self help, catering to the financial needs on a mutual basis.

Co-operative Credit Structure in India

Co-operative Credit Structure

- Short and Medium Term
  - State Co-operative Banks
  - Central Co-operative Banks
  - Primary Agricultural Credit Societies
- Long-Term
  - Central Land Development
  - Primary Land Development Banks

Merits / Benefits / Advantages of Co-Operative Credit Banking System

Following are the merits of co-operative banking system in India.

* Co-Operative, like money-lenders, can possess intimate knowledge to the character and financial position of their members, of and the local production possibilities and chances of growth.
* Co-Operative has lower administrative costs on account of voluntary services rendered by their members.
* They instill among their members a strong feeling of responsibility for prompt payment of interest and repayment of loans.
* They prompt thrift and savings among their members and mobilize their small savings for productive (or) useful purposes.
* The procedure of deposit and withdrawal of a co-operative credit society (or) bank is far less complicated.
* Co-Operative may provide loans to their members at lower rate of interest.
* They make their members financially more secure.
* They are suitable to help people of small means.

Co-operative Banks in India / Types of Co-operative Banks in India

The co-operative banks are small-sized units which operate both in urban centres. They finance small borrowers in industrial and trade sectors besides professional and salary classes. Regulated by the Reserve Bank is India, they are governed by the Banking Regulations Act 1949 and banking laws (co-operative societies) act 1965. The co-operative banking structure in India is divided into following 5 categories:

1. Primary Agricultural Credit Society
2. Central Co-operative Banks
3. State Co-operative Banks
4. Land Development Banks
5. Urban Co-operative Banks.

1. **Primary Agricultural Credit Society (PACS) / Primary Agricultural Co-operative Banks (PACBs)**

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 co-operative banks. The borrowing powers of the members as well as of the society are fixed. The loans are given to members for the purchase of cattle, fodder, fertilizers, etc.

2. **Central Co-operative Banks (CCBs) / District central Co-operative Banks (DCCBs)**

These are the federations of primary credit societies in a district and are of two types-these 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 the State Co-operative banks and joint stocks. These banks provide finance to member societies within the limits of the borrowing capacity of societies. They also conduct all the business of a joint stock bank.

3. **State Co-operative Banks (SCBs)**

The state co-operative bank is a federation of central co-operative bank 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 the farmers.

4. **Land Development Banks (LDBs)**

The land development banks are organized in 3 tiers namely: state, central and primary level they meet the long term credit requirements of the farmers for developmental purposes. The state land development banks oversee, the primary land development banks situated in the districts and tehsil areas in the state. They are governed both by the state government and Reserve Bank of India. Recently, the supervision of land development banks has been assumed by National Bank for Agricultural and Rural Development (NABARD). The sources of funds for these banks are the debentures subscribed by both central and state government. These banks do not accept deposits from the general public.

5. **Urban Co-operative Banks (UCBs)**

The term Urban co-operative banks (UCBs) though not formally defined, refers to primary co-operative banks located in urban and semi-urban areas. These banks, till 1996, were allowed to lend money only for non-agricultural purposes. This distribution does not hold today. These banks were traditionally centered on communities, localities, work place groups. They essentially lend to small borrowers and business. Today, their scope of operations has widened considerably.

State Co-Operative Banks (SCBs)

The State Co-Operative Banks (SCBs) or State Co-operative Credit Banks (SCCBs) are formed by federating all district central co-operative banks in particular state. The SCBs is the apex bank of co-operative sector in the state. The SCB raise its funds by way of share capital, deposits form the public, surplus funds of the affiliated CCBs reserve funds, loans from the State Bank of India , other commercial banks, and inter-bank borrowings. They are also supported by the Reserve Bank. Anywhere between 50-90 percent of the working capital of the SCBs are contributed by the Reserve Bank.

Functions of SCBs

- SCBs act as a banking centre by balancing excesses and deficiencies in the resources of central co-operatives banks.
- In the absence of a district co-operative bank in a state, the SCB may give direct financial assistance to the primary credit societies.
- They have no power to supervise (or) control the activities of the affiliated DCCBs.
- A SCB serves as a leader of co-operative movement in a state.
- As a bank, a SCB is expected to mobilize and create deposits for the benefit of co-operative credit movement and provide the essential banking services.
- They furnish loans to the central so-operative banks in order to enable them to help in promoting the lending activities of the primary agricultural credit societies (PACS)

Limitations/Weakness of SCCBs

The following are the major defects of SCBs:

- ✓ SCBs mix-up commercial banking activities with Co-Operative Banking.
- ✓ They have insufficient share capital.
- ✓ They utilize their reserve funds as working capital.
- ✓ Some SCBs are not pure federations as they permit individual membership along with affiliation to the DCCBs.

