INTRODUCTION TO BANKING

BA 1st YEAR

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FOREWORD

Since its establishment in 1976, Acharya Nagarjuna University has been forging ahead in the path of progress and dynamism, offering a variety of courses and research contributions. I am extremely happy that by gaining a B++ (80-85) grade from the NAAC in the year 2003, the Acharya Nagarjuna University is offering educational opportunities at the UG, PG levels apart from research degrees to students from over 285 affiliated colleges spread over the three districts of Guntur, Krishna and Prakasam.

The University has also started the Centre for Distance Education with the aim to bring higher education within reach of all. The centre will be a great help to those who cannot join in colleges, those who cannot afford the exorbitant fees as regular students, and even housewives desirous of pursuing higher studies. With the goal of bringing education to the doorstep of all such people, Acharya Nagarjuna University has started offering B.A., and B.Com courses at the Degree level and M.A., M.Com., M.Sc., M.B.A., and L.L.M., courses at the PG level from the academic year 2003-2004 onwards.

To facilitate easier understanding by students studying through the distance mode, these self-instruction materials have been prepared by eminent and experienced teachers. The lessons have been drafted with great care and expertise in the stipulated time by these teachers. Constructive ideas and scholarly suggestions are welcome from students and teachers involved respectively. Such ideas will be incorporated for the greater efficacy of this distance mode of education. For clarification of doubts and feedback, weekly classes and contact classes will be arranged at the UG and PG levels respectively.

It is my aim that students getting higher education through the centre for Distance Education should improve their qualification, have better employment opportunities and in turn facilitate the country's progress. It is my fond desire that in the years to come, the Centre for Distance Education will go from strength to strength in the form of new courses and by catering to larger number of people. My congratulations to all the Directors, Academic Coordinators, Editors and Lesson-writers of the Centre who have helped in these endeavours.

Prof. P. Rajasekhar
Vice-Chancellor
Acharya Nagarjuna University

CONTENT

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Lesson – 1

INTRODUCTION TO BANKING

1.0 OBJECTIVES

After going through this lesson student can know about:

- The Origin of Banking
- Characteristics and importance of banks
- Historical Evolution and development of banks

Structure

1.1 INTRODUCTION

The origin of banking is very old. The practice of banking was different in different ages. In the ancient Rome and Greece, the practice of storing precious metals and coins at safe places and loaning out money for public and private purposes on interest was prevalent. In India, money lending business prevailed and the same is found in the 'Manusmriti'. Chanakya in his book - Arthashastra written in about 300 B.C. has mentioned about the existence of powerful guilds of merchant bankers who received deposits, and advanced loans and issued hundis (letters of transfer).

The origin of banking lies in the business of money changing in ancient days. The emergence of banks in the early period was the need for borrowing by the monarchial governments from finance companies. In the middle ages, in Italy the first public enterprise bank called as the '**Bank of Venice'** which was established in 1157AD.

The origin of the word 'Bank' is derived from a Greek word 'banque' and Italian word 'Banca'. It referred to a bench for keeping, lending, and exchanging of money or coins in the market place by money lenders and money changers. Bench is a place where the money lenders and money charger used to display their coins and transact the business. Modern banking business was first started in 1349 in Barcelona. In 1407 Bank of Genoa was established and in 1609 Bank of Amsterdam was established. The Bank of England was established in 1694 on Italian lines to support the government with finance. Modern Joint-stock commercial Banks came into existence with the passage of Banking Act of 1833 in England. In India, modern banking system started when the English agency houses in Calcutta and Bombay began to serve as bankers to East India Company. The Hindustan bank was the first banking institution established in 1779 in India.

1.2 MEANING AND DEFINITION OF BANK

A bank is an institution which deals with money and credit. It accepts deposits and advances loans to those who need them, and helps in the remittance of money from one place to another. Bank is a financial institution where the customers can save their money and also borrow. Banks also invest money in order to build their reserves of money. Banks are regulated by laws, which differ from country to country.

The banking system constitutes the core of the financial sector. It plays a very vital role in the process of economic growth of the country. Its efficiency and development are significant for the country's economic progress. Banks play an important role in the organised sector of the Indian money market. They are the major source of institutional finance in the country. Modern Banks perform a variety of functions hence it is not easy to define bank and banking system. Different economists have viewed the concept of bank and banking in different way.

According to Cairn Cross "Bank is a financial intermediary institution which deals in loans and advances.

Indian Company Law 1936 defines Bank as "a banking company which receives deposits through current account or any other forms and allows withdrawal through cheques or promissory notes.

In the words of Kinley, "A bank is an establishment which makes to individuals such ad- vances of money as may be required and safely made, and to which individuals entrust money when not required by them for use".

In the views of P.A. Samuelson, "Bank provides service to its clients and in turn receives perquisites in different forms."

According to Crowther, a bank "collects money from those who have it to spare or who are saving it out of their incomes, and it lends this money to those who require it".

R.P. Kent viewed it as, "Bank is an institution which collects idle money temporarily from the public and lends to other people as per need.".

W. Hock defined bank as "Bank is such an institution which creates money by money only."

R.S.Sayers defines the term a bank as "an institution whose debts are widely accepted in settlement of other people's debts to eachother".

According to the Indian Banking Regulation Act, 1949, banking means "the accepting for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdraw able by cheque, draft or otherwise".

In short, the term bank refers to an institution which has the following features:

1 It deals with money; it accepts deposits and advances loans.
2 It is commercial institution, it aims at earningprofit.
3 It also deals with credit; it has the ability to create credit i.e., the ability to expand its liabilities as a multiple of its reserves.
4 It is unique financial institution that creates demand deposits which serve as a medium of ex- change and as a result, the banks manage the payment system of the

country.

1.3 CHARACTERISTICS OF A BANK

The main characteristic features of a bank are as follows:

1 Bank is a financial institution which deals with money given by depositors.

2 A bank may be a person, firm or a company.

3 A bank accepts money from the people in the form of deposits.

4 It gives safety to the deposits of its customers.

5 It also acts as a custodian of funds of its customers.

6 A bank lends out money in the form of loans to the needy.

7 A bank provides easy payment and withdrawal facility to its customers in the form of cheques and drafts.

8 A bank provides various banking facilities to its customers.

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

10 Bank acts as a connecting link between the borrowers and lenders of money.

1.4 IMPORTANCE OF BANKS

Bankers play very important role in the economic development of the nation. The growth of the economy depends on the development of banking system in the country. Though the banks don't create any new wealth still their process of collecting deposits and advancing loans helps in the process of production, distribution, exchange and consumption of wealth.

Importances of banks are as follows:

1. Banks mobilize small, scattered and idle savings of the people.
2. Banks make deposits available for productive purposes.
3. Banks provide convenient and economical means of transfer of funds
4. Banks promote savings by offering attractive interest rates.
5. Banks safe guard the savings of public.
6. Banks facilitate the movement of funds from unused regions to useful regions
7. Banks provide convenient and economical means of payments.
8. Banking connect saving and investment process
9. Banking help trade, commerce, industry and agriculture by meeting their financial

requirements

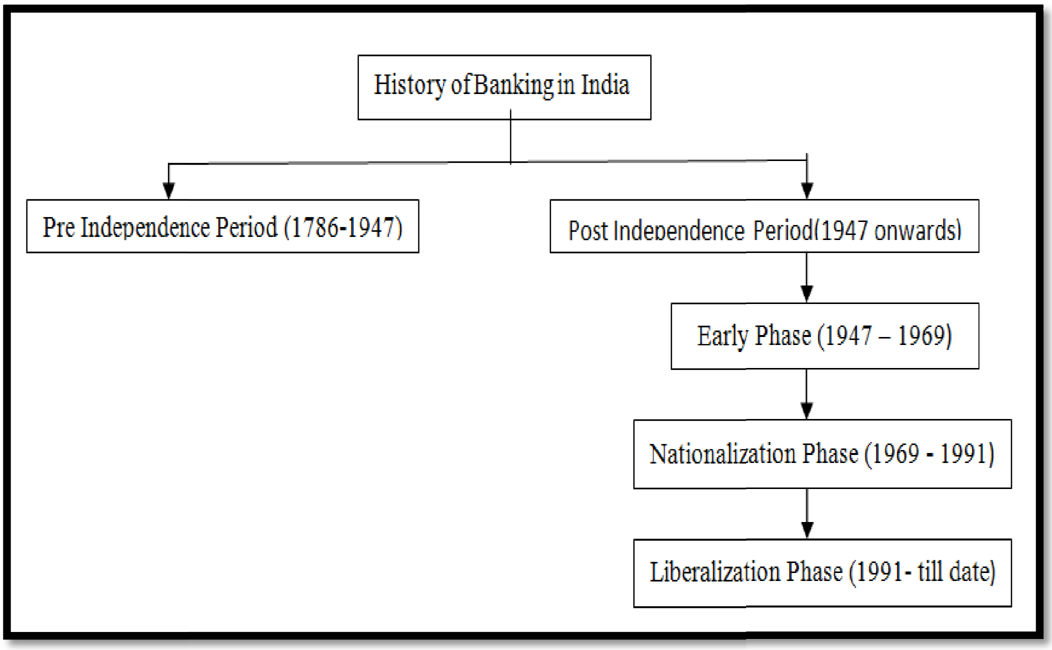
10. Through their control over the supply of money, Banks influence the economic activities, employment, income level and price level in the economy.

1.5 HISTORICAL EVOLUTION OF BANKS IN INDIA

Banking in India is very important as it forms the base for the economic development of the country. The history of banking in India dates back to the time of independence. The historical evolution and development of banking sector in India can be understood as pre-independent period and post independent period. The post independent period can be divided into three phases namely:

1. Early Phase
2. Nationalization Phase
3. Liberalization Phase

The Development of banking in India can be explained through the following flow chart:



The first bank in India was the **Bank of Hindustan** which was established in 1770 and was located in Calcutta. But due to many reasons like lack of machines and technology, human errors, fewer facilities, lack of proper management skills etc, many banks did not work successfully and they ceased to operate in 1832. In the first phase nearly 600 banks were registered in the country but only few could survive. Among the survived banks were – The General Bank of India, Oudh Commercial bank, Bank of Bengal, Bank of Bombay, Bank of Madras. The East India company established three banks: Bank of Bengal, Bank of Bombay, Bank of Madras and called them as the Presidential Banks. These banks later merged into one single bank in 1921 and that was called as the "Imperial Bank of India".

At the time of independence all the banks of the country were led privately and rural population was dependent on the money lenders for all the financial assistances. In order to solve this problem, the government has nationalized the banks. Banks were nationalized under the Banking Regulation Act, 1949 and Reserve Bank of India was nationalized in 1949. In the year 1969 the following banks 14 banks were nationalized:

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

Further in 1980, the following six banks were nationalized:

1. Andhra Bank
2. Corporation Bank
3. New Bank of India
4. Oriental Bank of Comm.
5. Punjab & Sind Bank
6. Vijaya Bank

Therefore the totally nationalized banks reach to 20. Apart from the above mentioned 20 banks, there were seven subsidiaries of SBI which were nationalized in 1959:

1. State Bank of Patiala
2. State Bank of Hyderabad
3. State Bank of Bikaner & Jaipur
4. State Bank of Mysore
5. State Bank of Travancore
6. State Bank of Saurashtra
7. State Bank of Indore

All these banks were later merged with the State Bank of India in 2017 except the Bank of Sauashtra, which was merged in 2008 and the State bank of Indore was merged in 2010. The recommendation of the Narasimham committee, Regional Rural Banks (RRBs) was formed on Oct 2, 1975. The main objective of RRBs was to serve the rural people and promote financial help. To meet the requirements of various sector like agriculture, housing, foreign trade, industry some apex banking were set up namely - NABARD (1982), EXIM (1982), NHB (1988) and SIDBI (1990).

In the third phase, RBI gave license to 10 private entities, out of which ICICI, HDFC, Axis Bank, IndusInd Bank, DCB survived. In 1998, the Narsimham committee recommended the entry of more private lenders. As a result, RBI gave a license to: Kotak Mahindra Bank (2001), Yes Bank (2004). In 2015, IDFC bank and Bandhan Bank emerged. To develop financial inclusion, RBI set up 2 new kinds of banks i.e. Payment Banks and Small Banks. In 2015, RBI gave in-principle license to 11 institutions to launch Payments Bank and granted 'in-principle' approval to the 10 applicants to set up Small Finance Banks.

1.6 DEVELOPMENT OF BANKING IN INDIA

Development of banking system is a pre-condition which is necessary for economic development of any country. The origin of modern banking in India was established in 1770, named the Hindustan Bank. But the bank ceased to operate by 1832.The real growth of modern commercial banking began in the country when the government was demanded to the need for banks in 1806 for the establishment of the first Presidency Bank, known as the Bank of Bengal in

Calcutta. Two other Presidency Banks were established as the Bank of Bombay in 1840 and the Bank of Madras in 1843. These banks enjoyed the monopoly of the government banking. They were also given the right of note issue in 1823, which was with- drawn in 1862. They were worked till 1920. In 1921 they were amalgamated into the Imperial Bank of India. Later it was nationalized in 1955 and known as State bank of India.

Since 1860 till the end of nineteenth century, a number of Indian Joint Stock Banks came into existence. For example, the Allahabad Bank was started in 1865 at Allahabad. In 1875 the Alliance Bank of Simla was started. In 1895, the Punjab National bank came into existence. Several Indian entrepreneurs entered into the modern banking business. During the boom period of 1906-13, many prominent banks came into existence. There were the Bank of India (1906), The Canara Bank (1906), The Bank of Baroda (1908) and the Central Bank of India (1911). The Indian Joint Sock Banks experienced several setbacks during 1913-17. Most of the banks in India were failed during 1913-1939. The reasons are low capital, in experienced management, no central bank in the country etc. With the growing many of them could not survive. The rate of establishment and failure are high until the Banking Regulation Act, 1949 was passed.

In the liberalization phase of economic policies a remarkable growth was found in the process of development of banks. Even after nationalization and the subsequent regulations that followed, a large portion of masses is untouched by the banking services. In 1991, the Narasimham committee gave its recommendation to allow the entry of private sector players into the banking system. Till then banking was in the hands of the government, but after the recommendations of Narasimham committee this sector was opened to the private institutions also.

Development of Banking in before nationalization

The services which are rendered by modern banks now were rendered by some individuals, agencies and communities in the Vedic period. References of full-fledged banking are found in Ramayana and Mahabharata which show that during those days banking was developed to a good extent in India. Banking business which was a side business during vedic period became a full time business during Ramayana and Mahabharata.

In the Smriti period, Vaishya Community has rendered the services of modern banking. It may, therefore, be said that Vaishayas are the fore-fathers of modern banking. The individuals or firms engaged in banking business were known as indigenous bankers. Thus, the growth of

Indian Banking Industry from that of the indigenous bankers to that of the setting of individual banks is seen during the period.

The growth of banking activities during 1939 - 1948 has seen tremendous changes in terms of their numbers, internal resources deposits, advances and investments. As per records Imperial Bank of India, there were 39 scheduled banks and 643 non-scheduled banks operating in India in the year 1939 while the corresponding numbers were found to be 77 and 541 in the year 1948. Scheduled banks recorded continuous growth during this period, but non-scheduled banks showed a declining trend till 1945. These changes are due to the policy decisions of RBI.

In the year, 1950, eleven banks went into voluntary liquidation while 4 scheduled banks in Bengal were amalgamated with United Bank of India Ltd., and 144 uneconomic offices (branches) of scheduled banks were closed. As such, the total offices of scheduled banks in India declined from 2,411 in 1949 to 2,355. The process of amalgamation and liquidation of uneconomic banks and their offices continued even during the planning period. During this period Reserve Bank of India was nationalized on 01st January, 1949 as the Central Bank of the country. Under the Reserve Bank of India Act, 1934 State Bank of India was established on 01st july, 1955, as the agent of the Reserve Bank of India, under section 45 of the Reserve Bank of India Act, 1934. As a result of continuous amalgamations and liquidations, there had been a continuous decline in the number of both scheduled and non-scheduled banks during 1951-69. Scheduled and non-scheduled banks operating in the country were found to be 57 and 14 only in the year 1969.

Development of Banks after nationalization:

Development of banking system in India during the last three decades has been phenomenal. All major development indicators posted two digit growth rates during this period. During March 2005, total Commercial Banks in India are increased. It includes State Bank of India and its subsidiaries 8, nationalized Banks, 19 Regional Rural Banks 196, Foreign Indian Banks 33, Private Indian Banks 30 (Old Private Sector banks 21 and New Private Sector Banks 9). Besides there are Co-operative banks and an Exim Bank.

A significant transformation of the Indian banking sector took place from 1969. More specialized banks like NABARD, SIDBI, National Housing Bank and RRBs appeared. Nationalized banks were directed to identify centers for branch expansion by selecting the hitherto unbanked areas. The Lead Bank scheme was introduced assigning the responsibility of developing banking activities in the district to each of the nationalized banks. District Credit Plans were prepared and implemented by the nationalized banks with the co-operation of non-nationalized banks and support given by the state government authorities.

However, the planners were not satisfied with the progress made by the commercial banks in extending credits. The government of India came out with programs to cater the needs of these some targeted groups. The Narasimham Committee recommended establishment of RRBs in selected regions to extend credit facilities to the targeted groups. On the basis of Regional Rural Banks Act, 1975, the RRBs started appearing on the scene in those areas where co-operative system was weak and commercial banks were not very active. RRBs helped in the overall development of the banking system in India. After nationalization, the banks are given importance to priority sector, which includes agriculture, small scale industries, small business people, transport operators, education and exports.

1.7 SUMMARY

The origin of the word ‘Bank’ is derived from a Greek word ‘banque’ and Italian word ‘Banca’. It referred to a bench for keeping, lending, and exchanging of money or coins in the market place by money lenders and money changers. Bench is a place where the money lenders and money charger used to display their coins and transact the business. A bank is an institution which deals with money and credit. It accepts deposits and advances loans to those who need them, and helps in the remittance of money from one place to another. Bank is a financial institution where the customers can save their money and also borrow. Banks also invest money in order to build their reserves of money. Bankers play very important role in the economic development of the nation. The growth of the economy depends on the development of banking system in the country. Banking in India is very important as it forms the base for the economic development of the country. The history of banking in India dates back to the time of independence. The historical evolution and development of banking sector in India can be understood as pre-independent period and post independent period. The post independent period can be divided into three phases namely: Early Phase, Nationalization Phase and Liberalization Phase.

1.8 TERMINOLOGY

Bank : A bank is an institution which deals with money and credit. It accepts deposits and advances loans to those who need them, and helps in the remittance of money from one place to another.

1.9 SELF ASSESSMENT QUESTIONS

Long Answers

1. Explain the historical development of banking in India.
2. What are the various phases of banking in India?

Short Answers

1. Define bank.
2. Explain history of banking in India.

1.10 REFERENCE BOOKS

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Lesson – 2

TYPES OF BANKING

2.0 OBJECTIVES

After going through this lesson student can know about:

- Types of banking
- Comparative study of types of banking

Structure

2.1 INTRODUCTION

Banks are the backbone for the growth and development of any country. They are the financial institutions that deal with the money and credit. They accept deposits and advance loans. It is a financial institution that links the flow of funds from savers to the users. Banks play vital role in the growth of economy of any country as they hold the saving of the public and help in advancing loans. They help in creating wealth by way of investments. Banks are one of the means to control the financial transactions and services in the country.

