

For XAT , CMAT , SNAP , MAT , IIFT Exam

BANKING IN INDIA

BANKING

- Banking sector acts as the backbone of modern business world. The banking system significantly contributes for the development of any country.
- The first bank of India was Bank of Hindustan (1770)

Nationalisation of Banks

- After Independence, the Government of India adopted planned economic development. The main objective of the economic planning aimed at social welfare. Before Independence commercial banks were in the private sector. These commercial banks failed in helping the Government to achieve social objectives of planning. Therefore, the government decided to nationalize 14 major commercial banks on 19 July 1969. In 1980, again the government took over another 6 commercial banks.

Objectives of Nationalisation

1. The main objective of nationalisation was to attain social welfare. Sectors such as agriculture, small and village industries were in need of funds for their expansion and further economic development.
2. Nationalisation of banks helped to curb private monopolies in order to ensure a smooth supply of credit to socially desirable sections
3. Banks created credit facilities mainly to the agriculture sector and its allied activities after nationalization.
4. Nationalisation of banks was required to reduce the regional imbalances where the banking facilities were not available

COMMERCIAL BANKS

- Commercial bank refers to a bank, or a division of a large bank, which more specifically deals with deposit and loan services provided to corporations or large/ middle-sized business - as opposed to individual members of the public/small business

Functions of Commercial Banks

- The functions of commercial banks are broadly classified into primary functions and secondary functions

Primary Functions

1. Accepting Deposits

- It implies that commercial banks are mainly dependent on public deposits.
- There are two types of deposits, which are discussed as follows
 - **Demand Deposits:** It refers to deposits that can be withdrawn by individuals without any prior notice to the bank. In other words, the owners of these deposits are allowed to withdraw money anytime by writing a withdrawal slip or a cheque at the bank counter or from ATM centers using debit card.
 - **Time Deposits:** It refers to deposits that are made for certain committed period of time. Banks pay higher interest on time deposits. These deposits can be withdrawn only after a specific time period by providing a written notice to the bank.

2. Advancing Loans

- It refers to granting loans to individuals and businesses. Commercial banks grant loans in the form of overdraft, cash credit, and discounting bills of exchange.

Secondary Functions

1. Agency Functions

- It implies that commercial banks act as agents of customers by performing various functions
 - **Collecting Cheques:** Banks collect cheques and bills of exchange on the behalf of their customers through clearing house facilities provided by the central bank.
 - **Collecting Income:** Commercial banks collect dividends, pension, salaries, rents, and interests on investments on behalf of their customers. A credit voucher is sent to customers for information when any income is collected by the bank.
 - **Paying Expenses:** Commercial banks make the payments of various obligations of customers, such as telephone bills, insurance premium, school fees, and rents. Similar to credit voucher, a debit voucher is sent to customers for information when expenses are paid by the bank.

2. Transferring Funds

- It refers to transferring of funds from one bank to another. Funds are transferred by means of draft, telephonic transfer, and electronic transfer.

3. Letter of Credit

- Commercial banks issue letters of credit to their customers to certify their creditworthiness.
 - **Underwriting Securities:** Commercial banks also undertake the task of underwriting securities. As public has full faith in the creditworthiness of banks, public do not hesitate in buying the securities underwritten by banks.
 - **Electronic Banking:** It includes services, such as debit cards, credit cards, and Internet banking.

3. General Utility Functions

- It implies that commercial banks provide some utility services to customers by performing various functions.
 - **Dealing in Foreign Exchange:** Commercial banks help in providing foreign exchange to businessmen dealing in exports and imports. However, commercial banks need to take the permission of the Central Bank for dealing in foreign exchange.
 - **Providing Locker Facilities:** Commercial banks provide locker facilities to its customers for safe custody of jewellery, shares, debentures, and other valuable items. This minimizes the risk of loss due to theft at homes. Banks are not responsible for the items in the lockers.

Other Functions

1. Money Supply

- It refers to one of the important functions of commercial banks that help in increasing money supply

2. Credit Creation

- Credit Creation means the multiplication of loans and advances. Commercial banks receive deposits from the public and use these deposits to give loans. However, loans offered are many times more than the deposits received by banks. This function of banks is known as 'Credit Creation'.

REGIONAL RURAL BANKS

- The Regional Rural Banks (RRBs) were first set up on 2 October, 1975 (only 5 in numbers)
- RRBs were established based on the recommendations of Narsimham Committee working group
- RRBs were set up as regional based rural lending institutions under the Regional Rural Banks Act, 1976.
- The Government of India, the concerned state government and the sponsoring nationalised bank contribute the share capital of the RRBs in the proportion of 50 per cent, 15 per cent and 35 per cent, respectively. The area of operation of the RRB is limited to notified few districts in a state.
- First RRB: Prathama Grameen Bank
- As per guidelines of Reserve Bank of India (RBI), the RRBs have to provide 75 per cent of their total credit under Priority Sector Lending(PSL)
- The main objective of the RRBs is to provide credit and other facilities particularly to the small and marginal farmers, agricultural labourers, artisans and small entrepreneurs so as to develop agriculture, trade, commerce, industry and other productive activities in the rural areas.