District Central Co-operative Banks(DCCBs)

The District Central Co-Operative Banks (DCCBs) or Central Co-operative Banks (CCBs) are federations of primary credit societies belonging to a specific district. The District Central Co-Operative Banks are of ***Two Types***:

- **Pure DCCBs**
- **Mixed DCCBs**

A pure DCCB confines its membership to Co-Operative organizations only. It is called the ***'Banking Union'.***

A mixed DCCB keeps its membership open to Co-operatives as well as individuals. Mixed DCCBs are found in the states of Assam, Andra Pradesh, Tamil Nadu, Mysore and Others.

The DCCBs manage their funds from sources like share capital, deposits, loans from State Co-Operative Banks and other Commercial Banks.

Functions of DCCB

The major functions of the DCCB are:

- DCCBs finance the primary credit societies. By furnishing credit to the primary societies, DCCBs serve as an important link between these societies at the base level and the money market of the country.
- They accept deposits from the public.
- They grant credit to their customers on the security of first-class gilt edged securities, gold, etc.
- They provide remittance facilities.
- They act as '**balancing centers'** by shifting the excess funds of a '**surplus'** primary society to the **'deficit'** ones.
- They keep watch on their debtor primary societies' working and progress of recovery of loans.

Limitations/Weakness of DCCBs

The following are the major defects of the DCCBs:

1. DCCBs violate the principle of co-operation by working on the lines of commercial banks.
2. They do not appoint experts to examine the creditworthiness of the primary societies. Hence, there have been problems of recovery and over dues.
3. They combine financing and supervisory work together. As a result supervisory work has been a failure in many cases.
4. Some CCBs have been utilizing their reserve funds as working capital. This is not a very sound practice.
5. Mixed CCBs vitiate the very purpose of federation of the primary societies.
6. The CCBs charge very high interest rates to meet their high administration costs of small and uneconomic units
7. Many DCCBs are financially and organizationally weak.

Primary Agricultural Credit Societies (PACS) (or) Primary Agricultural Co-operative Bank (PACBs)

As per the NABARD Act 1981, a Primary Agricultural Credit Society, which number about 90,000 at present, constitute the foundation of the three-tier co-operative credit structure in the country. They operate at the village level, along with the Farmers Service Societies (FSS), and the Large-Sized Adivasi Multi Purpose Co-Operative Societies (LAMPS).

PACs means a co-operative society which provides financial accommodation to its members for agricultural operations (or) for the marketing of crops, (or) for rural development.

Functions of PACS

A PACS is expected to perform the following functions:

1. To associate itself with programmes of agricultural production.
2. To lend adequate credit to members for their agricultural and consumption purposes on the basis of their paying capacity.
3. To borrow adequate funds from the central financial agencies for helping the members adequately for the above purposes.
4. To attract local savings for share capital and fixed deposits.
5. To supervise use of loans and to see that they are paid in time.
6. To distribute fertilizers, seeds, agricultural inputs etc, either on its own behalf (or) as agent.
7. To supply certain customer goods in common demand such as sugar, Kerosene etc., for selling the same.
8. To collect (or) purchase produce, on behalf of other societies (or) government, and.
9. To associate itself with programmes of economic and social welfare for the village.

Limitations/ Weaknesses of PACS

The All India Rural Credit Review Committee summed up its observations on the performance of the primary credit societies as follows:

- The proportion of co-operative credit to the total borrowings of the cultivators appears to be small in most parts of the country.
- The quantity of co-operative credit to production needs has been inadequate.
- A large number of primary societies are not potentially viable.
- The co-operative credit institutions have not successfully demonstrated that they are in a position to deal with the problems arising form crop failures and ensuring adequate and timely credit for the borrowing farmers.