In the past few centuries many types of banks have developed all over the world. Each type of bank has unique features and specialization in a particular type of business. Each type of bank can be distinguished according to the functions they perform.

2.2 TYPES OF BANKING

The banking structure differs from country to country depending on the economic, social, political and financial conditions of that country. Banks can be classified basing on the business, volume and areas of operations. They are termed as a system of banking. The following are various systems of banking:

2.2.1 Branch Banking:

This is a Banking system of England, where each commercial bank has a network of branches spread throughout the country. Branch banking is the operation of storefront locations away from the institution's home office for the convenience of customers. Since the 1980s, branch banking in the U.S. has undergone significant changes. One such change is that since, banks were allowed to not only sell investments and insurance product but also banking services.

Under Branch Banking system, a big bank as a single institution and under single ownership operates through a network of branches spread all over the country. Initially, branch banking is developed in England. Later on, it became popular in other countries like Canada, Australia, India etc. There are many advantages of branch banking like :

1. They possess economies of large scale operations.
2. There will be lesser risk and greater capacity to meet the risk.
3. In time of need the resources can be transferred from one branch to another.
4. Diversification of deposits and assets is possible.
5. There are cheap remittance facilities.
6. Uniform interest rates

7. Proper use of capital
8. Effective control
9. Better facilities can be provided to the customers.
10. Banking facilities can be provided in backward areas also.

There are certain disadvantages also namely:

1. Difficulty in management.
2. Monopolistic tendencies
3. Lack of initiative decision taking
4. Ineffective branches
5. Regional imbalances
6. Adverse linkages

2.2.2 Unit Banking:

Unit banking origin and development is in the U.S.A. Unit banking refers to a single very small bank which provides financial services to the local. In this system, small independent banks are functioning in a limited area or in a single town. It has its own board of directors and stockholders. Unit banking is also known as "localized Banking". They operate without any connecting branches in the locality. All the unit banks are not independent. They may not share the name with a large banking entity. There are some banks that retain a similar and familiar name though they are not owned by any large company or institute. Under unit banking system, an individual bank operates through a single office. The size and area of operations of a Unit Bank are much smaller as compared to those of a bank under branch banking system. According to Shapiro, Solomon and whit, "An independent unit bank is a corporation that operates one office and that is not related to each other banks through either ownership or control". Unit banking system originated and grew in the U.S.A.

The advantages of unit banking are:

1. Unit banking is localized banking so there will be local development
2. It promotes regional balances
3. It is easy for management.
4. It has full knowledge about the local problems and so better help can be provided.
5. No inefficient branches

6. No diseconomies of large scale operations.

The disadvantages of unit banking are:

1. No distribution of risk
2. Lack of specialization
3. Disparity in interest rates
4. Local pressures
5. Undesirable competition
6. Costly remittance of funds
7. Banking is very poor in backward areas
8. In ability in facing crisis

2.2.3 Group Banking:

It refers to that type of banking where planning is offered to groups such as employees in a corporation of people. These plans not only provide incentives but also other benefits for the participation. It can also be understood as a system in which two or more independently incorporated banks are brought under the control of a holding company, which may or may not be a banking company. Under group banking, the individual banks may be unit banks, or banks operating branches or a combination of the two. Group banking refers to the system of banking in which two or more banks are directly controlled by a corporation, an association or a business trust. The holding company may or may not be a banking company. Although each bank maintains its separate entity, but its business is managed by the holding company. This type of banking system was popular in U.S.A. between 1925-1929.

Advantages of Group banking:

1. Each bank has its separate entity.
2. There is centralized administration.
3. There is greater liquidity and mobility of resources.
4. There is economy of advertisement expenditure.
5. Common standardized accounting system improves the working of the banks.
6. Superior credit facilities are given to the customers.

The Disadvantages are:

1. The control of member banks in the group is less direct and more flexible.
2. Effective supervision is not possible.

3. Efficiency of the member banks is adversely affected by the management of the holding company.
4. The failure of one bank has adverse effects on other member banks.
5. The common purchasing agencies often indulge in corrupt practices.

2.2.4 Chain banking

Chain banking is another form of group banking. It refers to the system in which two or more banks are brought under common control by a device other than the holding company. The common management may be by a single person or a group of persons through stock ownership or otherwise. This type of banking system was developed in U.S.A. towards the middle of 19^{th} century and remained popular till the Great Depression of 1929. The advantages and disadvantages of chain banking system are more or less similar to those of group banking.

2.2.5 Correspondent Banking:

The correspondent banking system is developed to remove the difficulties in the unit banking system. They provide services on behalf of another financial institution. A correspondent bank is a bank that provides services on behalf of another, equal or unequal, financial institution. It can facilitate wire transfers, conduct business transactions, accept deposits, and gather documents on behalf of another financial institution. Correspondent banks are most likely to be used by domestic banks to service transactions that either originate or are completed in foreign countries, acting as a domestic bank's agent abroad. Therefore, correspondent banks are intermediaries through which all unit banks are linked with bigger banks in financial centers. Through correspondent banking, a bank can carry out business transactions in another place where it does not have a branch. Under this system, the smaller banks are called respondent banks while the bigger banks are called Correspondent banks.

The main functions of correspondent banking are:

i. Transfer of funds from one place to another.
ii. Loan participation for their respondent banks.
iii. Clearing outstation cheques.
iv. Strengthening the financial resources of respondent

2.2.6 Deposit Banking:

In this type of banking, the banks act as a custodian or a trustee of the depositors. It has its origin in England. Banks in England were confined only to accepting deposits and lending for short periods to industries and trade. The main principle of this system is that banks cannot lock up their deposits in long-term investments as the deposits are repayable on demand. Banks were regarded as custodian as well as trustees to safeguard the deposits of the public. Hence, deposit banking system is free from supplying fixed capital requirements of industries in olden days.

2.2.7 Mixed Banking:

In mixed banking commercial banks perform dual function of commercial banking and investment banking. Commercial banks normally provide both short and medium term loans. Most banks in India play both roles. In other words mixed banking is a combination of deposit banking and Investment banking. German banking system is the best example of mixed banking system. There are many advantages of mixed banking system namely: banks help the industrial organizations by providing them loans and expert guidance. They further advice them in the matters of investment and help in rapid industrialization. The German banks are mixed type. The banking system in India is of pure type right from the beginning. In recent years, particularly after nationalization of major commercial banks, there has been a change in the investment pattern of the banks. They have started providing long-term industrial credit with a view to encourage industrialization in the country.

Advantages of mixed banking are:

1. Banks also benefited by acquiring a thorough knowledge of the working of the industrial system of the country.
2. The provision of long-term accommodation to industries enable the banks to invest their surplus resources for industrial development of the country.
3. The industrial units financed by the banks have the advantage of receiving their expert guidance on various financial issues.

Disadvantages of mixed banking are:

1. This system constitutes a serious threat for the existence of the banks.
2. It is not a desirable practice to lock up the bank resources in long-term

investments.

2.2.8 Investment Banking:

This refers to banks whose main function is to provide finance for investment to industrial concerns. They provide this by purchasing shares and debentures of newly floated companies. Investment banking involves advising organizations on mergers and acquisitions as well as on wide array of capital raising strategies. Major investment banks include Bank of America, Goldman Sachs, Morgan Stanley, JPMorgan Chase, Citigroup, Credit Suisse and Deutsche Bank. Some investment banks specialize in particular industry sectors. Many investment banks also have retail operations that serve small, individual customers.

2.2.9 Pure Banking:

Under pure Banking, commercial banks give only short-term loans to industry, trade, and commerce. They specialize only in short-term loans. This type of banking is popular in United Kingdom.

2.2.10 Relationship Banking:

Relationship banking may be defined as the efforts of a bank to promote personal contacts and to keep continuous touch with customers who are very valuable to the bank. The basic concept in this banking system is that it develops and builds a more comprehensive working relationship with every client, and recommends different services offered by the bank to help develop the financial well-being of the customer. This approach is mostly linked with smaller banks that use a more personal approach with customers. In order to retain such profitable accounts with the bank or to attract new accounts, it is necessary for the bank to serve their needs by maintaining a close relationship with such customers.

2.2.11 Narrow Banking:

A bank may be concentrating only on the collection of deposits and lend or invest the money within a particular region or certain chosen activity. This type of restricted minimum banking activity is referred to as ‘Narrow Banking’.

2.2.12 Universal Banking:

Universal Banking refers to broad-based and comprehensive banking activities.

2.2.13 Wholesale Banking:

Wholesale or corporate banking is concern with limited large-sized customers. In wholesale banking, the banks deal with large customers normally corporate customers and keep only large accounts.

2.2.14 Regional Banking:

Central Government set up Regional Banks, known as Regional Rural Banks all over India jointly with State Governments and some Commercial Banks to provide adequate and timely credits to small borrowers in rural and semi-urban areas.

2.2.15 Private Banking:

Private or Personal Banking is banking with rich individuals. It attends to the need of individual customers, their preferences and the products or services needed by them.

2.2.16 Retail Banking:

Retail banking is a major form of commercial banking and targeted to consumers.

2.3 SUMMARY

The banking structure differs from country to country depending on the economic, social, political and financial conditions of that country. Banks can be classified basing on the business, volume and areas of operations. They are termed as a system of banking. In the past few centuries many types of banks have developed all over the world. Each type of bank has unique features and specialization in a particular type of business. Each type of bank can be distinguished according to the functions they perform.

2.4 TERMINOLOGY

Branch Banking : Branch banking is the operation of storefront locations away from the institution's home office for the convenience of customers.

Unit Banking : Unit banking refers to a single very small bank which provides financial services to the local.

Group Banking : It refers to that type of banking where planning is offered to groups such as employees in a corporation of people.

Mixed Banking : In mixed banking commercial banks perform dual function of commercial banking and investment banking. Commercial banks normally provide both short and medium term loans.

Private Banking : Private or Personal Banking is banking with rich individuals.

Mixed banking : The system under which the Commercial banks meet both short term as well as long term loans to industries is mixed banking system.

Investment Banking : The system under which the banks provide capital requirements of industries in Investment Banking System.

Deposit Banking : The system under which receiving deposits and lending for short periods to industries and trade is Deposit Banking System.

Chain Banking : The system, where two or more banking companies are controlled by one or few individuals is chain banking system.

2.5 SELF ASSESSMENT QUESTIONS

Long Answers

1. Explain various types of banking.
2. Differentiate banking types based on their functions.

Short Answers

1. Explain Branch banking.
2. What is the difference between group banking and unit banking?
3. Explain the advantages and disadvantages of branch banking.

4. Explain the advantages and disadvantages of Unit banking
5. Define mixed banking.
6. Explain Relationship banking.

Very Short Answers

1. Private banking
2. Regional banking
3. Universal banking
4. Narrow banking
5. Group banking
6. Pure banking
7. Chain banking

2.6 REFERENCE BOOKS

1. Money and Banking : Robert e. Wright, NYU, 2012, Saylor foundation.
2. Indian Banking System : T. Avaswamy, Lavanya Publishing House Bombay, 1968
3. Practice and Law of Banking : Sheldon H.P
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Lesson Writer

Dr.M.Syamala

Lesson – 3

BANKING STRUCTURE IN INDIA

3.0 OBJECTIVES

After going through this lesson student can know about:

- Banking system in India
- Structure of banking system in India
- Central bank, commercial banks cooperative banks etc.

Structure

3.1 INTRODUCTION

Banks and banking system in India is divided into different groups. Each group has its own merits and limitations in operation process. Some banks are concentrated in the rural sectors and some in the urban. Many of them are in the cities and towns. The structure and composition of banking system differs from country to country. Nationalization was a vital structural change in the functioning of the commercial banks in the country. This resulted the origin of private sector banks and foreign banks in India. The banking system in India is quite different from that of other countries, which might be due to the country's unique socio-economic characteristics. This chapter mainly deals with the Banking system in India, its structure and composition. In the coming chapters a detailed study will be done on banking system in India. This chapter gives a bird's eye view.

3.2 STRUCTURE OF BANKING SYSTEM IN INDIA

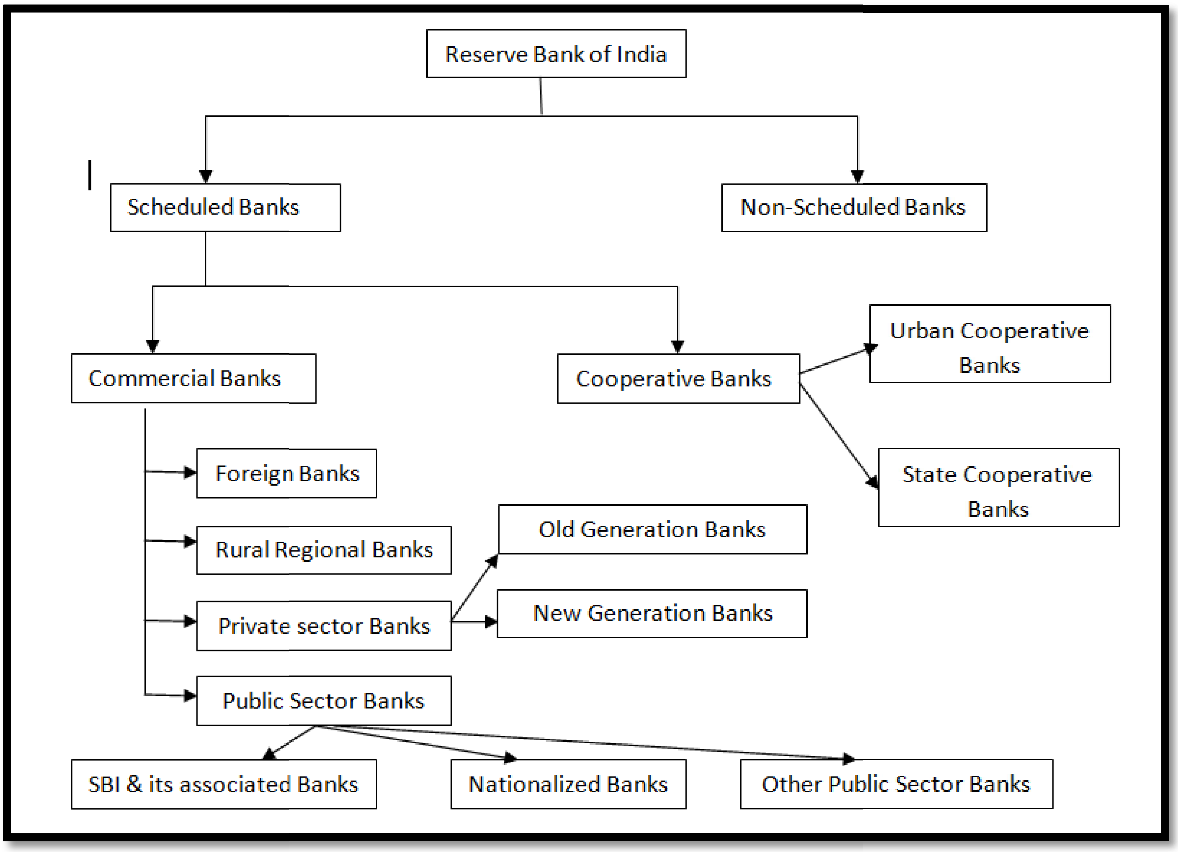
The banking structure in India is well organized and it is broadly divided into three categories namely –

1. Central bank i.e. Reserve Bank of India.
2. Commercial Banks
3. Co-operative banks.

The Indian banking system is totally regulated by Reserve Bank of India. Under the control of RBI, there are Scheduled Banks and non-Scheduled Banks. Schedule banks consist of commercial banks and cooperative banks. Scheduled commercial banks consist of foreign banks, regional banks, private and public sector banks. A public sector bank consists of SBI and its associated banks, nationalized banks.

Private sector banks consist of old and new generation banks. Scheduled cooperative banks consist of urban and state banks. Non- Schedule banks include the local area banks. This is the total structure of Indian Banking System. The same is depicted in the flow chart below.

Structure of Indian Banking System



3.2.1 Reserve Bank of India

Reserve bank of India which is the Central Bank of India was established in 1934 and started its operations from 1st April, 1935. RBI guides and regulates the banking system of our country. It has no relation with the general public. It acts as banker to banks, government, issues currency, regulates money circulation, keeps the deposits of commercial banks, and provides financial accommodation to them. As RBI guides the commercial banks it is known as bankers' bank. It maintains the government records relating to revenue and expenditure under various heads. It advises the government on monetary and credit policies and decides on the interest rates applicable to bank deposits and loans and advances. A detailed study of RBI's structure and functions will be dealt in another lesson.

The RBI acts as a regulator and supervisor of the overall financial system. This injects public confidence into the national financial system, protects interest rates, and provides positive banking alternatives to the public. RBI also acts as issuer of national currency. This provides with a supply of currency in the form of dependable notes and coins, a lingering issue in India. In 2018 the RBI banned the use of virtual currencies by the financial agencies and banks that it regulates. In the coming chapters a detailed study on RBI is done.

3.2.2 Scheduled banks

Scheduled banks are those banks which are included in the second Schedule of Reserve Bank of India Act 1934. For this inclusion, the banks have to comply with the criteria laid down vide Section 42(6) of the RBI Act. The paid up capital and collected fund of the bank should not be less than five lakh. In other words these banks have a paid- up capital and reserves of an aggregate value of not less than five lakhs. It is a State Cooperative Bank.

Scheduled banks are of two types:

1. **Scheduled Commercial Banks** – These banks accept deposits and lend short term loans and advances to the customers. They are the bedrock of the Indian financial system and account for three fourths of the financial markets in the country. Their branches are available all over

the country now. The branch networking of these banks is around one lakh now. The scheduled commercial banks are divided into three types. They are

a. Public sector banks
b. Private sector banks
c. Foreign banks
d. Regional rural banks.

2. **Scheduled cooperative banks** –These banks carry out the banking by following the principles of cooperation from the cooperative society under the Cooperative Societies Act. It is mandatory of these banks also to get RBI permission before starting the banking business. These banks follow the guidelines of RBI for their functioning and they function under the supervision of the Registrar and Cooperative Societies of the State. Their main customers are agriculturalists, small industrialists, retail and trade, self employed traders in rural and urban areas. RBI and NABRD have taken many reform measures to improve the financial position of the cooperative banks. Cooperative banks can be either scheduled or non-scheduled. The scheduled cooperative banks can be divided into two types. They are :

a. Urban Cooperative Banks
b. Rural Cooperative Banks

3.2.3 Non-Scheduled banks

They are the banks which are defined in the clause (c) of section 5 of Banking Regulation Act, 1949 (10 of 1949), they are not the scheduled banks. They function as local area banks. They have to follow the Cash Reserve Ratio condition but are not compelled to deposit these funds in RBI. Presently there are no non-schedule banks. Non-Scheduled banks are those which are not in the list of the second schedule of RBI ACT, 1934. Banks with a reserve capital of less than five lakhs are considered to be non-scheduled banks.