SMALL & PAYMENT BANKS

- In 2014, the RBI issued the draft guidelines for setting up small banks and payment banks. The guidelines said that both are ‘niche’ or ‘differentiated’ banks with the common objective of furthering financial inclusion

Small finance banks

- Small finance banks are a type of niche banks in India. Banks with a small finance bank license can provide basic banking service of acceptance of deposits and lending. The aim behind these to provide financial inclusion to sections of the economy not being served by other banks, such as small business units, small and marginal farmers, micro and small industries and unorganized sector entities

Payments Banks

- The objective of payments banks is to increase financial inclusion by providing small savings accounts, payment/remittance services to migrant labour, low income households, small businesses, other unorganized sector entities and other users by enabling high volume-low value transactions in deposits and payments/remittance services in a secured technology-driven environment.
- Payments Banks can accept demand deposits (only current account and savings accounts). They would initially be restricted to holding a maximum balance of 1 lakhs per customer. Based on performance, the RBI could enhance this limit.
- The Payments Banks would be required to use the word ‘Payments’ in its name to differentiate it from other banks.
- No credit lending is allowed for Payments Banks.
- Payments Banks Formation - Nachiket Mor Committee

CO-OPERATIVE BANKS

- Banks in India can be broadly classified under two heads — commercial banks and co-operative banks. While commercial banks (nationalized banks, State Bank group, private sector banks, foreign banks and regional rural banks) account for an overwhelming share of the banking business, cooperative banks also play an important role.
- It can be divided into 2 broad segments i) Urban Cooperative Banks ii) Rural Cooperative Banks

Urban Cooperative Banks

- Urban Cooperative Banks are scheduled and non-scheduled.
- Banking activities of Urban Cooperative Banks are monitored by RBI. Registration and Management activities are managed by Registrar of Cooperative Societies (RCS). These RCS operate in single-state and Central RCS (CRCS) operate in multiple state.

Rural Cooperatives Banks

- Rural cooperative Banks are short-term and long-term structures.
- The short-term co-operative credit structure operates with a three-tier system
 1. State Cooperative Banks: Operate at the apex level in states
 2. District Central Cooperative Banks: Operate at the district levels
 3. Primary Agricultural Credit Societies: Operate at the village or grass-root level

MUDRA (Micro Units Development and Refinance Agency)

- Pradhan Mantri MUDRA Yojana (PMMY) is a scheme launched by the Hon'ble Prime Minister on April 8, 2015 for providing loans non-corporate, non-farm small/micro-enterprises.
- These loans are classified as MUDRA loans under PMMY. These loans are given by Commercial Banks, RRBs, Small Finance Banks, MFIs and NBFCs.
- The products designed under it are categorized into three buckets of finance named **Shishu** (loan up to ₹50,000), **Kishor** (₹50,000 to ₹5 lakh) and **Tarun** (₹5 lakh to ₹10 lakh).
- The scheme's objective is to refinance collateral-free loans given by the lenders to small borrowers
- Though the scheme covers the traders of fruits and vegetables, in general, it does not refinance the agriculture sector.

(Non-Banking Financial Companies) NBFCs

- A non-bank financial company (NBFC) is a financial institution that does not have a full banking license or is not supervised by the central bank.
- NBFCs can be broadly classified into two categories. Viz., (1) Stock Exchange; and (2) Other Financial institutions. Under the latter category comes Finance Companies, Finance Corporations, ChitFunds, Building Societies, Issue Houses, Investment Trusts and Unit Trusts and Insurance Companies.
- It is company under companies Act,1956
- It is engaged in the business of loans and advances, acquisition of bonds/debentures/securities issued by Government or local authority or other marketable securities, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods or providing any services and sale or purchase of immovable property
- It cannot have demand deposits like current and saving accounts

NABARD (A National Bank for Agriculture and Rural Development)

- NABARD was established on the recommendation of B.Sivaramman Committee on 12 July 1982
- NABARD set up in July 1982 by an Act of parliament to take over the functions of ARDC and the refinancing functions of RBI in relation to co-operative banks and RRBs
- NABARD is linked organically with the RBI by the latter contributing half of its share capital the other half being contributed by the Government of India.
- Deputy Governor of RBI is appointed as Chairman of NABARD.

Functions of NABARD

- NABARD acts as a refinancing institution for all kinds of production and investment credit to agriculture, small-scale industries, cottage and village industries, handicrafts and rural crafts and real artisans and other allied economic activities with a view to promoting integrated rural development.
- It provides short-term, medium-term and long-term credits to state co-operative Banks (SCBs), RRBs, LDBs and other financial institutions approved by RBI
- NABARD has the responsibility of coordinating the activities of Central and State Governments, the NITI Aayog and other all India and State level institutions entrusted with the development of small scale industries, village and cottage industries, rural crafts, industries in the tiny and decentralized sectors, etc.
- It has the responsibility to inspect RRBs and co-operative banks, other than primary co-operative societies.
- It maintains a Research and Development Fund to promote research in agriculture and rural development

Pradhan Mantri Jan-Dhan Yojana

- To achieve the objective of financial inclusion by extending financial services to the large hitherto unserved population of the country and to unlock its growth potential, the Pradhan Mantri Jan-Dhan Yojana (PMJDY) was launched on 28 August 2014.