Regional Rural Banks (RRBs)

Introduction

Regional Rural Banks were set up following the recommendations of a Working Group Headed by M.Narasimhan, constituted by the Government of India in 1975. The objective of setting up these banks was to provide credit and other facilities mainly to the small and marginal farmers, agricultural labourers and artisans, who had, by and large not been adequately served by the existing credit institutions comprising commercial and co-operative banks. Thus, RRBs form the third component of the multi-agency credit system for agriculture.

The RRBs are generally base and rural oriented banks. Each RRB is sponsored by a commercial bank which provides assistance in several ways, viz., subscription to its share capital, provision of managerial and financial assistance, etc., Regional Rural Banks are also scheduled commercial banks. They are governed by Regional Rural Banks Act, 1976.

Distinguish Between RRBs and Commercial banks

Distinguished between RRBs Commercial Banks are explained below.

1. The area of regional banks is limited to a specified region comprising one or more districts of a state.
2. The regional rural banks are to grant loans and advances to small and marginal farmers, rural artisans and agricultural labourers and others of small means for productive purposes.

3. The lending rates of the RRBs would not be higher than the lending rates of co-operative societies in any particular state.

Role of RRBs

The regional rural banks have an important role to play in our rural economy as they have to act as alternative agencies to provide institutional credit in rural areas; in course of time, they are intended to eliminate money-lenders altogether. They have not been set up to the replace co-operative credit societies but to supplement them. The sponsorship by commercial banks is intended to provide them with funds, guidance and direction and managerial skill.

The sponsor bank's and responsibility in the development of RRBs are:

1. To subscribe to its share capital
2. To recruit and train the personnel for the RRB during its initial period, the RRB may also ask the sponsor bank to send its officers and other staff on deputation for specified periods.
3. To provide managerial and financial assistance as mutually agreed upon;
4. To provide genera counseling and support as their RRBs and oversee their activities so that they are in a position to achieve their corporate objectives.

Functions of RRBs

According to the Banking Commission, the rural banks should render the following functions:

- To accept deposits
- Granting of loans and advances to small and marginal farmers and agricultural labourers, whether individually (or) in groups, and to Co-Operative societies, agricultural processing societies, Co-Operative farming societies, primarily for agricultural purposes (or) for agricultural operations and other related purposes.
- To supply inputs and equipments to farmers.
- To provide assistance in the marketing of their products and
- To maintain godowns.

Above all, a rural bank has to help generally in the overall development of villages in the area. The Banking Commission held that rural banks should also extend credit and all other banking services besides members / shareholders to the general public in their areas by enrolling them as associate members.

Granting of loans and advances to artisans, small entrepreneurs and persons of small means engaged in trade, commerce and industry (or) other productive activities within its area of Co-Operation.

Problems of RRBs

According to Professor ***Charan Wadhva***, following are the major problems faced by the RRBs:

1. Lack of Co-ordination in Branch Expansion
2. Difficulties in Deposit Mobilization
3. Slow progress in lending activity
4. Urban-Orientation of Staff
5. Rigid Procedures

1. Lack of Co-ordination in Branch Expansion

In several cases, it could not be ensured that the branches of the RRBs are opened at centres where no commercial (or) Co-operative banking facilities were provided. It is mainly because of lack of Co-ordination among the RRBs.

2. Difficulties in Deposit Mobilization

On account of RRBs' restrictive lending policy which excludes richer sections of the Village Society, these potential depositors show least interest in depositing their money with these banks.

3. Slow progress in lending activity

The RRBs' pace of growth in loan business is slow. For this the following reasons may be given:

* There has been limited scope for direct lending by RRBs in their fields of operations.
* It is always difficult to identify the potential small borrowers.
* Most of the small borrowers do not like the bank formalities and prefer to borrow from the money lenders.
* The Differential Interest Rate (DIR) scheme also posed a special problem to the RRBs. While the RRBs charge 14% interest, the commercial banks charge only 4% under the DRI scheme in rural areas.

4. Urban-Orientation of Staff

An important practical difficulty experienced in their working by the RRBs is the Urban-orientation of their staff. There is no true local involvement of the bank staff in the villages where they serve.

5. Rigid Procedures

RRBs follow the procedures of the commercial banks in the matter of deposits and loans which are highly complicated and time consuming from the villages point of view. As a result they hesitate to approach the RRBs for any banking purpose.