3.2.4 Commercial banks

Commercial Banks play a vital role in directing affairs of the economy in various ways. Commercial banks in India are the backbone of all major economic activities in the country. The operations of Commercial banks record the economic pulse of the country. The size and composition of their transactions depicts the economic growth of the country. Economist, David Ricardo stated that a bank is a dealer in money in a financial system. It is the banks who set the tempo of aggregate economic activity in any economy. Commercial banks are profit making financial institutions. They accept deposits from the general public and advance loans to the households, entrepreneurs, businessmen etc. The functions and operations of all the commercial banks are regulated by RBI. Commercial banks main income source is the difference between the rate of interest they give for deposits and charge for the loans. A detailed study regarding the commercial banks is in the coming chapter. Commercial banks in India are divided into the following:

a. Private sector banks – In these banks the majority of the stake is held by the private individuals. Eg. ICICI bank, IDBI bank, HDFC bank, etc.
b. Public sector banks - In these banks the majority of the stake is held by the government. Eg. SBI, Union Bank of India, Syndicate bank etc.
c. Foreign banks- The head office of these banks are located outside the country. Their origin and control is not in our country. Eg. Citi bank, Standard Chartered bank, etc.
d. Regional rural banks – They are the part of scheduled commercial banks operating at regional level. They have been established mainly to serve the rural areas of the country by providing basic banking and financial services.

The main functions of Commercial Banks are:

Primary functions

1. They accept deposits of all types.
2. Advance loans.
3. Provide overdraft facility.
4. Provide cash credit facility.
5. Discounting of bills.

Secondary functions

1. Agency functions
2. Credit creation

3. Providing lockers.
4. Providing drafts.
5. Providing utility functions.

3.2.5 Cooperative Banks

Regional Rural Banks or RRBs are government banks operating at regional level in different states of the country. They are designed to cater the needs of the rural area people. Presently, there are 43 RRBs in India and each RRB is sponsored by Government of India along with State Government and Sponsor bank. Regional Rural Banks (RRBs) were set up under the provisions of 26^{th} September, 1975 ordinance and the RRB Act of 1976 to allocate banking and credit services for agriculture and other rural sectors. They were established on the recommendation of Narshimham Working Group. The regional rural banks are owned by three entities namely – central government, with a share of 50 percent, state government with a share of 15 percent and sponsor bank with a share of 35 percent. Sponsored bank can be any commercial bank. The main aim of any RRBs is to mainly provide banking facilities to the rural and semi-urban areas.

3.3 SUMMARY

The banking structure in India is well organized and it is broadly divided into central bank, commercial banks and cooperative banks. The Indian banking system is totally regulated by Reserve Bank of India. Under the control of RBI, there are Scheduled Banks and non-Scheduled Banks. Schedule banks consist of commercial banks and cooperative banks. Scheduled commercial banks consist of foreign banks, regional banks, private and public sector banks. A public sector bank consists of SBI and its associated banks, nationalized banks. Private sector banks consist of old and new generation banks. Scheduled cooperative banks consist of urban and state banks. Non- Schedule banks include the local area banks.

3.4 TERMINOLOGY

Scheduled banks: They are those banks which are included in the second Schedule of Reserve Bank of India Act 1934. The paid up capital and collected fund of the bank should not be less than five lakh.

Scheduled Commercial Banks: These banks accept deposits and lend short term loans and advances to the customers.

Scheduled cooperative banks: These banks carry out the banking by following the principles of cooperation from the cooperative society under the Cooperative Societies Act.

Non-Scheduled banks: They are the banks which are defined in the clause (c) of section 5 of Banking Regulation Act, 1949 (10 of 1949), they are not the scheduled banks. They function as local area banks.

Private sector banks: In these banks the majority of the stake is held by the private individuals. Eg. ICICI bank, IDBI bank, HDFC bank, etc.

Public sector banks : In these banks the majority of the stake is held by the government. Eg. SBI, Union Bank of India, Syndicate bank etc.

Foreign banks : The head office of these banks are located outside the country. Their origin and control is not in our country. Eg. Citi bank, Standard Chartered bank, etc.

Regional rural banks: They are the part of scheduled commercial banks operating at regional level. They have been established mainly to serve the rural areas of the country by providing basic banking and financial services.

3.5 SELF ASSESSMENT QUESTIONS

Long Answers

1. Explain banking structure in India.
2. Explain about commercial banks and its functions.

Short Answers

1. What are scheduled and non-scheduled banks?
2. Explain the difference between private and public banks in India.
3. What are Regional Rural banks?

Very Short Answers

1. Foreign banks
2. Cooperative banks
3. Scheduled banks
4. Private banks

3.6 REFERENCE BOOKS

1. Money and Banking : Robert e. Wright, NYU, 2012, Saylor foundation.
2. Indian Banking System : T. Avaswamy, Lavanya Publishing House Bombay, 1968
3. Practice and Law of Banking : Sheldon H.P
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Lesson – 4

TYPES OF BANKING SYSTEM IN INDIA

4.0 OBJECTIVES

After going through this lesson student can know about:

- Banking system in India
- Types of banking system in India

Structure

4.1 INTRODUCTION

The structure of banking system in India that we studied in the previous chapter and the types of banking system in India that we are going to study in this chapter have some similarities. The banking system in India can be classified into various types basing on the organizational setup of the banks, ownership of the banks and functions performed by the banks.

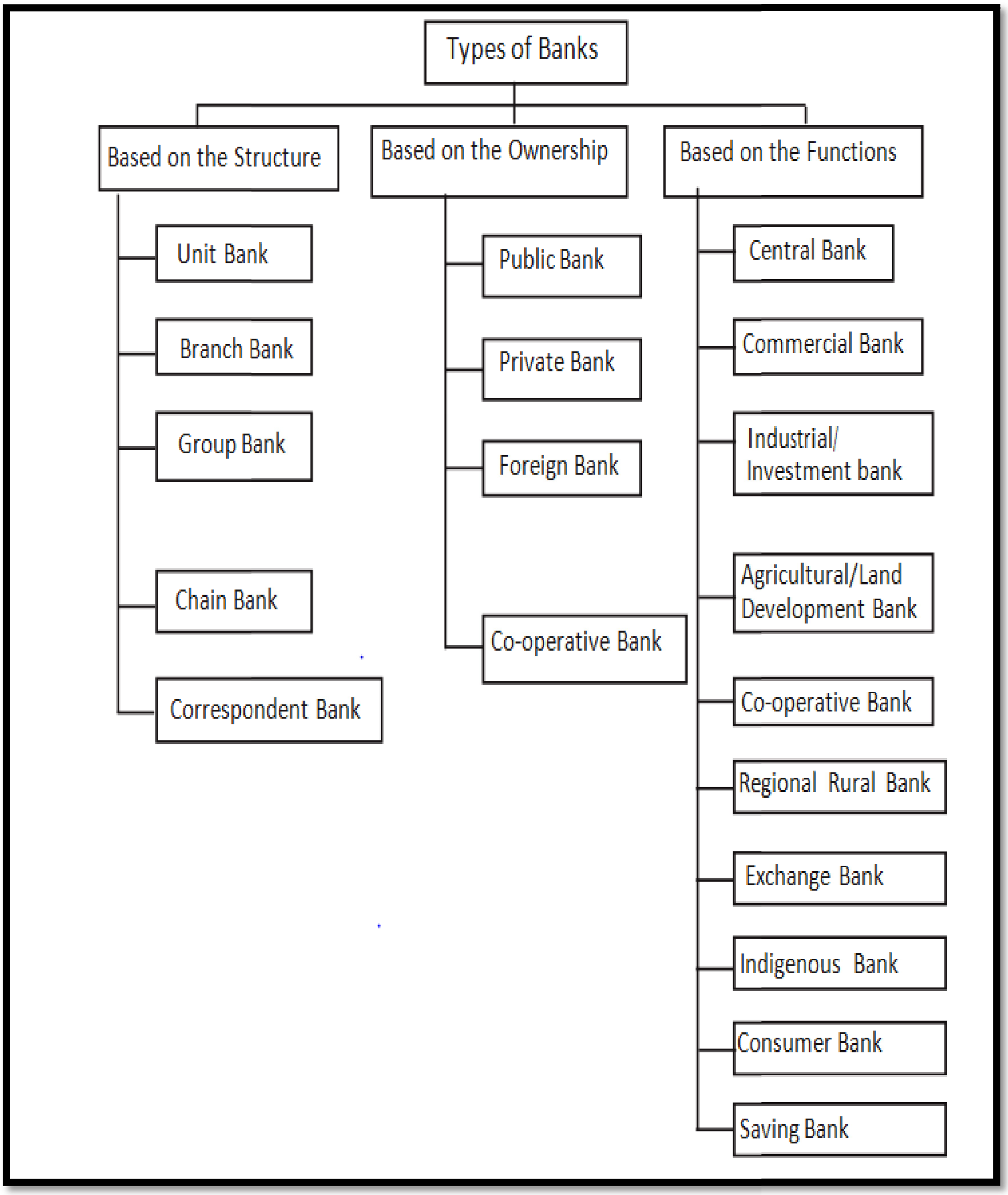
The factors which affected the classification of the banking system in any country are:

a. The regulatory set up in the country.
b. The impact of LPG (Liberalization, Globalization Privatization) process
c. The need for various financial services for the customers.

The banking system and its functions in India had undergone drastic changes in the recent past. In this chapter, we will learn about the classification of banks based on organizational set up, ownership and functions performed by banks. The classification of banking system and the structure of banks has already been explained in the previous chapters. In this chapter we would learn about the classification of banking system with reference to India.

4.2 TYPES OF BANKING SYSTEM IN INDIA

The following flow chart explains the various types of banks based on structure, ownership and functions.



The above figure shows the types of banks which we would discuss now in detail.

4.2.1 TYPES OF BANKS BASED ON STRUCTURE

Banks can be divided into the following based in the structure:

1. **Unit Bank -** It is type of bank in which the banking operations are carried out by a single branch with a single office. Their operations are extended to a limited area. Unit banks do not have any branch or it may have one or two branches. Unit banking system has its origin in United State of America. It has its own board of directors and stockholders. It is also called as "localized Banking".

2. **Branch Bank –** It refers to a banking system in which the banking operations are carried with the help of branch network and the branches are controlled by the Head Office of the bank through their zonal or regional offices. Each branch of a bank will be managed by a branch manager who is assisted by the officers, clerks and sub-staff. In England and India, this type of branch banking system is in practice. In India, State Bank of India (SBI) is the biggest public sector bank with a very wide network of 24000 branches in India and over 190 offices in 35 countries across the world.

3. **Group Bank –** It refers to that system of banking in which there will be holding company controlling the subsidiary companies which carry out banking business. Best example in India is SBI which has many subsidiary banks such as State Bank of Mysore, State Bank of Indore, State Bank of Hyderabad, State Bank of Bikaner and Jaipur, State Bank of Travancore, State Bank of Patiala, etc. These subsidiary banks also carry out banking and other operations such as leasing, merchant banking and so on.

4. **Chain Bank –** Chain Banking is a form of banking when a small group of individuals control three or more banks which are independently chartered. Individuals secure enough stocks to get the controlling interest in the banking corporations involved. The management can also be established via a board of directors that can effectively create a network and undertake

supervision of banking activities. Chain banking systems took shape in USA around 1925 when 33 chains were co-existing having ownership of 933 banks. An apt example in India is Karur Vysya Bank and Lakshmi Vilas Bank having their head offices at Karur and sharing common directors by which they may have common managementpolicy.

5. **Correspondent Bank –** Correspondent bank is a bank which link two banks of different stature or size. Many Indian banks act as correspondent banks for foreign banks. ICICI bank is a best example of such bank which is committed for making banking convenient for global India.

4.2.2 TYPES OF BANKS BASED ON OWNERSHIP

Banks can be divided into the following based on the Ownership:

1. **Public Sector Banks -** These are those banks in which majority of the shares are held by the government. These banks have more than 75% of the total banking business in the nation. They are called nationalized banks. The government holds the majority stakes at these banks. Post-merger, SBI is the largest public sector banks by volume. It also ranks amongst the top 50 banks in the world. There are 21 nationalized banks in India. Some examples of public sector banks in India include State Bank of India, Andhra Bank, Allahabad Bank, Union Bank of India, Punjab National Bank, Canara Bank, Corporation Bank, Indian Bank etc.

2. **Private Sector Banks** are those banks which are owned by group of private shareholders. They elect board of directors which manages the affairs of the banks. Private shareholders hold majority stakes in private sector banks. Reserve Bank of India lays down all the rules and regulations. Some examples of private banks in India include HDFC, ICICI bank, AXIS bank, DCB bank, IDFC bank, The Lakshmi Vilas Bank Ltd., The Karur Vysya Bank Ltd., The City Union Bank Ltd. Etc.

3. The share capital of the foreign banks will be fully contributed by the foreign investors. A bank operating as a private entity in India but headquartered in a foreign country is a foreign bank. They are governed by

both the country they are located in as well the country they have headquarters in. Some examples of foreign banks in Indian include CITI bank, Standard Chartered Bank, ABM Amro bank, JP Morgan Chase Bank etc.

4. **Cooperative Banks** - These banks run by following cooperative principles of service motive. Their main motive is not profit making but to help the weaker sections of the society. Run by the elected members of a managing committee and registered under the Cooperative Societies Act, 1912 are the cooperative banks. These are no-profit, no-loss banks and mainly serve entrepreneurs, industries, small businesses, and self-employment. Some examples of cooperative banks in India include Central Cooperative Banks, State Cooperative Banks.

4.2.3 TYPES OF BANKS BASED ON FUNCTIONS

Banks can be divided into the following based on the Functions:

1. **Central Bank –** It is banker to all the banks as they give financial accommodation to them. It is the key bank in any country. Every county has a central bank. The prime responsibility of a Central Bank is to regulate the banking system and control the monetary policy of the country. They act as banker to the government, issue currency notes, etc. They are non-profit making institutions. They maintain foreign exchange reserves of the country and government accounts with them. They help in money circulation in the economy and also provide financial assistance to the government. In India, Reserve Bank of India is the central bank.

2. **Commercial Banks -** These banks are established to help the public in trading and other business activities. They mobilize deposits from public and lend short-term loans in the form of overdrafts, cash credit, etc for their commercial activities. The commercial banks play a key role in promoting commercial activities in the country as the commercial activities are of paramount importance to economic development. Normally, commercial banks do not provide long term loans. They concentrate more on only providing short and medium term loans. Apart from lending, they also provide services like cheque collection, discounting bills of exchange, facilitating money transfer, etc. All the commercial banks have to

follow the regulations of Reserve bank of India. A detailed study on commercial banks will be dealt in the next chapter. Some examples of commercial banks in India are – State bank of India, Andhra bank, Union Bank, Syndicate bank etc.

3. **Industrial Banks / Investment Banks -** These banks provide long term loans to the industries for the purpose of expansion and modernization. They raise capital by issue of shares and debentures and provide long term loans to industries. These banks take the responsibility of development of backward areas. In India, examples for industrial banks are ICICI bank, IFCI, etc. Investment bank is a financial and banking organization, which provides both financial as well as advisory banking services. Besides this, they also deal with research, marketing and sales of financial products like commodities, currency, credit, equities etc. They contribute to the share capital. The industrial activities are promoted by these banks and they also mobilize long term deposits. In India, Bank of America, JP Morgan and BNP Paribas are some of the leading investment banks.

4. **Agricultural/Land Development Banks -** These are those banks which are known as Land Mortgage or Agricultural Banks. They provide finance to agricultural sector. They provide long term loans to agriculture. Loans are issued to purchase new land, heavy agricultural machinery like tractor, repayment of old debt, conservation of soil and reclamation of loans etc. In India, Government of India has guaranteed the debentures issued by agricultural/ land development banks. In India NABARD is the main bank which helps the farmers to a very large extent. These banks follow the principles of cooperative banks and help the weaker sections. Commercial banks do not take active part as they view agricultural financing as risky one and hence, Agricultural Development Banks play a key role in this activity and they help in the development of the country.

5. **Co-operative Banks-** Cooperative banks are those which are registered under the Cooperative Societies Act 1912. These banks collect share capital from the public and lend to economically weaker sections. They provide financial assistance to

farmers, salaried class, small scale industries, etc. They are mainly established in and around the rural and urban areas. Their functions are similar to that of commercial banks, but they charge less interest rate than the commercial banks for the loans and advances.

6. **Regional Rural Banks -** These banks are established in 1975 under the provision of the Ordinance promulgated on 26th September, 1975 and Regional Rural Banks Act, 1976 with a view to develop the rural economy. They aim to provide credit and other facilities for the development of agriculture, trade, commerce, industry and other productive activities in the rural areas. These banks provide loans particularly to small and marginal farmers, agricultural labourers, artisans and small entrepreneurs, and for matters connected therewith and incidental thereto. Each RRB operates within the specified local areas. Some examples of such banks in India are – Andhra Pradesh Grameena Vikas Bank, Allahabad UP Gramin Bank, Chaitanya Godavari Grameena Bank, Dena Gujarat Gramin Bank etc.

7. **Exchange Banks –** Exchange banks are also called as foreign exchange banks. They are the banks which performs the conversion of foreign exchange in local currency, while doing so the Banks earn some commissions for such conversion. They are incorporated outside the country but carry out business in India. They provide foreign exchange subject to the rules and regulations of the country in which they are operating. They also provide finance to exporters and letter of credit/guarantee to importers. They help in remitting of funds from one country to another country, discount foreign bills, buy and sell gold silver, promote foreign trade. Some examples of exchange bank are ANZ Grindlays Bank ltd., Bank of America, Bank of Ceylon, Bank of Baroda, Hong Kong Bank, etc.

8. **Indigenous Banks -** Indigenous bankers are private firms or individuals who operate as banks and as such both receive deposits and give loans. Like banks, they are also financial intermediaries. They should be distinguished h professional moneylenders whose primary business is not banking but money lending. They can be referred as money lenders and Sahukars. They use their own funds and

deposits mobilized from public. They also grant loans to the needy people. They are more popular in villages and small towns. They act as traders and bankers. They do not constitute a homogeneous category. Their functions are very much similar to the other banks. Some examples in India, are as Marwaries, Multani etc.

9. **Consumers Banks** – These banks operate only in advanced countries like USA and Germany. The primary objective of these banks is to provide loans to customers to purchase consumer durables like Car, TV, Washing Machine, Furniture, etc. The consumers repay the loans in easy installments. But now even in India most of the banks which provide loans to purchase such consumer goods.

10. **Saving Banks** – Saving banks are mainly established to encourage savings habit among the public. There are no separate banks called savings banks in India but postal department performs the functions of savings bank. In the postal department, public can save even a very small amount. Further, these banks discourage withdrawals by limiting the number of withdrawals during a year. The amount collected from the customers is invested in securities such as bonds, government securities, etc. The main objective of these banks is to promote thrift and savings among the public. Salaried people and low income groups prefer these banks to save their income. At present, in India all the commercial banks act as savings banks besides providing various other services.

4.3 SUMMARY

The banking system in India can be classified into various types basing on the organizational setup of the banks, ownership of the banks and functions performed by the banks. Types of banks in India are based on the structure, ownership and functions of the banks. On bases of the structure banks can be divided into unit, branch, group, chain and correspondent banks. Basing on the ownership they may be divided into public, private, foreign and cooperative banks. On basis of functions banks are central bank, commercial, industrial, agricultural, rural, exchange, indigenous, consumer and savings banks.

4.4 TERMINOLOGY

1 **Unit Bank -** It is type of bank in which the banking operations are carried out by a single branch with a single office.

2 **Branch Bank –** It refers to a banking system in which the banking operations are carried with the help of branch network and the branches are controlled by the Head Office of the bank through their zonal or regional offices.

3 **Group Bank –** It refers to that system of banking in which there will be holding company controlling the subsidiary companies which carry out banking business.

4 **Public Sector Banks -** These are those banks in which majority of the shares are held by the government. These banks have more than 75% of the total banking business in the nation. They are called nationalized banks.

5 **Foreign Banks -** These are those banks which belong to foreign countries and have their incorporated head office in foreign countries and branch offices in other countries.

6 **Commercial Banks -** These banks are established to help the public in trading and other business activities. They mobilize deposits from public and lend short-term loans in the form of overdrafts, cash credit, etc for their commercial activities.

7 **Agricultural/Land Development Banks -** These are those banks which are known as Land Mortgage or Agricultural Banks. They provide finance to agricultural sector. They provide long term loans to agriculture.

4.5 SELF ASSESSMENT QUESTIONS

Long Answers

1. Explain types of banking system in India.

Short Answers

1. What are the types of banks based on structure?
2. Classify various types of banks basing on ownership.
3. How many types of banks are there in India basing on its functions?

Very Short Answers

1. Chain banks
2. Correspondent banks
3. Commercial banks
4. Agricultural banks
5. Public banks
6. Industrial banks
7. Exchange banks

4.6 REFERENCE BOOKS

1. Money and Banking : Robert e. Wright, NYU, 2012, Saylor foundation.
2. Indian Banking System : T. Avaswamy, Lavanya Publishing House Bombay, 1968
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Lesson – 5

COMMERCIAL BANKS

5.0 OBJECTIVES

After going through this lesson student can know about:

- Historical development of commercial banks
- Classification, functions of commercial banks

Structure

5.1 INTRODUCTION

Commercial banks are very important for any country's financial system. They are the profit seeking institutions that accept deposits from the public and advance loans to the individuals, entrepreneurs, etc. The prime objective is to earning profits in the form of interest, commission etc. The operations of all the commercial banks are regulated by the Central Bank of the country. In India RBI is the central bank and the supreme financial authority. The major source of income for any commercial bank is the difference between the interest they charge for the borrowings and the interest they pay for the depositors. Economic development of any country depends on the development of agricultural, industrial and service sectors. The development of these sectors is possible only when there are huge investments. This would be possible only when the financial system of the country is strong. Hence, every country should have a strong financial system. Money market is the basis for an effective monetary policy. Money market mobilizes savings from different sources and makes them available for investment. It is the mechanism through which funds flow from surplus units to deficit units in the economy.

5.2 HISTORY OF COMMERCIAL BANKS

Commercial banking began in 1770 AD in India with the establishment of first Joint Stock Bank, the bank of Hindustan in Calcutta. But it was failed in 1832AD. Then the modern commercial banking made its real beginning in India with the setting up of the first Presidency Bank, the Bank of Bengal, in Calcutta in 1806. Later two other Presidency banks namely Bank of Bombay and Bank of Madras were set up in 1840AD and 1843AD respectively. Presidency Banks were set up in Bombay and Madras in 1840AD and 1843AD respectively. In those days these banks were partly finance by the East India Company and they were given the right of note issue in their own regions. This right was, however, taken over by the government in 1862. They were amalgamated into the Imperial Bank of India in 1921AD, which was nationalized into the State Bank of India in 1955AD.

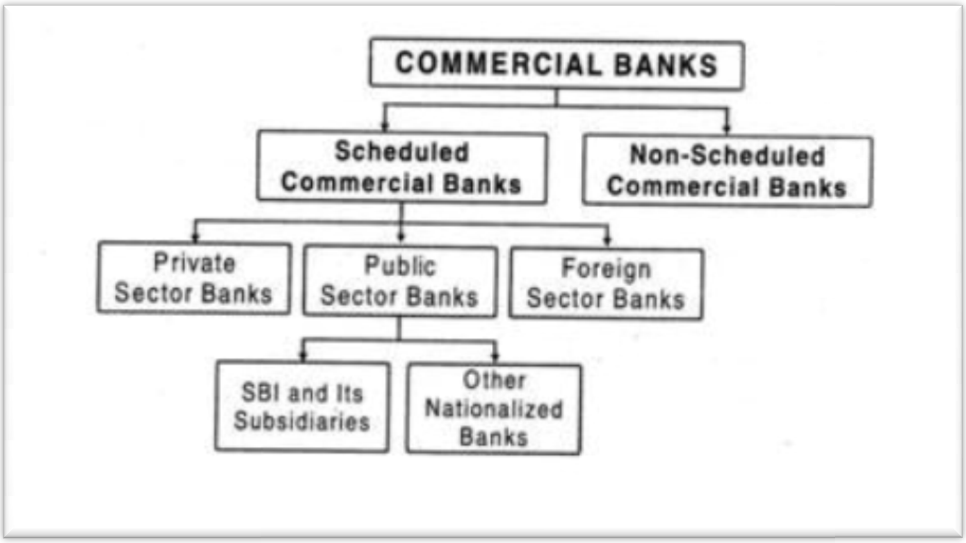
In 1881, the first indigenous bank, Oudh Commercial Bank was started. It was followed by setting up of Punjab National Bank in 1894AD and People's Bank in 1901AD. The Allahabad Bank and the Punjab National bank were established in 1865AD and 1894AD respectively. The Swadeshi movement in 1905 has encouraged and gave a good push to the growth of commercial banks in India. Large banks of to-day namely the Bank of India, the Central Bank of India, the Bank of Baroda, the Canara Bank, the Indian Bank, and the Bank of Mysore got established between 1906AD and 1913AD. During 1913-48AD, this was the period of banking crisis nearly 1100 banks failed. Though the Reserve Bank of India came into existence in 1935 still there was no change in the state of the commercial banks. Thus recurrent bank failure was the main hindrance for the growth of banking in India in this period. This situation prevailed all over the world. The birth and death rates of banks are high, until Banking Regulation Act, 1949 was passed. It weeded out a large number of unviable banking companies. RBI acquired a supervisory and development role. The small banks were the main victims of the bank failures. They rose like mushrooms in this period of high economic activity and ended immediately. Later in the period of World War – I some banks grew into large banks that exist today.

The major banking events of the inter-war period (1918-39), were the amalgamation of the three Presidency Banks into the Imperial Bank of India in 1921AD and the establishment of the Reserve Bank of India in 1935 as the central bank of the country. The establishment of the Imperial Bank of India, with its large network of branches all over India, strong capital base, and conservative management, according to the principles of commercial banking, lent stature and strength to commercial banking in India. The setting up of the RBI filled a big gap in India's banking structure and met one of the necessary conditions for a healthy growth of banking in the country.The progress of banking during the Second World War and its immediate aftermath was again characterized by over-rapid expansion and large-scale failure of banks. When India became independent in 1947AD, it inherited an extremely weak banking structure, with around 640 banks of which only 96 were scheduled banks and the rest were the non-scheduled banks. The banking facilities were totally concentrated in metropolitan centers, cities, and port towns, with a very high proportion of total advances going to trade.

Another major development in the history of Indian banking was the establishment of State Bank of India in July, 1955AD, by nationalizing the Imperial Bank of India. The period of multidimensional expansion of the banking sector begins with the nationalization of the major banks in 1969AD. As a result of the financial sectors reforms in 1990s doors were opened up to private banks in 1993AD. Nine new sector banks were started. But with the merger, their number came down to eight. Some of the like ICICI and IDBI which have sponsored the bank have made efforts to become universal banks. With a view to provide credit in rural and semi-urban areas, Local area banks were permitted to be established. The related guidelines were announced by the RBI in 1997AD.

5.3 STRUCTURE OF COMMERCIAL BANKS

The structure of commercial banks is a part of the structure of banking system in India. The same is shown in the flow chart below and explained in details in the following pages.



Modern banks in India are Joint Stock Banks. They are registered under the Indian Companies Act. The Reserve Bank of India has classified these banks into two categories namely:

1) Scheduled Banks 2) Non-Scheduled Banks.

1. **Scheduled Banks**: These banks have been included in the Second Schedule of RBI Act 1934. The Reserve Bank of India Act, 1934, 42(b) (a) lays down the following conditions for a bank to a scheduled Bank:

i. The bank must have a paid up capital and reserve of not less than Rs.5 Lakhs.

ii. It must satisfy the RBI that its affairs are not being conducted in a manner detrimental to the interest of depositors.

iii. It must be a company as defined by the Companies Act, 1956 or Corporation established by an Act of Parliament. These conditions are fulfilled; it may direct the bank for inclusion in the second schedule of the RBI Act.

2. Non-scheduled Banks: Banks which are not included in the second schedule of RBI Act are non- scheduled banks. Presently there is no non-scheduled commercial bank in India.

Schedule Commercial banks are of the following types:

1. Public Banks – These banks are those banks in which the majority of stake is held by the government. . Eg. SBI, Union Bank of India, Syndicate bank etc.
2. Private Banks - In these banks the majority of the stake is held by the private individuals. Eg. ICICI bank, IDBI bank, HDFC bank, etc.
3. Foreign banks - The head office of these banks are located outside the country. Their origin and control is not in our country. Eg. Citi bank, Standard Chartered bank, etc.
4. Regional rural Banks - They are the part of scheduled commercial banks operating at regional level. They have been established mainly to serve the rural areas of the country by providing basic banking and financial services. The main aim of thee banks is to provide credit for the weaker sections of the society and help the agricultural labourers, marginal farmers and small enterprises. These banks normally work at the regional levels in different states of our country and they may also have some branches in some selected urban areas. The important functions of RRBs other than providing credit are:
   a. These banks provide both banking and financial services to the rural and semi-urban areas.
   b. These banks provide para-banking facilities like debit card, credit cards and locker facilities.

c. Government operations like disbursement of wages of MGNREGA workers, pensioners etc is also done by such banks.

By 31st March, 2001 there are 296 scheduled Commercial Banks in India. Of these 27 are public sectors banks, 196 are Regional Rural banks, 42 foreign banks and 31 are in Private sector. As per the para 2(b) of notification dated April 13, 2020 of RBI the following are the list of Commercial banks and its classification i.e., public sector banks, private banks and foreign banks as per the records of RBI is given below:

List of Scheduled Commercial Banks

PUBLIC SECTOR BANKS		PRIVATE BANKS	
1	State Bank of India	1	Axis Bank Ltd.
2	Bank of Baroda (Including Vijaya Bank and Dena Bank)	2	Catholic Syrian Bank Ltd.
3	Bank of India	3	City Union Bank Ltd.
4	Bank of Maharashtra	4	Development Credit Bank Ltd.
5	Canara Bank (Including Syndicate Bank)	5	Dhanlaxmi Bank Ltd.
6	Central Bank of India	6	Federal Bank Ltd.
7	Indian Bank (Including Allahabad Bank)	7	HDFC Bank Ltd.
8	Indian Overseas Bank	8	ICICI Bank Ltd.
9	Punjab National Bank (including Oriental Bank of Commerce and United Bank of India)	9	Indus Ind Bank Ltd.
10	Punjab & Sind Bank	10	Jammu & Kashmir Bank Ltd.
11	Union Bank of India (including Andhra Bank &Corporation Bank)	11	Karnataka Bank Ltd.
12	UCO Bank	12	Karur Vysya Bank Ltd.
		13	Kotak Mahindra Bank Ltd.
		14	Lakshmi Vilas Bank Ltd.
		15	Nainital Bank Ltd.
		16	Ratnakar Bank Ltd.
		17	South Indian Bank Ltd.
		18	Tamilnad Mercantile Bank Ltd.
		19	Yes Bank Ltd.
		20	Bandhan Bank
		21	IDFC Bank Ltd.
		22	IDBI Bank Ltd

FOREIGN BANKS			
1	The Royal Bank of Scotland N.V	23	Mizuho Corporate Bank Ltd.
2	Abu Dhabi Commercial Bank Ltd.	24	Oman International Bank
3	Antwerp Diamond Bank N.V	25	SocieteGenerale
4	Arab Bangladesh Bank Ltd.(AB Bank)	26	Sonali Bank
5	Bank International Indonesia	27	Standard Chartered Bank
6	Bank of America	28	State Bank of Mauritius
7	Bank of Bahrain & Kuwait B.S.C	29	JSC - VTB Bank
8	Bank of Ceylon	30	UBS AG
9	Bank of Nova Scotia	31	American Express Banking Corporation
10	Bank of Tokyo - Mitsubishi Ltd.	32	First Rand Bank Ltd.
11	Barclays Bank	33	Commonwealth Bank of Australia
12	BNP Paribas	34	United Overseas Bank Ltd.
13	China Trust Bank	35	Credit Suisse A.G
14	Shinhan Bank	36	Sberbank
15	Citibank N.A	37	Australia and New Zealand Banking Group Ltd.
16	Credit Agricole Corporate and Investment Bank	38	Rabobank International
17	Deutsche Bank	39	National Australia Bank
18	DBS Bank Ltd.	40	Woori Bank
19	Hongkong and Shanghai Banking Corpn. Ltd.	41	Industrial & Commercial Bank of China
20	J.P.Morgan Chase Bank N.A	42	Sumitomo Mitsui Banking Corporation
21	Krung Thai Bank	43	Westpac Banking Corporation
22	Mashreqbank	44	Doha Bank

5.4 FUNCTIONS OF THE COMMERCIAL BANKS

The functions of commercial banks are mainly of two types namely:

Primary functions: The primary function of any commercial bank in India is to accept the deposits and advance loans to its customers.

a. **Accepts deposit:** The banks accept the deposits in the form of saving deposits or current deposits or term deposits. People prefer to save with the commercial banks as there is safety, security and liquidity. The Scheduled commercial banks in India have fixed deposits worth ₹77.32 trillion as of 31st March, 2020. India's Total Deposits has increased from 1,866.257 USD billion for December, 2019 to 1,897.822 USD billion in March, 2020. Deposits can be of the following types:

i. **Demand deposits:** They are also known as current accounts. These are repayable on demand without any notice. Usually no interest is paid on them, because the bank cannot utilize short-term deposits. A little commission is charged for the services rendered. But sometimes small interest is paid to people who keep large balances.

ii. **Fixed Deposits or Time Deposits:** These deposits can be withdrawn only after the maturity of the period for which these deposits were made. Higher interest is paid on such deposits. The rate of interest for such deposits in India varies from 6 per cent to 10 per cent depending on the time period of the deposit.

iii. **Savings Bank Deposits:** These deposits stand midway between current and fixed accounts. These deposits are not as freely withdraw-able as current accounts. The rate of interest is less than that on the Fixed Deposits.

b. **Provides Loan and Advances:** The second major function of the commercial banks is to provide loans and advances to all types of people, especially businessmen, investors, against personal security, gold and silver and other assets. The commercial banks advances loans in the form of cash credits, overdrafts, discounting bills of exchange and call loans. After banking reforms, banks have started giving loans not only to the traditional businesses but also for vehicles, housing, consumer durables etc. Every bank aims for making profits. In this process, a bank retains a small number of deposits as a reserve and lends the remaining amount to the borrowers in demand loans, overdraft, cash credit, and short-run loans etc.

c. **Credit Creation:** Credit creation is one of the important functions of the commercial banks. They aim for profit making like any other financial institutions. For this they accept the deposits and advance loans by keeping small cash in reserve for the day – to – day transactions. When the bank advances loan, it would open an account in the name of the customer and allows him to withdraw the money by cheque instead of paying the customer cash. In this way it creates credit.

d. **Credit Cash:** When a customer is provided with credit or loan, they are not provided with liquid cash. First, a bank account is opened for the customer and then the money is transferred to the account. This process allows a bank to create money.

2. Secondary functions: The following are the secondary functions of the commercial banks:

a. **Discounting bills of exchange:** Bill of exchange is a written agreement acknowledging the amount of money to be paid against the goods purchased at a given point of time in future. The amount can also be cleared before the quoted time through a discounting method of a commercial bank.
b. **Overdraft Facility:** It is an advance given to certain customers by keeping the current account to overdraw up to the given limit.
c. **Helps in transferring the funds:** Commercial banks also help the customers to transfer their funds from one account to another account and from one place to another place. This can be done through cheques or Electronic Fund Transfer (EFT).
d. **Financing foreign trade:** Commercial banks finance foreign trade for its customers by accepting the foreign bill of exchange and they collect it from the foreign banks. These banks also transact other foreign exchange business and they also buy and sell the foreign currency. Banks also provide facilities like anywhere money, anytime banking and virtual banking etc.
e. **Purchasing and Selling of the Securities:** Commercial banks offer the facility of selling and buying the securities.
f. **Locker Facilities:** Bank provides lockers facility to the customers to keep their valuable belonging or documents safely. Banks charge a minimum of an annual fee for this service.
g. **Agency functions:** Commercial banks also act as agents for the customers to buy and sell the shares, securities on their behalf. On behalf of the customer the banks pay subscriptions to insurance premiums, mutual funds, tax returns, rent, water taxes, current bills, property tax etc. Further commercial banks may also act as a trustee and executor of the property and will of their customers.

5.5 GROWTH OF COMMERCIAL BANKS IN INDIA

The banking system in India is very much effective, efficient and disciplined. To be more specific the commercial banks are the back bone for the development in the country. They bring about a rapid growth in various sectors of the economy.

There has been constant development in the commercial banking system in India. This can be understood by:

1. **Branch Expansion**

Rapid economic development pre-supposes rapid expansion of commercial banks. There has been a rapid and dynamic expansion of bank branches after nationalization of banks. The

Lead Bank scheme has played an important role in this process. The branches of the scheduled commercial banks has steadily increased from 4151 to 8262 (during 1951-1969) during 18 years of pre-nationalization period and gone up from 8262 to 66,640 during (1969-2003). Further the branches have increased from 88203 to 166045 (during 2010 to 2017). Mr. M. Gopala Krishnan, a professional banker states that, "The single striking feature of the post-nationalization banking scene is the rapidity with which the branch net work has multiplied itself. The rate of branch expansion has been unparalleled anywhere else in the world".