National Bank For Agricultural and Rural Development (NABARD)

The Sivaraman Committee was set in March 1978, by the Reserve Bank of India at the instance of the Govt. of India to review arrangements for institutional credit for agricultural and rural development had, in its interim report submitted in November 1979, recommendation the establishment of a National Bank for Agricultural and Rural Development (NABARD). While examining and reviewing the activities of the Agricultural Refinance and Development Corporation (ARDC) and RBI in the background of the massive credit needs of rural development over the next decade, the committee felt that the present national level institutions has certain deficiencies affecting their capacity to meet the stupendous task of integrated rural development aimed at the uplift of the weaker sections in the rural area within a given time horizon.

The NABARD started functioning from 12 July, 1982 as the apex bank for agriculture and rural development. It was set up by merging the Agriculture Credit Department. It was set up by merging the Agriculture Credit Department and Rural Planning and Credit Cell of Reserve Bank of India and the entire undertaking of Agriculture Refinance and Development Corporation. It has taken over from the RBI, the overseeing of the entire rural credit system, including credit for rural artisans and village industries and the statutory inspection of co-operative banks and RRBs.

NABARD has a share capital of Rs. 100 crores contributed by the central government and the Reserve Bank on 50:50 basis. Other sources of funds are from the govt. of India, the World Bank and other agencies.

Objectives

The main objectives of the NABARD are as under:

1. The National Bank as apex organization in respect of all matters relating to policy, planning and operational aspects in the field of credit for promotion of agriculture, small-scale industries, cottage industries, handicrafts and other rural crafts and other allied economic activities in rural areas.
2. The Bank serves as a refinancing institution for institutional credit such as long-term, short-term for the promotion of activities in the rural area.
3. The Bank maintains organic links with the Reserve Bank and maintains a close link with it.

In this connection, the preamble to the NABARD act reads as under:

"An Act to establish a bank to be known as the National Bank for Agriculture and Rural Development for providing credit for the promotion of agriculture, small-scale industries, cottage and village industries, handicrafts and other rural crafts and other allied economic activities in rural areas with a view to promoting integrated rural development and securing property of rural areas and for matters connected therewith or incidental threats."

Functions of NABARD

The functions of NABARD can be divided into three categories:

1. Providing Credit Facilities
2. Regulatory Activities
3. Development Activities

These will discuss below in detail.

1. **Providing Credit Facilities**

(a) It provides by way of refinance to the banks all kinds of production and investment credit to agriculture, small-scale industries, artisans, cottage and village industries, handicrafts and other allied economic activities in an integrated manner.

(b) It extends short-term credits, repayable over a maximum period of 18 months, to the State Co-operative Banks (SCBs) and Regional Rural Banks (RRBs) and other Reserve Bank approved financial institutions for agricultural operations, marketing of crops, marketing and distribution of inputs required for form and rural development, bonafide commercial and trade transaction and production and marketing activities of artisans, small-scale industries, tiny and decentralized sector industrial units, village and cottage industries, handicrafts and other rural crafts. There is a provision to convert these short-term loans granted to SCBs and RRBs into medium-term loans for a maximum period of seven years under drought conditions.

(c) It provides medium-term loans for a minimum period of 18 months and a maximum of seven years to SCBs and RRBs.

(d) It provides long-term credit not exceeding 2 years, including the period of rescheduling to SCBs and RRBs.

(e) NABARD extends loans and advances to state governments for periods not exceeding 20 years to enable them to suitable directly or indirectly to the share capital of co-operation credit societies.

(f) It gives long-term loans directly to any institution approved by the Govt. of India.

(g) It contributions to the share capital or invest in securities of any institution concerned with agricultural and rural development.

2. **Regulatory Activities**

The Banking Regulation Act, 1949, empowers NABARD to undertake the inspection of RRBs and Co-operative Banks other than Primary Co-operative Banks. Applications from these banks for opening new branches will be submitted to the Reserve Bank through NABARD, which will forward them with its comments.

3. **Development Activities**

It formulates designs and aid, projects and programmes to suit the requirements of agricultures and rural development. Such projects will be aided from Research and Development Fund. It will also monitor and implement the various projects and evaluate implement the various projects and evaluate them for ensuring development of better project.

END OF THE V UNIT & SYLLABUS

All The Very Best For Ur Examination

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