COMMERCIAL BANKS

INDICATORS	**2020**	**2019**	**2018**
Scheduled Commercial banks	141	147	149
Offices in : rural	52098	50081	49578
Semi- Urban	41738	39063	38564
Urban	26933	25498	25410
Metropolitan	28135	27114	27061
TOTAL	148904	141756	140613

The above table shows the increase in the commercial banks in the rural, semi-urban, urban and metropolitan regions in the past three years. The number of scheduled commercial banks in the rural areas increased from 49578 in 2018 to 52098 in March 2020. In June 1969 in rural areas there were 1832 branches and they increased to 35,212 in 1991. But later it was declined to 20413 by 2002. In 1969 there were 3322 branches in small towns and it increased to 11281 in 1991 and 12664 in 2002. It is clearly understood that the branch expansion was increased in 1991 but later declined by 2002 but now again we find an increase. The expansion was better in towns and cities. The numbers of branches in metropolitan areas have increased from 27061 to 28135 during 2018 to 2020. Some banks have started mobile and satellite offices. Rapid expansion of branches of Commercial banks with the help of lead bank scheme has led to integration of rural and urban and as well as integration of organized and unorganized money market in India.

2. **Mobilization of Deposits** :

Since nationalization of banks, there has been a significant increase in the deposits of Commercial banks. Planned economic development, deficit financing and increase in currency issue have led to increase in bank deposits.

The aggregate saving deposits of public and private sector banks (PSBs) stood at Rs 39.72 lakh crore as on March 31, 2019, according to Reserve Bank of India (RBI) data published in Handbook of Statistics on Indian Economy 2018-19. On the other hand, foreign banks had a share of Rs 58,630 crore in terms of savings deposits in the same fiscal, the data showed.

The total savings deposits with commercial banks, including foreign ones, in 2018-19 stood at Rs 40.31 lakh crore, up from Rs 36.55 lakh crore in 2017-18.In general, there has been regular and continuous rise in bank deposits indicating clearly that banking habit is growing in India. During pre-nationalization period of 18 years, deposits of banks increased from Rs.908 crores in 1951 to Rs.4646 crores in 1969. During 18 years of post nationalization period, the deposits increased from Rs.4646 crores to Rs.1,07,345 crores in 1987.

There are various reasons for the increase of bank deposits in India especially after bank nationalization. They are-

1. Rapid branch expansion.
2. Increase in the amount of cash with the banking system.
3. The smaller ratio of cash reserves.
4. Favourable business conditions in the country.
5. High rate of interest on bank deposits.

3. Bank Credit :

After nationalization of banks there has been continuous expansion of bank credit in the country, which reflects the rapid expansion of industrial and agricultural output. The banks are also meeting the credit requirements of industry, trade and agriculture on a much larger scale than before.

The Bank credit refers to credit lending by various scheduled commercial banks to various sectors of the economy. The bank credit is categorized into food credit and non-food credit. The food credit indicates the lending made by banks to the Food Corporation of India mainly for procuring food grains. It is a small share of the total bank credit. The major portion of the bank credit is the non-food credit which comprises of credit to Agriculture, Industry, and Services sectors of the economy and also in the form of personal loans.

The data on bank credit is normally collected on monthly basis by the Reserve Bank of India. The data is sourced from 46 commercial banks, accounting for about 95% of the total non-food credit deployed by all scheduled commercial banks.

Since September 2016, credit to the industry has been contracting by 1.7%. Just as bank deposits have expanded, bank credit too has expanded tremendously year after year. In recent years, bank credit has picked up by around 20 to 21 percent per year. Following are the factors responsible for the growth of bank credit.

1. Large reduction is reserve requirements of banks.
2. Fall in rates of interest
3. Increased demand for credit from public sector undertaking
4. Large increase in export credit.
5. Release of impounded cash balances under Incremental Cash Reserve Ratio.

During April 2017 to July 2017, all scheduled commercial banks business advances and deposits has seen decline in both year-to-date (YTD) and year-on-year (YoY) basis.

BANK CREDIT GROWTH – 2006 to 2018

FY	YTD Growth (Apr-Jul)		YoY Growth (Jul)	
	Rs Bn	% Change	Rs Bn	% Change
FY18	-1527	-1.9%	4483	6.2%
FY17	-91	-0.1%	6126	9.2%
FY16	916	1.4%	5437	8.9%
FY15	1008	1.7%	6886	12.8%
FY14	1352	2.6%	6911	14.7%
FY13	926	2.0%	6931	17.3%
FY12	693	1.8%	6314	18.7%
FY11	1194	3.7%	5907	21.3%
FY10	807	3.0%	3662	15.2%
FY09	1297	5.7%	4933	25.8%
FY08	454	2.4%	3659	23.6%
FY07	1004	6.9%	3723	31.7%
FY06	754	6.9%	2922	33.1%

Source: RBI, SBI Research

Soumya Kanti Ghosh, Group Chief Economic Adviser, State Bank of India, said, "Decline in deposits growth is expected, as huge amounts of money that flowed into the banking system post demonetization is now mean reverting." In quarter ended June 30, 2017, credit saw growth of just 4.4% compared to growth of 7.3% a year ago same period.

Credit to agriculture sector was 7.5% in financial year 2018 as compared to 13.85 growths seen in 2017, while credit to service sector was at 4.7% versus 9.2% in 2017. Personal loans have also seen slowdown in 2018 by witnessing only 14.1% growth compared to 18.5% in 2017, housing loans was at 11.4% from 18.4% in 2017 and vehicle loans were at 9.7% from 20.7% growth in 2017. Credit to industry continued to remain a major problem with it reaching negative 1.1% in first quarter as against 0.6% growth recorded a year ago same period.

4. **Coverage of Rural Areas** :

Rural areas were starved of banking facilities. The main idea of nationalization is increasing the banking facilities in the rural areas. There had been a significant increase in rural branches since 1969. The percentage of bank branches in rural areas to total branches has risen from 22.4% (1832 branches) in 1969 to 58.4% (35212 branches) in 1991.

5. **Reduction of Regional Imbalances**:

Commercial banks undertook a program of massive expansion of bank branches in the rural, under-banked and unbanked areas, which aimed at ensuring balanced regional development of banking sector in the country. The licensing policy adopted by the commercial banks aim at achieving coverage of 15,000 populations per bank in rural and semi-urban areas of each development block. The policy also aims at providing a bank office within 10 kms each village.

5.6 SUMMARY

Commercial banks are very important for any country's financial system. They are the profit seeking institutions that accept deposits from the public and advance loans to the individuals, entrepreneurs, etc. The operations of all the commercial banks are regulated by the Central Bank of the country i.e. Reserve Bank of India. Commercial banking began in 1770 AD in India with the establishment of first Joint Stock Bank, the bank of Hindustan in Calcutta. But it was failed in 1832AD. In 1881AD, the first indigenous bank, Oudh Commercial Bank was started. It was followed by setting up of Punjab National Bank in 1894AD and People's Bank in 1901AD. The structure of commercial banks is a part of the structure of banking system in India. The Reserve Bank of India has classified these banks into two categories namely: Scheduled Banks Non-Scheduled Banks. The functions of commercial are very important; they are primary and secondary functions.

5.7 TERMINOLOGY

1. **Demand deposits:** They are also known as current accounts. These are repayable on demand without any notice.
2. **Fixed Deposits or Time Deposits:** These deposits can be withdrawn only after the maturity of the period for which these deposits were made. Higher interest is paid on such deposits.
3. **Savings Bank Deposits:** These deposits stand midway between current and fixed accounts. These deposits are not as freely withdraw-able as current accounts.
4. **Credit Creation:** Credit creation is one of the important functions of the commercial banks. They aim for profit making like any other financial institutions.
5. **Discounting bills of exchange:** Bill of exchange is a written agreement acknowledging the amount of money to be paid against the goods purchased at a given point of time in future. The amount can also be cleared before the quoted time through a discounting method of a commercial bank.
6. **Overdraft Facility:** It is an advance given to certain customers by keeping the current account to overdraw up to the given limit.
7. **Purchasing and Selling of the Securities:** Commercial banks offer the facility of selling and buying the securities.
8. **Locker Facilities:** Bank provides lockers facility to the customers to keep their valuable belonging or documents safely. Banks charge a minimum of an annual fee for this service.
9. **Agency functions:** Commercial banks also act as agents for the customers to buy and sell the shares, securities on their behalf. On behalf of the customer the banks pay subscriptions to insurance premiums, mutual funds, tax returns, rent, water taxes, current bills, property tax etc. Further commercial banks may also act as a trustee and executor of the property and will of their customers.

5.8 SELF ASSESSMENT QUESTIONS

Long Answers

1. Explain the functions of commercial banks in India.
2. Describe the growth and development of commercial banks.

Short Answers

1. Briefly explain the structure of commercial banks.
2. What are the primary functions of commercial banks?
3. Explain the historical evolution of commercial banks in India.

Very Short Answers

1. Scheduled commercial banks.
2. Private banks
3. Foreign banks
4. Secondary functions of commercial banks
5. Discounting bills of exchange
6. Agency functions

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Lesson – 6

COOPERATIVE BANKS

6.0 OBJECTIVES

After going through this lesson student can know about:

- Cooperative banks
- The evolution, structure, functions of cooperative bank
- Growth and development of cooperative banks.

Structure

6.1 INTRODUCTION

Cooperative banks in India are registered under the States Cooperative Societies Act. They are also regulated by RBI and government by the banking Regulations Act 1949, banking laws Act, 1955. Cooperative bank is a financial institute that belongs to its members, who may be the owners and customers of the banks. Urban cooperative banks are regulated and supervised by the State Registrars of the cooperative societies and for the single state cooperative banks the central registrar of cooperative societies take care. The banking related functions are regulated and supervised by the RBI under the provision of the Banking Regulation Act, 1949. These institutions are established on the cooperative basis and deal with ordinary banking business. Like other banks, the cooperative banks are founded by collecting funds through shares, accept deposits and grant loans.

6.2 FEATURES OF COOPERATIVE BANKS

Cooperative banks are organized and managed on the principal of cooperation, self help and mutual help. They function with the rule of "one member, one vote". They function on no profit, no loss basis. They do not pursue the aim of profit maximization.

The main features of a cooperative bank are:

1. The members of the cooperative bank are both customers and the owners of the bank.
2. These banks are owned and controlled by the members who elect a board of Directors democratically.
3. Members have equal rights.
4. Major part of the yearly profit is usually allocated to the constitute reserve and a part of the profit may be distributed to the cooperative members with legal and statutory limitations.
5. They play a vital role in the financial inclusion of unbanked rural masses.

There are many advantages and disadvantages of these banks. The main **advantages** are:

1. They provide cheap credit to the rural masses.
2. They provide effective credit facilities.
3. They encourage productive borrowing
4. They encourage saving and investment in the rural areas.
5. They help in introduction of good agricultural practices.
6. They provide credit for purchase of high quality seeds, chemicals, fertilizers etc.
7. They provide higher interest rate on deposits.

The main disadvantages are:

1. The primary credit societies are weak and are unable to meet the needs of the farmers.
2. Needs of small farmers and tenants are not met completely.
3. Over dues are alarmingly rising.
4. They are not in a position to issue timely adequate credits to the borrowers.
5. Most of the benefits from these banks have been taken by the big land owners.
6. They are losing their importance due to expansion of the Schedule Commercial Banks.

7. Long term credits are declining.
8. Political interference has added to the problems.
9. Regional disparities are noted.

6.2 EVOLUTION OF COOPERATIVE BANKS

The cooperative movement in India has started a century back, mainly to deal with the problems of the rural credit. The historical evolution of the Indian cooperative banking started with the passing of the Cooperative Societies Act in 1904. The main objective of this Act was to establish cooperative credit societies, to encourage thrift, self help and cooperation among the Agriculturists, rural artisans etc. At that time many cooperative credit societies were set up under this Act. During British rule, based on the recommendations of Sir Frederick Nicholson (1899) and Sir Edward Law (1901), the Co-operative Credit Societies Act was passed in 1904AD which led to the establishment of co-operative credit societies in rural and urban areas. The first urban co-operative credit society was registered in October 1904 at Kanjeepuram now in Tamil Nadu State. In October and December 1905 AD, Betegiri Co-operative Credit Society in Dharwar District and the Bangalore city co-operative credit society, both in Karnataka State were registered. The introduction of the Co-operative Credit Societies Act 1904, for providing credit to farmers marked the beginning of the institutionalization of co-operative Banking in India. The Cooperative Societies Act, 1912 recognized the need for establishing new organizations for supervision, auditing and supply of cooperative credit. These organizations were:

(a) A union, consisting of primary societies
(b) The central banks; and
(c) Provincial banks.

The Bombay Co-operative Societies Act, 1925 was formed for serving development of the state. Later Madras, Bihar and Bengal also passed their own Acts in 1932, 1935 and 1940 respectively. Since 1950s, the co-operatives in India have made remarkable progress in the various segments of Indian economy. During the last century, the co-operative movement has entered several sectors like credit, banking, production, processing, marketing, housing, warehousing, irrigation, transport, textiles and even industries. In fact, dairy and sugar co-operatives have made India a major nation in the world with regard to milk and sugar production. Today, India can claim to have the largest network of co-operatives in the world numbering more than half a million, with a membership of more than 200 million.

Though beginning was made in the direction of establishing cooperative societies and extending cooperative credit, but later the progress remained unsatisfactory in the pre-independence period. Even after being in operation for half a century, the cooperative credit formed only 3.1 per cent of the total rural credit in 1951-52. In the formative stage, Co-operative banks were urban co-operative societies run on community basis and their lending activities were restricted to meeting credit requirements of their members. The concept of Urban Co- operative Bank was first spelt out by Mehta Bhansali Committee in 1939 which defined on Urban Co-operative Bank. Provisions of Section 5 (CCV) of Banking Regulations Act, 1949 (as applicable to Co-operative Societies) defined an Urban Co-operative Bank as a Primary Co-operative Bank other than a Primary Co-operative Society was made applicable in 1966.

Now the there are 23 state cooperative banks in India. The list is given below.

List of Scheduled State Co-operative Banks

S. No.	Scheduled State Co-operative Banks
1	The Andhra Pradesh State Co-operative Bank Ltd.
2	The Bihar State Co-operative Bank Ltd.
3	The Chhatisgarh Rajya Sahakari Bank Maryadit
4	The Goa State Co-operative Bank Ltd.
5	Gujarat State Co-operative Bank Ltd.
6	The Haryana State Co-operative Apex Bank Ltd.
7	The Himachal Pradesh State Co-operative Bank Ltd.
8	The Karnataka State Co-operative Apex Bank Ltd.
9	The Kerala State Co-operative Bank Ltd.
10	The Madhya Pradesh Rajya Sahakari Bank Maryadit
11	The Maharashtra State Co-operative Bank Ltd.
12	The Odisha State Co-operative Bank Ltd.
13	The Puducherry State Co-operative Bank Ltd.
14	The Punjab State Co-operative Bank Ltd.
15	The Rajasthan State Co-operative Bank Ltd.
16	The Tamil Nadu State Apex Co-operative Bank Ltd.
17	The Telangana State Cooperative Apex Bank Ltd.
18	The Uttar Pradesh Co-operative Bank Ltd.

19	The Uttarakhand State Co-operative Bank Ltd.
20	The West Bengal State Co-operative Bank Ltd.
21	Tripura State Co-operative Bank Ltd.
22	The Delhi State Cooperative Bank Ltd.
23	The Meghalaya Co-operative Apex Bank Ltd.

6.3 STRUCTURE OF COOPERATIVE BANKS

In India we can find different types of cooperative credit institutions working. These cooperative banking institutions can be classified into two categories namely:

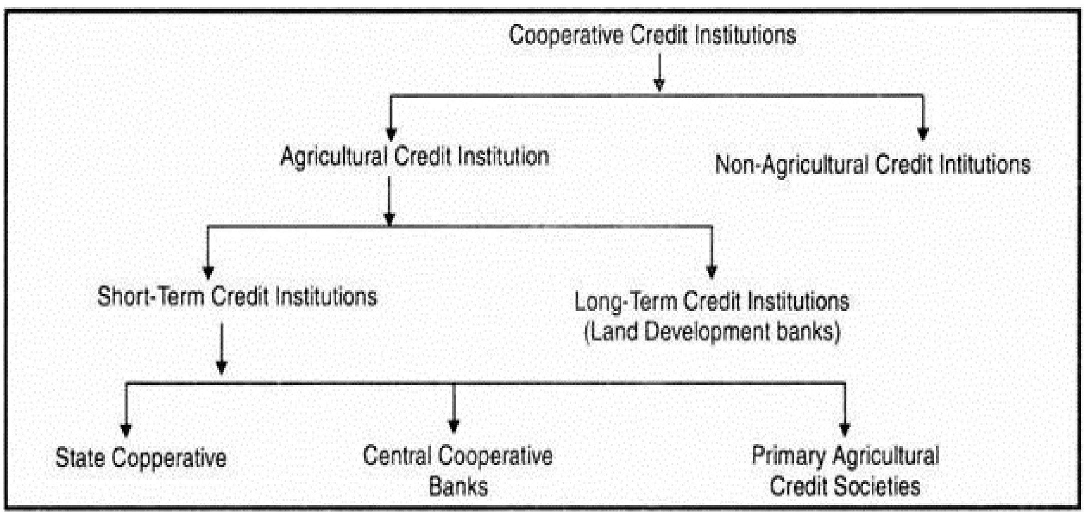
1. Agricultural
2. Non-agricultural

Agricultural credit institutions dominate the entire cooperative credit structure. They are further divided into short term agricultural credit institutions and the long term agricultural credit institutions.

The short term agricultural credit institutions cater to the short term credit needs of the agriculturalists. It has three tier federal structures:

i. At the apex level there is the State cooperative bank
ii. At the district level, there are central Cooperative banks and
iii. At the village level, there are primary agricultural credit societies.

The long term agricultural credit is provided by the land development banks. The cooperative credit structure is shown in the flow chart below.



6.3.1 Short term rural cooperative credit structure

In rural India, there is a 3-tier short-term rural cooperative structure namely:

1. State cooperative banks (SCBs) at the state level,
2. Central cooperative banks (CCBs) at the district level,
3. Primary agricultural credit societies (PACSs).

In 19 states, there are 3-tier short-term cooperative credit structure, consisting of SCBs, CCBs and PACSs. And in 12 states, there is 2-tier short-term cooperative structure. In the north-eastern states, we find 2-tier, i.e., only SCBs and PACSs.

6.3.1.1 State Cooperative banks

They play a vital role in the credit structure of the economy. The State Cooperative banks obtain their working capital from its own funds, deposits, borrowings and other sources. The main source of deposits is also the cooperative societies and central cooperative banks. The remaining deposits come from individuals, local bodies and others. Borrowings of the state cooperative banks are mainly from the Reserve Bank and the remaining from state governments and others. State cooperative banks are mainly interested in providing loans and advances to the cooperative societies. More than 98 per cent loans are granted to these societies of which about 75 per cent are for the short-period. Mostly the loans are given for agricultural purposes.

The number of state cooperative banks were 15 in 1950-51 and they rose to 21 in 1960-61 and then to 28 in 1991-92. In 2013 they were 31 SCBs. In 2012 the loans advanced by them was Rs. 75600 crores. Now in 2020 there are 33 state cooperative banks in India. The loans advanced by these banks increased from Rs. 42 crore in 1950-51 to Rs. 260 crore in 1960-61, and further to Rs. 7685 crore in 1991-92. In 2020 RBI has taken up the supervision of 1,482 urban cooperative banks and 58 multi-state cooperative banks. The powers of RBI are same on the scheduled banks and cooperative banks. The deposits of 8.6 crore depositors are with the cooperative banks amounts to Rs.4.8 lakh cores. NABARD has also disbursed huge amounts to these state cooperative banks to extend help to the rural farmers at the time of lockdown.

6.3.1.2 District Central Cooperative Banks

These are the banks in the middle of the three-tier cooperative credit structure. They are of two types namely: cooperative banking unions whose membership is open only to cooperative societies and mixed central cooperative banks whose membership is open to both individuals and cooperative societies. The main functions of the central cooperative banks are to provide loans to the primary cooperative societies. However, some loans are also given to individuals and others. The central cooperative banks raise their working capital from own funds, deposits, borrowings and other sources. Deposits largely come from individuals and cooperative societies. Some deposits are received from local bodies and others. Deposit mobilization by the central cooperative banks varies from state to state. They too have the problem of over dues.

The number of central cooperative banks in 1991-92 was 361 and the total amount of loans advanced by them in 1991-92 stood at Rs. 14226 crore. In 2013 they were 370 banks. The loans that they advanced in 2012 was Rs. 14400 crores. In 2019 the total number of central cooperative banks is 363 and the total amount of loans advanced was Rs. 1542 crores. About 98 per cent loans are received by the cooperative societies and about 75 per cent loans are short-term. Mostly the loans are given for agricultural purpose. About 80 per cent loans given to the cooperative societies are unsecure and the remaining loans are given against the securities such as merchandise, agricultural produce, immovable property, government and other securities etc.

6.3.1.3. Primary Agricultural Credit Societies

Primary agricultural credit society forms the base in the three-tier cooperative credit structure. It is a village-level institution which directly deals with the rural people. It encourages savings among the agriculturists, accepts deposits from them, gives loans to the needy borrowers and collects repayments. The members of the society have unlimited liability. The management of the society is under the control of an elected body. The working capital of the primary credit societies comes from their own funds, deposits, borrowings and other sources. Deposits are received from both members and non- members. Borrowings are mainly from central cooperative banks. The primary agricultural societies covering more than 96 per cent rural areas. The membership of these societies was 8.68 crore. During the past few decades, the Reserve Bank in collaboration with State governments, has been taking various measures to reorganize the viable primary credit societies and to amalgamate non-viable societies with large-sized multipurpose societies. The number of these credit societies in 2013 counted to 92432. In 2013 the loans they gave was Rs.91200 crores. The total number of Primary Agricultural Credit Societies in 2009-10 was 131 and it has increased to 226 in 2016. The loans and advances that they have issued to their members in 2009-10 were 4316.64 to 8075.92 in 2016.

6.3.1.4 Land Development Banks -

They are also known as Cooperative Agricultural and rural Development Banks. These banks take care of the agriculturists needs for both short term and long-term credit for their agricultural activities. Traditionally, the long-term requirements of agriculturists were mainly met by money lenders and some by other agencies. But this source of credit was found defective and has been responsible for the exploitation of farmers. Cooperative banks and commercial banks by their very nature are not in a position to provide long-term loans because their deposits are mainly short-term deposits. Due to the need for a long-term credit to agriculturists, the establishment of land development banks now known as cooperative and rural development banks came into existence.

These banks are two tier structures:

(a) At the state level, there are state or central land development banks, now known as state cooperative agricultural and rural development banks. They were previously known as central land mortgage banks.

(b) At the local level, there are branches of the state land development and primary land development banks now known as primary cooperative agricultural and rural development banks.

Land development banks raise their funds from share capital, reserves, deposits, loans and advances, and debentures. Debentures form the biggest source of finance. The debentures are issued by the state land development banks. They carry fixed interest, have maturity varying from 20 to 25 years, and are guaranteed by the state government. These debentures are subscribed by the co-operative banks, commercial banks, the State Bank of India and the Reserve Bank of India. In India, the first cooperative land mortgage bank was organized in Jhang in Punjab in 1920. But the effective beginning was made in Madras with the establishment of a central land development bank in 1929. Later on other states also established such institutions. The number of state cooperative agricultural and rural development banks which was 5 in 1950-51, rose to 20 in 2013. The number of primary cooperative agricultural and rural development banks was 697 in 2013.

The land development banks provide long-term loans to the agriculturists for the following reasons:

(a) For old debt redemption

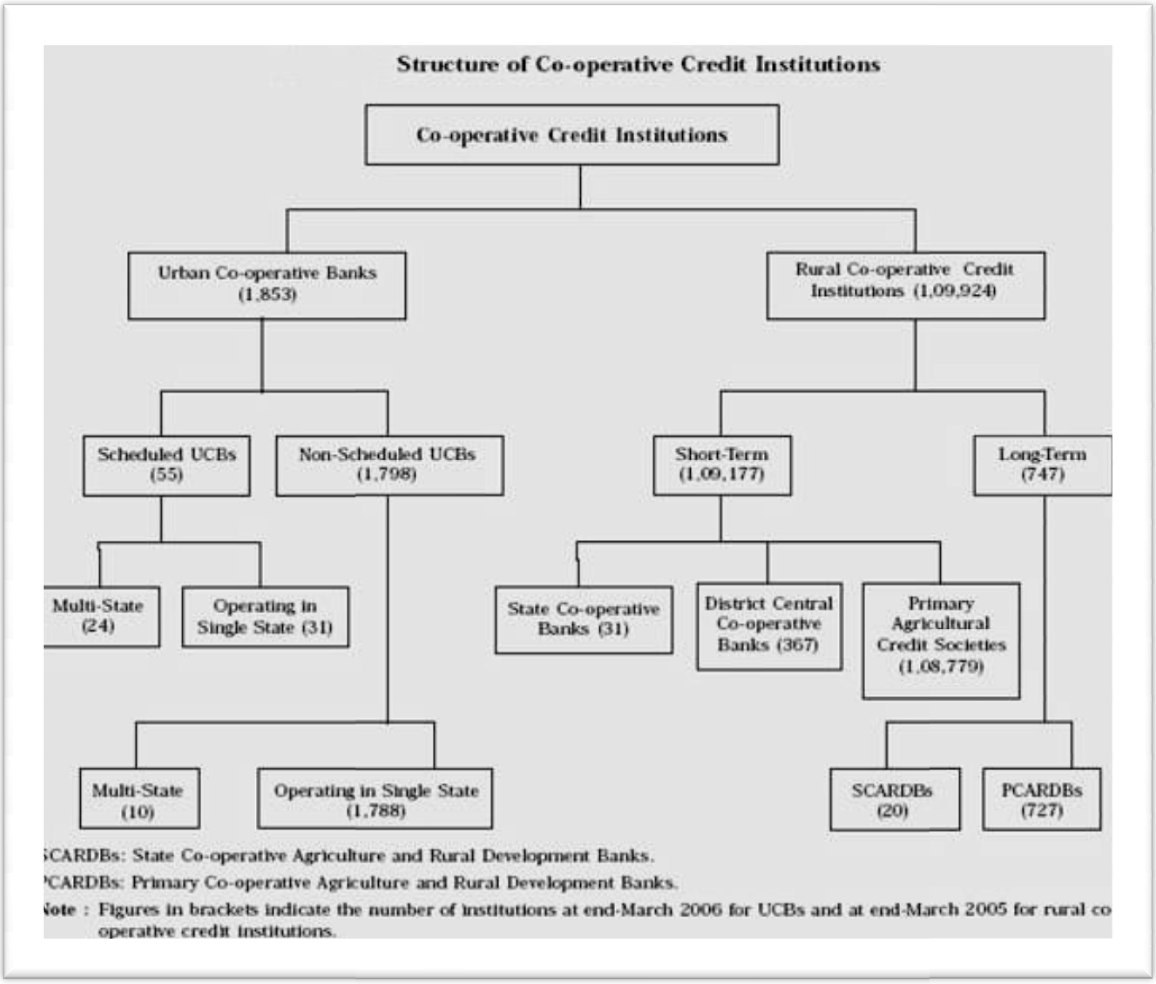
(b) For improvement methods of cultivation

(c) For purchasing machinery

(d) For purchasing land.

These banks have sanctioned loans to an amount of Rs.2520 crore in 1999 - 2000 and the amount of loans outstanding was Rs. 11670 crore. The amount of loans outstanding in 2012 was Rs. 19400 crore by SCARDBs and Rs.12000 crore by PCARDBs. NABARD provides long-term loans by way of reimbursement to State Governments under Section 27 of NABARD Act, 1981 for contributing to the share capital of cooperative credit institutions, viz. State Cooperative Banks (StCBs), District Central Cooperative Banks (DCCBs), Primary Agricultural Credit Societies (PACS)/Farmers Service Societies (FSS)/Large sized Adivasi Multipurpose Society (LAMPS), State Cooperative Agriculture and Rural Development Banks (SCARDBs) and Primary Cooperative Agriculture and Rural Development Banks (PCARDBs).

The structure of the cooperative credit institutions can also be explained with the help of the following flow chart.



Source: www.drishtiias.com

From the above figure it is very clear that the structure of the cooperative credit institution in India is mainly of two types:

1. **Urban Cooperative Banks** – Urban cooperative banks are not formally defined. They are the primary cooperative banks which are located in the urban and semi urban areas. These banks right from the formation day to till date have been mobilizing the savings from the middle and low income urban groups. The urban cooperative banks are again divided into schedule urban cooperative banks and non-scheduled urban cooperative banks. Further these are of two types – multi state and single state banks. These multi and single state banks are further categorized into two namely unit urban cooperative bank and non- unit urban cooperative bank.
2. **Rural Cooperative Credit Institutions** – They play a vital but silent role in the day-to-day lives of the rural population. They perform financial intermediation by

pooling the savings and diverting them by giving agricultural and farm allied credits to the people in the rural areas. These banks give short and long terms loans. The banks that concentrate in the short term loans are the –

a. State cooperative banks
b. District Central cooperative banks
c. Primary Agricultural credit societies

We have already discussed about them in this chapter. The long term loans are mainly issued by the Primary Cooperative Agricultural and Rural Developments Banks (PCARDBs) and State Cooperative Agriculture and Rural Development Banks (SCARDBs)

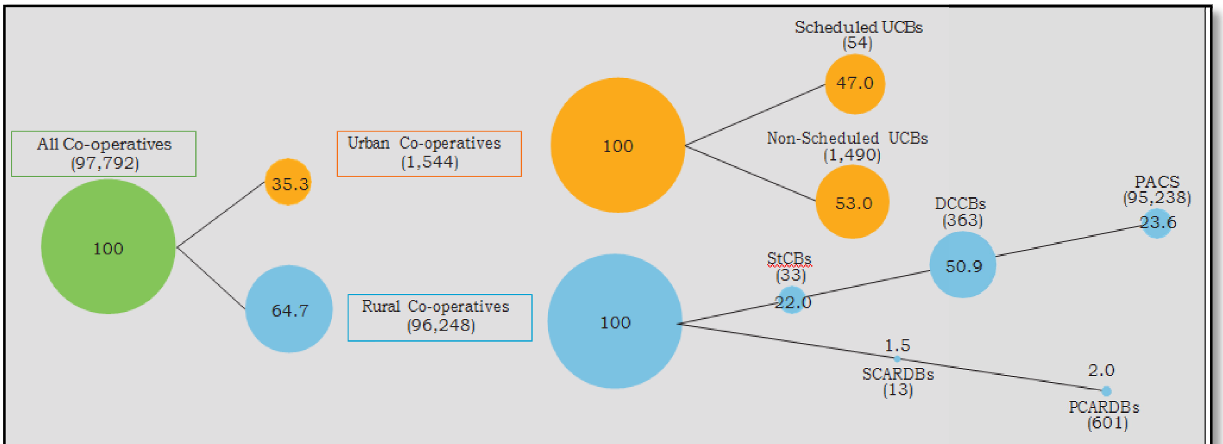
6.4 FUNCTIONS OF COOPERATIVE BANKS

The major functions of the cooperative banks are listed below:

1. They provide a link, through which the Reserve Bank of India provides credit to the cooperatives and thus participates in the rural finance,
2. They function as balancing centers for the central cooperative banks by making available the surplus funds of some central cooperative banks.
3. The central cooperative banks are not permitted to borrow or lend among themselves
4. They finance, control and supervise the central cooperative banks, and, through them, the primary credit societies.
5. They are involved in economic activities like production, processing, marketing, distribution, servicing and banking in India.
6. They supervise and guides affiliated societies.
7. They mobilize of funds from their members.
8. They issue rural finance for farming, cattle, milk, hatchery, personal finance, etc.
9. They also provide urban financing for Self – employment, Industries Small scale units, Home finance, Consumer finance, Personal finance
10. They function on the principle of cooperation and not entirely on commercial parameters.

6.5 GROWTH OF COOPERATIVE BANKS

Co-operative banks in India play a critical role in achieving developmental goals among which financial inclusion has crucial importance. These institutions are extending financial services across the length and breadth of the country. In 2019, credit co- operatives comprised 1,544 urban co-operative banks (UCBs) and 96,248 rural co-operative banks, with the latter accounting for 64.7 per cent of the total assets of co-operatives. This is shown in the figure below.



Notes: 1. Figures in per cent and bubble size is scaled to asset size.
2. StCBs: State Co-operative Banks; DCCBs: District Central Co-operative Banks; PACS: Primary Agricultural Credit Societies; SCARDBs: State Co-operative Agriculture and Rural Development Banks; PCARDBs: Primary Co-operative Agriculture and Rural Development Banks
3. Figures in parentheses indicate the number of institutions at end-March 2019 for UCBs and at end-March 2018 for rural co-operatives. Out of 54 scheduled UCBs- 34 are multi-state and 20 are single-state. Out of 1,490 non-scheduled UCBs – 24 are multi-state and 1,466 are single state.

UCBs and among the rural co-operatives, the State Co-operative Banks (StCBs) and the District Central Co-operative Banks (DCCBs) are registered either under the Co-operative Societies Act of the state concerned or under the Multi State Co-operative Societies Act, 2002. Banking laws were made applicable to co-operative societies since 01st March, 1966. Currently, there is duality of control over StCBs/DCCBs/UCBs between the Registrar of Cooperative Societies or the Central Registrar of Cooperative Societies and the Reserve Bank. The Reserve Bank is also entrusted with the responsibility of supervision of UCBs, entailing prescription of prudential norms for capital adequacy, income recognition, building of employees and assists in implementation of IT infrastructure in UCBs.

Primary Agricultural Credit Societies and long-term co-operatives are outside the purview of the Banking Regulation Act, 1949. The NABARD has been given power under Section 35 (6) of the Banking Regulation Act to conduct inspections of StCBs and DCCBs. The NABARD also conducts voluntary inspections of State Co-operative Agriculture and Rural Development Banks. At the end of March 2018, the combined assets of urban and rural co-operatives were 10.6 per cent of the total assets of scheduled commercial banks (SCBs), down from 19.4 per cent in 2004-05. Several operational and governance-based impediments have operated as drags on their performance, stunting their growth.

6.6 SUMMARY

Cooperative banks in India are registered under the States Cooperative Societies Act. They are also regulated by RBI and government by the banking Regulations Act 1949, banking laws Act, 1955. Cooperative bank is a financial institute that belongs to its members, who may be the owners and customers of the banks. The features of the cooperative banks are similar to that of any other banks. The cooperative banks started in India with a idea to solve the problems of the rural credit. The structure of cooperative banks is divided into agricultural credit institutions and non-agricultural credit institutions. There are also state cooperative banks, district central cooperative banks. Co-operative banks in India play a critical role in achieving developmental goals among which financial inclusion has crucial importance. These institutions are extending financial services across the length and breadth of the country.

6.7 TERMINOLOGY

State Cooperative bank: The State Cooperative banks obtain their working capital from its own funds, deposits, borrowings and other sources. The main source of deposits is also the cooperative societies and central cooperative banks.

District Central Cooperative Banks: These are the banks in the middle of the three-tier cooperative credit structure. They are of two types namely: cooperative banking unions whose membership is open only to cooperative societies and mixed central cooperative banks whose membership is open to both individuals and cooperative societies.

Primary Agricultural Credit Societies: Primary agricultural credit society forms the base in the three-tier cooperative credit structure. It is a village-level institution which directly deals with the rural people. It encourages savings among the agriculturists, accepts deposits from them, gives loans to the needy borrowers and collects repayments. The members of the society have unlimited liability.

Land Development Banks: They are also known as Cooperative Agricultural and rural Development Banks. These banks take care of the agriculturists needs for both short term and long-term credit for their agricultural activities.

Urban Cooperative Banks – Urban cooperative banks are not formally defined. They are the primary cooperative banks which are located in the urban and semi urban areas. These banks right from the formation day to till date have been mobilizing the savings from the middle and low income urban groups.

Rural Cooperative Credit Institutions – They play a vital but silent role in the day-to-day lives of the rural population. They perform financial intermediation by pooling the savings and diverting them by giving agricultural and farm allied credits to the people in the rural areas. These banks give short and long terms loans.

6.8 SELF ASSESSMENT QUESTIONS

Long Answers

1. Explain the structure of cooperative banks in India.
2. Describe the growth and development of cooperative banks.

Short Answers

1. Briefly explain the functions of cooperative banks.
2. What are the advantages and disadvantages of cooperative banks?
3. Explain the historical evolution of cooperative banks in India.

Very Short Answers

1. State Cooperative bank.
2. District cooperative banks
3. Urban cooperative banks
4. Rural cooperative banks
5. Primary agricultural credit societies
6. Cooperative bank

6.9 REFERENCE BOOKS:

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2. Management and Operations of Co - Operative Banks First Edition – Indian institution of Banking and finance.
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Lesson – 7

PRIVATE SECTOR AND PUBLIC SECTOR BANKS

7.0 OBJECTIVES

After going through this lesson student can know about:

- Private and Public sector banks
- Functions and types of private and public sector banks
- Comparative study of private and public sector banks

Structure

7.1 INTRODUCTION

Banks play an important role in the economic development of a country. Banks are a fundamental component of the financial system. The Indian Banking System comprises two major sectors of banks namely Public and Private Sector Banks. Public Sector banks are controlled by the Government and the private sector banks are owned by individuals and their share or equity is held by private shareholders. The Private Sector Banks in India are of two types namely: Old Private Sector Banks and New Private Sector Banks.

In India private banks are available in plenty and known for offering expeditious service to their customers. In Today's competitive business environment, the banking industry like many other financial service industries is facing a hastily changing market, new technologies, economic fears, ferocious competition, and especially more demanding customers; and the changing climate has presented an unparalleled set of challenges. Major changes took place in the functioning of Banks in India only after liberalization, globalization and privatization. This lesson discusses about the private and public sector banks, their functions and types.

7.2 PRIVATE SECTOR BANKS

The private sector banks are those banks where the larger part of the stake or equity is held by the private shareholders. Government does not have any role here. In India banking has always been dominated by the public sector. Since nationalization of banks in 1969 their role has been more predominate. However since liberalization in 1990s, old and new private sector banks have re-emerged. They have grown faster and bigger since liberalization. These banks have been using the latest technology, providing contemporary innovations and monetary tools and techniques. The private sector banks are split into two groups by financial regulators in India as old and new banks.

The old private sector banks are those which existed prior to the nationalization in 1969. The new private sector banks are those who acquired their banking license since the liberalization in the 1990s. Private-sector banks have been functioning in India since the very beginning of the banking system. In 1921 we had private banks like the bank of Bengal, Bank of Madras and Bank of Bombay. Later they merged into the Imperial bank of India. During 1969 to 1980 there was a rapid increase in the private sector banks. In April 1980, they were nearly 17.5 percent of bank branches in India. In 1980, after 6 more banks were nationalized, about 10 percent were the branches of private-sector banks. The share of the private bank branches stayed nearly same between 1980 and 2000. In 1990s, RBI's liberalization policy the government gave licenses to private banks, which came to be known as new private-sector banks. The first private bank in India which received license from RBI was the Housing Development Finance Corporation Limited. It received license as a part of the RBI's liberalization policy of the banking sector, to set up a bank in the private-sector banks in India.

Historically, the private sector banks played a vital role in the growth of joint stock banking in India. The first half of the 20th century witnessed phenomenal growth of private sector banks. As a result in 1951, there were 566 private banks of which 474 were non-scheduled and 92 scheduled classified on the basis of their capital size. The role of private sector banking started declining when the Government of India entered banking business with the establishment of State Bank of India in 1955 and subsequently two rounds of bank nationalization one in July 1969 (14 major banks), another in April 1980 (takeover of 6 banks). Consequently, the presence of public sector banks has increased. There are 32 private banks comprising of 24 old banks, which existed prior to 1993-94 and eight new private banks, which were established during 1993-94 and onwards after the RBI announced guidelines in January 1993 for establishment of new banks in private sector following the recommendations of Narasimham Committee-I (1991). Compared to New private sector banks, the old banks are smaller in size. At present in 2020 there are the following 22 private sector banks.

List of private Sector Banks in India as on 2020

Sl. No.	Name of the bank	Headquarters	No. of branches
1.	Axis Bank	Mumbai	1000
2.	Bandhan Bank	Kolkata, West Bengal	426
3.	Catholic Syrian Bank	Thrissur, Kerala	600
4.	City Union Bank	Thanjavur, Tamil Nadu	323
5.	DCB Bank	Mumbai, Maharashtra	269
6.	Dhanlaxmi Bank	Thrissur, Kerala	1252
7.	Federal Bank	Aluva, Kerala	4787
8.	HDFC Bank	Mumbai, Maharashtra	4882
9.	ICICI Bank	Mumbai, Maharashtra	1892
10.	IDBI Bank	Mumbai, Maharashtra	301
11.	IDFC First Bank	Mumbai, Maharashtra	1004
12.	IndusInd Bank	Mumbai, Maharashtra	958
13.	Jammu & Kashmir Bank	Srinagar, Jammu and Kashmir	835
14.	Karnataka Bank	Mangaluru, Karnataka	668
15.	Karur Vysya Bank	Karur, Tamil Nadu	1369
16.	Kotak Mahindra Bank	Mumbai, Maharashtra	570
17.	Lakshmi Vilas Bank	Chennai, Tamil Nadu	135
18.	Nainital Bank	Nainital, Uttarakhand	342
19.	RBL Bank	Mumbai, Maharashtra	852
20.	South Indian Bank	Thrissur, Kerala	509
21.	Tamilnad Mercantile Bank Limited	Thoothukudi, Tamil Nadu	1050
22.	Yes Bank	Mumbai, Maharashtra	1000

By the end of March 2000, the average net worth of the 24 Old Private Banks (OPBs) was Rs.179.67 Crore per OPB compared to that of the New Private Bank (NPB) at Rs.

479.88 Crore per NPB. The OPBs are essentially regional in character although some of them have scattered presence in areas other than in and around the areas of their origin. The number of branches of the NPBs was 999 at end March 2003, while those of OPBs 3491. Acting on the recommendations of the Narasimham committee, the RBI laid down guidelines for the establishment of the private sector banks on January 1993. The guidelines prescribed that the private banks should be established as public limited companies under the Indian Companies Act: 1956. The paid-up capital shall not be less than Rs. 100 Crore. The new guidelines issued in 2001 raised the minimum paid-up capital to Rs. 200 Crore, which would be enhanced to Rs. 300 Crore within three years after the commencement of business.

The New Private Sector Banks started publishing balance sheets since 1995-96. In that year the share of OPBs in total assets was 6.2 per cent while that of NPBs was 1.4 per cent. The NPBs had improved their market share to 5.3 per cent by 1999-2000 at the cost of PSBs. The share of private sector banks in the total number of branches in 1992-93 was only 8.33 percent. In 2002-03, the share of private sector banks in total bank branches is 8.75 percent. Nine banks were set-up in private sector including some by development financial institutions. Prominent among them are ICICI Bank, GTB, HDFC and IDBI bank. Bareily Corporation Ltd merged with Bank of Baroda in 1999, Times Bank merged with HDFC Bank in 1996, Bank of Madura Ltd merged with ICICI bank in 2001 and Nedungadi Bank Ltd merged with Punjab National Bank in 2003. With regard to branch expansion, banks attaining capital adequacy norms and prudential accounting standards can set up new branches without the prior approval of RBI. Banks have the freedom to rationalize their existing branch network by relocating branches, opening of specialized branches, spinning off business, setting up of controlling offices, etc.

7.3 TYPES OF PRIVATE SECTOR BANKS

Private sector banking is a type of banking process that involves financial institutions which are primarily owned and operated by private individuals and business organizations rather than by a government entity. Private sector institutions do typically have to comply with governmental regulations that apply to banking in general.

There are types of Private Banks in India;

a. Old generation private banks.
b. New generation private banks
c. Foreign banks operate in India
d. Co-operative banks

a. Old generation private banks:

The banks, which were not nationalized during 1969 and 1980's are known as old private-sector banks. These were not nationalized, because of their small size and regional focus. Most of the old private-sector banks are closely held by certain communities. The operations of these banks are restricted to the areas in and around their place of origin. The Board of directors of these banks consists of the locally prominent personalities from trade and business circles. The following are the list of the old private sector banks in India:

1. Bank of Rajasthan Ltd.
2. Catholic Syrian Bank Ltd.
3. City Union Bank Ltd.
4. Dhanalakshmi Bank Ltd. 5 Federal Bank Ltd.
6. ING Vysya Bank Ltd.
7. Jammu and Kashmir Bank Ltd.
8. Karnataka Bank Ltd.
9. Karur Vysya Bank Ltd.
10. Lakshmi Vilas Bank Ltd.

b. New generation private banks:

The banks, which came into function after 1991, with the introduction of economic reforms and financial sector reforms are known as "new private-sector banks". The Banking Regulation Act which was amended in 1993 permitted the entry of new private-sector banks in the Indian banking sector. The following are the criterion which was set for the establishment of the new private-sector banks, some of those criteria being:

1. The bank should have a minimum net worth of Rs. 200 Crores.
2. The promoters holding should be a minimum of 25% of the paid-up capital.
3. Within 3 years of the starting of the operations, the bank should offer shares to public and their net worth must increased to 300 crores.

The following is the list of the new private-sector banks in India:

1. Bank of Punjab Ltd. (since merged with Centurian Bank)
2. Centurian Bank of Punjab (since merged with HDFC Bank)
3. Development Credit Bank Ltd.

4. HDFC Bank Ltd.
5. ICICI Bank Ltd.
6. IndusInd Bank Ltd.
7. Kotak Mahindra Bank Ltd.
8. Axis Bank (earlier UTI Bank)
9. Yes Bank Ltd.

c. Foreign banks operate in India:

It is fact that India is one of the fastest growing economies in the world. It has received an amount of $65.37billion as Foreign Direct Investment (FDI) in 2019-2020. This boom has led to an unparallel growth in the financial institutions in India. There are 46 foreign banks that are operating in the country. India is enjoying twofold benefits due to the presence of foreign entities namely – there is a boost in the international transaction and an increase in the employment opportunities for qualified people in the country. In fact the foreign banks in India have helped India to establish a firmer international presence while bringing in ease of business on a global scale for the domestic enterprises.

In 2005 RBI has released the road map for the foreign banks in India. It mainly gave a two track approach. One track was the consolidation of the domestic banking system, both in private and public sectors, and the second track was the gradual enhancement of foreign banks in a synchronized manner. The Road map was divided into two phases, the first phase is during March 2005 to March 2009, and the second phase beginning after a review of the experience gained in the first phase. At the end of the first phase there were some global turmoil and uncertainties in the banks all over the world and so the existing policy and procedures were continued for the working of the foreign banks in India.

Foreign banks in India today, such as Standard Chartered Bank and HSBC, found their roots in financing the growing trade between Asia and the rest of the world. Standard Chartered Bank‘s antecedent, the Chartered Bank of India opened an office in Calcutta in 1858, after receiving a Royal Charter from Queen Victoria. The arrival of the Hong Kong and Shanghai Banking Corporation (HSBC) in 1859 marked the entry by a foreign bank India. The National City Bank of New York, entered India in 1902, and JP Morgan, in 1922. As of March 2013, there are 43 foreign banks from 26 countries operating as branches and 46 banks from 22 countries operating as representative offices. Foreign banks present in India as representative offices often have correspondent banking relationships with domestic banks and provide a useful platform for foreign banks to access opportunities for foreign currency lending to Indian corporate and financial institutions. Foreign banks have less than 1% of the total branch network but about 7% of the total banking sector assets and a sizeable 11% of profits. With 334 branches in all, the share of foreign bank branches is less than1%.

Foreign banks borrowings rose to Rs 1.51 trillion in the financial year 2019, Rs 1.3 trillion. Other assets rose by 67% over the year, to Rs 1.47 trillion. The number of foreign banks did not increase in number, but the numbers of branches increased from 286 to 299. The RBI issued license to two more foreign lenders, SBM Bank and DBS Bank in December 2017 and October 2018 respectively and they started their operations as wholly owned subsidiary from 1st December, 2018, and 1st March, 2019, respectively.

Foreign banks have made considerable contribution to the banking sector over the years by bringing capital and global best practices as well as grooming talent. Foreign banks have been innovative in identifying specific needs of the market, creating products, and developing organizational constructs. Foreign banks used technology to their advantage to create and maintain lead in premium services such as integrated cash management, private banking, 24- hour phone banking, internet banking, securitization, forex and interest rate derivatives trading, risk management and Know Your Customer (KYC) software solutions. For example the first Automated Teller Machine (ATM) in the country was set up by HSBC in 1987. In the process, foreign bank executives in India have also become a rich source of talent for their global banking networks.

The list of foreign banks in India is listed below:

Foreign banks in India as on 31st May, 2020

Sl. No.	**Name of bank**	**Country of Incorporation**	**No of banking branches**
1.	AB Bank Ltd.	Bangladesh	1
2.	Abu Dhabi Commercial Bank Ltd.	UAE	2
3.	American Express Banking Corporation	USA	1
4.	Australia and New Zealand Banking Group Ltd.	Australia	3
5.	Barclays Bank Plc.	United Kingdom	6
6.	Bank of America	USA	4
7.	Bank of Bahrain & Kuwait BSC	Bahrain	4
8.	Bank of Ceylon	Sri Lanka	1
9.	Bank of China	China	1

10.	Bank of Nova Scotia	Canada	3
11.	BNP Paribas	France	8
12.	Citibank N.A.	USA	35
13.	Cooperative Rabo bank U.A.	Netherlands	1
14.	Credit Agricole Corporate & Investment Bank	France	5
15.	Credit Suisse A.G	Switzerland	1
16.	CTBC Bank Co., Ltd.	Taiwan	2
17.	DBS Bank India Limited*	Singapore	
18.	Deutsche Bank	Germany	17
19.	Doha Bank Q.P.S.C	Qatar	3
20.	Emirates Bank NBD	UAE	1
21.	First Abu Dhabi Bank PJSC	UAE	1
22.	FirstRand Bank Ltd	South Africa	1
23.	HSBC Ltd	Hong Kong	26
24.	Industrial & Commercial Bank of China Ltd.	China	1
25.	Industrial Bank of Korea	South Korea	1
26.	J.P. Morgan Chase Bank N.A.	USA	4
27.	JSC VTB Bank	Russia	1
28.	KEB Hana Bank	South Korea	1
29.	Kookmin Bank	South Korea	1
30.	Krung Thai Bank Public Co. Ltd.	Thailand	1
31.	Mashreq Bank PSC	UAE	1
32.	Mizuho Bank Ltd.	Japan	5
33.	MUFG Bank, Ltd.	Japan	5
34.	NatWest Markets Plc	United Kingdom	1
35.	PT Bank Maybank Indonesia TBK	Indonesia	1
36.	Qatar National Bank (Q.P.S.C.)	Qatar	1
37.	Sberbank	Russia	1
38.	SBM Bank (India) Limited*	Mauritius	
39.	Shinhan Bank	South Korea	6
40.	Societe Generale	France	2
41.	Sonali Bank Ltd.	Bangladesh	2
42.	Standard Chartered Bank	United Kingdom	100
43.	Sumitomo Mitsui Banking Corporation	Japan	2
44.	United Overseas Bank Ltd	Singapore	1
45.	Westpac Banking Corporation	Australia	1
46.	Woori Bank	South Korea	3

* SBM Bank (India) Limited (Subsidiary of SBM Group) and DBS Bank India Limited (Subsidiary of DBS Bank Ltd.) have been issued license on December 6, 2017 and October 4, 2018 respectively for carrying on banking business in India through Wholly Owned Subsidiary (WOS) mode. They have commenced operations as WOS w.e.f from December 01, 2018 and March 01, 2019 respectively.

d. Co-operative banks:

The concept of cooperative banks has already been discussed in the previous chapter.

7.4 FUNCTIONS OF PRIVATE SECTOR BANKS

The private sector banks play a vital role in the Indian economy by offering a healthy competition to the public sector banks. The following are their functions:

1. They create healthy competition - The private sector banks provide a healthy competition on general efficiency levels in the banking system.
2. They encourage foreign investment - The private sector banks especially the foreign banks have much influence on the foreign investment in the country.
3. They provide professional management - They help in introducing a high degree of professional management and marketing concept into banking. It helps the public sector banks as well to develop similar skill and technology.
4. They help to access foreign capital markets - The foreign banks in the private sector help the Indian companies and the government agencies to meet financial requirements from international capital markets.
5. They help to develop innovation – Private Banks always strive to have a new product and therefore they encourage innovation. This helps to provide better guidance and quality services to the customers.
6. Private Banks introduce new technology in the banking service – these banks try to lead other banks in various new fields. E.g., introduction of computerized operations, credit card business, ATM service, etc.

7.5 PUBLIC SECTOR BANKS

Public sector in the banking industry emerged with the nationalization of Imperial Bank of India (1921) and creating the State Bank of India (1955). It is the single largest bank in the country with large international presence, with a network of 48 overseas offices spread over 28 countries. In 1959, eight banking companies functioning in formerly princely states were acquired by the SBI, which later came to be known as Associate Banks. Later, two of the subsidiary banks', viz., the State Bank of Bikaner and Jaipur were merged to form the State Bank of Bikaner and Jaipur, thus form eight banks in the SBI group then making banks in the state bank group.

The Public sector in the Indian banking spread with two times nationalization of banks, ones in July 1969 and second in 1980, April. The nationalization of banks was undertaken by the government for the development of the country. This significant step was taken for:

1. To increase public confidence in the banking system and encourage public to save and invest.
2. To eliminate regional bias and promoted opening up of branches in the remote areas.
3. To strengthen the banking network.
4. To eliminate monopoly or credit competition.

The following are the nationalized banks in India:

1. **Allahabad Bank:** Established in 1865. It is one of the oldest joint stock banks in India. Allahabad Bank was nationalized on July 19, 1969.
2. **Andhra Bank:** Andhra Bank was established in 1923. It is a medium-sized public sector bank and was nationalized in April 1980. The turnover of this bank for the year 2016 was around Rs 18027.42 crores. Andhra Bank was the pioneer of credit cards in India.
3. **Bank of Baroda:** This bank was established in 1908. The bank's headquarter is situated in Vadodara, Gujarat. It was nationalized in 1969.
4. **Bank of India:** Bank of India was established in the year 1906 and was nationalized in the 1969. It is situated in Mumbai.
5. **Bank of Maharashtra:** It was founded in 1935 with its headquarter in Pune. It is a private sector bank, which has the largest number of branches in the state of Maharashtra. Bank of Maharashtra was nationalized in the year 1969.
6. **Canara Bank:** Canara Bank is one of the oldest public sector banks. The bank has branches in other countries such as Hong Kong, Shanghai, Moscow, etc. It was established in the year 1906 and was nationalized in the year 1969.
7. **Central Bank of India:** It was founded in the year 1911 and was nationalized in 1969. The headquarters of this bank is in Mumbai, the financial capital of India.
8. **Corporation Bank:** It was established in the year 1906. It is 114 years old. It's headquarter is in Mangalore and also has representative branches in Hong Kong, Dubai. It was nationalized in the year 1980.
9. **Dena Bank:** This bank was founded in 1938 by Devkaran Nanjee and was nationalized in 1969. It generated a total turnover of Rs 10645.73 crores in 2016, although in 2017 it has started making losses. It is headquartered in Mumbai.

10. **Indian bank:** It is one of the top performing public sector banks in India. Indian Bank was established on 15 August 1907. It has its headquarters in Chennai. It also has overseas branches in Colombo and Singapore. The bank was nationalized in 1969.
11. **Indian Overseas Bank:** It was established in the year 1937 and was nationalized in 1969. Its headquarters is at Chennai, and provides banking services at various places like Dubai, Bangkok, Shanghai, etc.
12. **Oriental Bank of Commerce:** OBC or Oriental Bank of Commerce was founded in Lahore in 1943. Currently, it is headquartered in Gurugram, India. It was nationalized in the year 1980.
13. **Punjab and Sind Bank:** This bank was founded in 1908 Punjab and Sind Bank was nationalised in the year 1969.
14. **Punjab National Bank:** Punjab National Bank was established in the year 1894 and is one of the oldest banks. It has its branches in UK, Dubai, Kabul etc. It was nationalized in the year 1969.
15. **Syndicate Bank:** Syndicate bank was nationalized in the year 1969 and is one of the major banks in India. Its headquarters is in Manipal.
16. **UCO Bank:** UCO Bank or United Commercial Bank was established in 1943. This bank was nationalized in 1969.
17. **Union Bank of India:** It was established in 1919 and was nationalized in 1980. It has its representative offices in Shanghai, Abu Dhabi, Beijing, etc.
18. **United Bank of India:** United Bank of India was founded 1950 and was nationalized in 1969. Its headquarters is in Kolkata.
19. **Vijaya Bank:** This bank was established in 1931 in Mangalore and has its headquarters in Bengaluru. It was nationalized in the year 1980.

The following is the list of the public sector banks in India as on 2020.

List of Public Sector Banks in India 2020

Sl. No.	Bank Name	Establishment	Headquarter
1	Bank of Baroda	1908	Vadodara, Gujarat
2	Bank of India	1906	Mumbai, Maharashtra
3	Bank of Maharashtra	1935	Pune, Maharashtra
4	Canara Bank	1906	Bengaluru, Karnataka

5	Central Bank of India	1911	Mumbai, Maharashtra
6	Indian Bank	1907	Chennai, Tamil Nadu
7	Indian Overseas Bank	1937	Chennai, Tamil Nadu
8	Punjab and Sind Bank	1908	New Delhi, Delhi
9	Punjab National Bank	1894	New Delhi, Delhi
10	State Bank of India	1955	Mumbai, Maharashtra
11	UCO Bank	1943	Kolkata, West Bengal
12	Union Bank of India	1919	Mumbai, Maharashtra

7.6 TYPES OF PUBLIC SECTOR BANKS

Public sector banks are divided into two groups i.e. Nationalized Banks and State Bank of India and its associates. Among them, there are 19 nationalized banks and 8 State Bank of India associates. Public Sector Banks dominate 75% of deposits and 71% of advances in the banking industry. Public Sector Banks dominate the commercial banking India. These can be further divided as:

a. State Bank Group
b. Nationalized banks
c. Regional Rural Banks

a. **State Bank Group:**

It is the largest commercial bank group in India. On 30th April, 1955 the Imperial Bank of India became the State Bank of India. The SBI group is rated the best bank in India by the Global Finance, NewYork. It is the only Indian bank which could find a place in the fortune Global 500 list. It is also the first Indian bank to take up merchant banking in 1986. SBI has around 6500+ associate bank branches. State Bank of India has electronically networked all of its branches under Core Banking System (CBS). The bank has one of the largest ATM networks in the region. More than 8500 ATMs are across India. In 1959 the Government passed the State Bank of India (Subsidiary Banks) Act, enabling the SBI to take over eight former State associated banks as its subsidiaries. On Sept 13, 2008, State Bank of Saurashtra, one of its Associate Banks, merged with State Bank of India.

There are six associate banks that fall under SBI, and together these six banks constitute the State Bank Group. All use the same logo of "State Bank". Originally, the then seven banks that became the associate banks belonged to princely states until the government nationalized them between October, 1959 and May, 1960. During the first five year plan period SBI has emphasized the development of rural areas in the country. The government integrated these banks into State Bank of India to expand its rural outreach. There has been a proposal to merge all the associate banks into SBI to create a "mega bank" and streamline operations. In this process on 13th August, 2008 State Bank of Saurashtra merged with SBI. On 19th June 2009 the SBI board approved the merger of its subsidiary, State Bank of Indore, with itself. The acquisition of State Bank of Indore will help SBI add 470 branches to its existing network of 11,448.

SBI has 92 branches, agencies or offices in 32 countries. It has branches of the parent in Colombo, Dhaka, Frankfurt, Hong Kong, Johannesburg, London and environs, Los Angeles, Male in the Maldives, Muscat, New York , Osaka, Sydney, and Tokyo. It has offshore banking units in the Bahamas, Bahrain, and Singapore, and representative office at Bhutan, Cape Town. SBI also operates in several foreign subsidiaries or affiliates. In 1990 it established an offshore bank, State Bank of India (Mauritius). It has two subsidiaries in North America, State Bank of India (California), and State Bank of India (Canada). All these banks are well developed and in turn have branches. The State Bank of India in California which was established in 1982 has seven branches in the state of California and one in Washington DC. The SBI in Canada also has seven branches. In Nepal SBI owns 50% of Nepal SBI Bank, which has branches throughout the country. In Moscow SBI owns 60% of Commercial Bank of India, with Canara Bank owning the rest.

b. Nationalized banks:

In July 1969, 14 banks with a deposit base of Rs.50 crores or more were nationalized. Again in 1980, six more private banks were nationalized, bringing up the number to twenty. These Banks are already explained in the above paragraphs. Nationalized banks have always dominated the other banks in India. The main aim of nationalizing the banks in India was to reach the length and breadth of the country and provide quality services. As per RBI 2019, in India there are 20 Scheduled Commercial banks. It comprises of Public Sector Banks, Regional Rural Banks, Private Sector Banks, Small Finance Banks (SFBs), Scheduled Payments Banks and Foreign Banks. After merging there are 12 public sector banks in India and 22 private sector banks and 44 foreign banks.

Nationalized banks in India are of higher quality because they are strong, clean and have very transparent balance sheets than other ordinary banks. The main aim of the nationalized banks is to manage volatility, with a fixed exchange rate. These banks are providing all facilities at our door step like credit card, cheques, online payments, net banking etc. These banks offer great and quality services to their customers.

c. Regional Rural Banks:

We will learn about Regional Rural banks in detailed in the 12th chapter. Here we will just know the gist of RRBs. Regional Rural Banks are constituted to meet the financial and banking needs of weaker sections of the rural areas with a special attention on small and marginal farmers, agricultural labourers, artisans, landless farmers, small traders, tint enterprises etc. RRBs were established in India in 1975 essentially for the purpose of taking banking service to the doorsteps of rural people. RRBs are commercial banks and adopt principles of cooperative banks. They operate under the control of NABARD and RBI. It's the Narasimham committee that conceptualized the foundation of Regional Rural Banks in India. RRBs mobilize financial resources from rural/semi-urban areas and grant loans and advances mostly to small and marginal farmers, agricultural labourers and rural artisans. For the purpose of classification of bank branches, the Reserve bank of India defines rural area as a place with a population of less than 10,000. RRBs are jointly owned by Government of India, the concerned State Government and Sponsor Banks; the issued capital of a RRB is shared by the owners in the proportion of 50%, 15% and 35% respectively. The first five RRBs are as follows;

a. Prathama Bank in Uttar Pradesh
b. Gorakhpur kshetriya Gramin Bank in Uttar Pradesh
c. Haryana Krishi Gramin Bank in Haryana
d. Gour Gramin Bank in West Bengal
e. Jaipur-Nagpur Anchalik Gramin Bank, Rajasthan.

7.7 FUNCTIONS OF PUBLIC SECTOR BANKS

The main functions of public sector banks are very much same as that of the commercial banks, which we have discussed in the fifth chapter. These banks accept deposits from the public and advancing them loans. Apart from these functions there are other functions that these banks perform. The following are the functions that these banks perform:

1. **Accepting Deposits**: Most import function of any bank is to accept deposits from the public. People deposit their savings according to their need. Normally, fixed income and lower income people deposit in small amounts for security, income and saving promotion. Traders and businessmen deposit their savings in the banks for the convenience of payment. Therefore, keeping the needs and interests of various sections of society, banks formulate various deposit schemes. There are three types of deposits in the banks namely – current deposits, fixed deposits and saving deposits.
2. The current deposits are also known as Demand Deposits because these can be demanded or withdrawn by the depositors at any time they want. These deposits have either no or low interests. These deposits are highly useful for traders and big business firms because they have to make payments and accept payments many times in a day. Fixed deposits on the other hand are deposited for a definite period of time. It generally one year so, they are also known as long term deposits. These deposits cannot be withdrawn before the expiry of the stipulated time and, therefore, these are also called as time deposits. They have higher rate of interest. Saving deposits are those deposits where money can be deposited up to a certain limit and withdrawn once or twice in a week. The rate of interest is very less. These deposits are generally done by salaried people and the people who have fixed and less income.
3. **Issuing Loans**: It is one of the important functions of any bank. Banks charge interest from the borrower which is the main source of income for them. Banks create loans out of deposits and deposits out of loans. This is called credit creation. Modern banks give secured loans for productive purposes. The value of security or collateral is equal to the amount of loan. Banks also give loans on the basis of personal security. Therefore, such loans are called as unsecured loan. Banks issue cash credit, demand loans, and short term loans to their customers.
4. **Facility of over draft**: Banks advance loans to its customers up to a certain amount through over-drafts, if there are no deposits in the current account. For this banks demand a security from the customers and charge very high rate of interest.
5. **Discounting of Bills of Exchange:** It is one of the important method of issuing loans to the traders for short term. Here banks advance loans by discounting their bills. In this way, businessmen get loans on the basis of their bills of exchange before the time of their maturity.

6. **Banks invest surplus funds:** The banks invest their surplus funds in three types of securities—Government securities, other approved securities and other securities. Government securities include both, central and state governments, such as treasury bills, national savings certificate etc.
7. **Agency functions:** with the concern of the customers banks function in the form of agents and representatives of their customers. They perform certain functions like - collect cheques, drafts, bills of exchange and dividends of the shares for their customers, make payment for their clients, pay insurance premium of their customers, they also deposit loan installments, income-tax, interest etc. as per directions, purchase and sell securities, shares and debentures on behalf of their customers, etc.
8. **Other functions:** Banks provide lockers for their customers to safe guard their valuable assets such as gold, silver, legal documents etc. Banks collect necessary and useful statistics relating to trade and industry. For facilitating foreign trade, banks undertake to sell and purchase foreign exchange. Banks advise their clients relating regarding investment decisions. They also issue letters of credit, etc. They provide loans for durables goods like Car, Air-conditioner, and Fridge etc.

7.8 COMPARATIVE STUDY OF PRIVATE AND PUBLIC SECTOR BANKS

Totally, there are 12 Public sectors banks 44 foreign banks, 22 Private sector banks, banks are operating in India. From 2013-2018, the total banking sector asset in these three types of banks are: The public sector banks contribute $1,557.04 (66%) and public sector and private banking contributes around $666.99 (28%). The remaining $135.96 (6%) contributed by foreign banks. In the 2018 Private bank interest income reached $47.39 billion, whereas public sector bank interest income stood at $102.46 billion. The credit market in India is the fourth largest market worldwide. It increased to $281 billion in 2017 from $181 billion on 2014. The total lending has also increased at a CAGR of 11% during the financial year 2007-2018 and the deposits increased by 11.66% CAGR during the same period. Increase in number of internet users is proving a boost to the digital banking along with that the policy formed by the government like Banking regulation bill, Insolvency and bankruptcy code ordinance will help the banks to fight against the NPA and will also strength the overall banking sector of the country.

The major differences between a private and public sector banks are:

Sl. No.	**Public Sector Banks**	**Private Sector Banks**
	They are owned by the government.	They are owned by business entities or individuals.
1	More than fifty percentage of the stake is held by the Government	The stake owned to private shareholders, including corporations and individuals.
2	They offer normal rate of interest	They also follow the same rules as the public sector but some new age banks offer better interest rates than their counterparts.
3	The loan interest rates are marginally lower	They charge a bit higher rate of interest on loans
4	The fees and charges are less	They provide better service and charge for the extra services.
5	Public sector accounts are opened for government employees for their salaries, fixed deposits, lockers etc.	Private sector bank in India target company employees, for their salary accounts, credit cards and net banking.
6	Their customer base is also relatively large	
7	They offer pension to their employees	They do not offer any pension
8	Employees get promotions based on their seniority	Promotions are based on the performance
9	They are the financial backbone of the country as they contribute to the nation's financial security.	They aim for quality service delivery.
10	Financial institutions with a maximum of its shares contained by the government.	Financial institutions with a maximum of its shares contained by private shareholders.
11	People find these banks trustworthy.	People failed to trust such banks with their finances fully.
12	They exist for a longer period.	The private sector banks now exist for a shorter period
13	There is transparency in public sector banks regarding their interest rates policies	There may be more hidden charges on various operating systems.
14	There is job security	There is usually constant performance evaluation, which adds on to the constant worries regarding job security.

15	They take time to implement new technologies that usually make work easier for both the employees and customers.	Private sectors stay up-to-date for the latest technological trends that make operations easier.
16	Sometimes one has to visit various departments to attain the needed information	One can receive all the assistance that is needed in one desk.

7.9 SUMMARY

The private sector banks are those banks where the larger part of the stake or equity is held by the private shareholders. The old private sector banks are those which existed prior to the nationalization in 1969. The new private sector banks are those who acquired their banking license since the liberalization in the 1990s. Public sector in the banking industry emerged with the nationalization of Imperial Bank of India (1921) and creating the State Bank of India (1955). It is the single largest bank in the country with large international presence, with a network of 48 overseas offices spread over 28 countries. In 1959, eight banking companies functioning in formerly princely states were acquired by the SBI, which later came to be known as Associate Banks.

7.10 TERMINOLOGY

Private Banks **:** The private sector banks are those banks where the larger part of the stake or equity is held by the private shareholders. Government does not have any role here.

Old generation private banks : The banks, which were not nationalized during 1969 and 1980‘s are known as old private-sector banks.

New generation private banks: The banks, which came into function after 1991, with the introduction of economic reforms and financial sector reforms are known as "new private-sector banks".

Public Sector Banks : They are owned by the government and more than fifty percentage of the stake is held by the government.

7.11 SELF ASSESSMENT QUESTIONS

Long Answers

1. Explain the functions of the private sector banks.
2. Define public sector bank and explain its functions.
3. What are the differences between public and private sector banks?
4. Explain about the nationalized banks in India.

Short Answers

1. What are the types of public sector banks?
2. Briefly explain the types of private sector banks.
3. What are nationalized banks?
4. Differentiate between new and old generation private sector banks.

Very Short Answers

1. Private Sector bank.
2. Public Sector banks
3. Regional rural banks
4. Types of deposits
5. Agency functions of a bank
6. New generation private banks

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Lesson – 8

RURAL AND URBAN BANKS

After going through this lesson student can know about:

- Rural and Urban banks
- Functions and types of Rural and Urban banks
- Comparative study of Rural and Urban banks

Structure

8.1 INTRODUCTION

This lesson deals with the rural and urban banks in India. The rural banks are the Regional Rural Banks, were established in 1975 under the provisions of the Ordinance promulgated on the 26th September 1975 and followed by Regional Rural Banks Act, 1976 with a view to develop the rural economy. The Government of India, the concerned State Government and the bank, which had sponsored the bank contributed to the share capital of RRBs in the proportion of 50%, 15% and 35%, respectively.

The urban Banks are the urban cooperative banks 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. These banks were traditionally centered on communities, localities work place groups. They essentially lent to small borrowers and businesses. Today, their scope of operations has widened considerably. The origin of the banking movement in India is in nineteenth century. This lesson helps to understand as what are rural and urban banks in India, how do they function and what are the objectives of these banks.

8.2 RURAL BANKS

The importance of rural banking in the economic development of the country cannot be overlooked. As it is said “Real India lies in villages” and village economy is the backbone of Indian economy. Without developing the rural areas the economy cannot develop. The real growth of the economy lies in the freeing the rural masses from poverty, unemployment and other problems. This can be made possible by providing the rural poor with credit facilities. And this is done by the rural banks which are also known as Gramin banks. The Rural Banks were established on the recommendations of Narsimha Committee on Rural Credit. The committee viewed that rural banks would be much better to meet the needs of rural areas. Considering the recommendations of the committee the Government of India passed Regional Rural Banks Act 1976. After passing the Act within a year around 25 banks were established in various parts of India. The aim behind establishment of these banks was to function as commercial organizations in the rural areas.

The Act gave a scope to develop the rural economy by providing credit facilities for the purpose of development of agriculture, trade, commerce, industry and other such productive activities in the rural areas. They provide basic banking facilities and financial services. The first rural banks Prathama Bank in India was established on 2nd October, 1975. Several commercial banks sponsor these banks. Prominent examples include the Maharashtra Gramin Bank sponsored by the Bank of Maharashtra and the Himachal Gramin Bank sponsored by Punjab National Bank. These rural banks were set up to eliminate other unorganized financial institutions like money lenders and supplement the efforts of co-operative banks. The rural banks are the newest form of banks that have been set up in the country on the sponsorship of individual nationalized commercial banks. At the end of March 1994, they numbered 196, with about 14,500 branches covering 408 districts.

8.3 FEATURES OF RURAL BANKS

Some special features of these banks are:

a. The area of operation of each rural bank has been limited to a specified region comprising one or more districts in any anything

b. The lending rates of these banks cannot be higher than the prevailing lending rates of co-operative credit societies in the state.
c. The aim of establishing these banks was to meet the credit requirements of the small and marginal farmers in the rural areas.
d. Focus was on the agro sector.
e. These banks envisaged as a low cost financial intermediation structure in the rural India.
f. These banks ensure sufficient flow of institutional credit for the agriculture and other rural sectors in the country.
g. These banks have the local feel and familiarity of the cooperative banks with expertization of the commercial banks.
h. The salary structure of the employees of these banks has been fixed in consonance with the salary structure of the employees of the state government and local authorities of comparable level and status in the bank's area of operation.
i. The aim to provide and meet the needs of the weaker section of the rural population.
j. The loans are mainly provided to the small and marginal farmers, agricultural labourers, artisans, small entrepreneurs etc. in the rural areas.

The paid-up capital of each rural bank is Rs. 25 lakhs, 50 per cent of which has been contributed by the Central Government, 15 per cent by the state government concerned and 35 per cent by the sponsoring public sector commercial banks.

The main objectives in establishing the rural banks can be summarized as:

i. Developing the rural areas.
ii. Bridging the credit gaps in rural areas.
iii. To reduce regional imbalances and increase rural employment generation activities.
iv. To develop measures this could restrict the outflow of rural deposits to urban areas.
v. For achieving its objectives the RRBs provide financial assistance to different segments of rural population engaged in rural activities.

8.4 FUNCTIONS OF RURAL BANKS

Rural banks are Indian Scheduled Commercial Banks (Government Banks) operating at regional level in different States of the country. They have been created with a view of serving primarily the rural areas of India with basic banking and financial services.

The functions of rural banks are:

1. Granting 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;
2. Granting 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; and
3. Accepting deposits.
4. Provide banking facilities to rural and semi-urban areas.
5. Carrying out government operations
6. Provide banking facilities like locker facilities, debit and credit cards, mobile banking, internet banking, UPI etc.
7. Small financial banking facilities.
8. They help in implementing central and state government sponsored various programs of poverty alleviation like SGSRY, PMRGP, old age pension, mid day meals, Indira Awas Yojana etc.

8.5 URBAN BANKS

Urban Banks have an important place in the Non-Agricultural Credit Society. They look into the credit needs urban areas. They issue loans to the small traders, monthly income groups etc. They also advance loans against gold, silver and produce. Urban Banks accept deposits and issue loans to the needy. These banks provide various kinds of Banking facilities like Commercial and Nationalized Bank to their members and customers. They are very important in the financial system of the country. Urban banks refer to the banks that are located in the urban and semi urban areas. These banks, till 1996, were allowed to lend money only for non-agricultural purposes. These banks were traditionally centered on communities, localities and work place groups. They essentially lent to small borrowers and businesses. Today, their scope of operations has widened considerably.

The first known mutual aid society in India was the Anyonya Sahakari Mandali organized in the erstwhile princely State of Baroda in 1889 under the guidance of Vithal Laxman also known as Bhausaheb Kavthekar. These banks mobilize savings from the middle and low income urban groups and purvey credit to their. The enactment of Co-operative Credit Societies Act 1904, however gave the real impetus to the movement. The first urban co-operative credit society was registered in Kanjivaram in the erstwhile Madras province in October 1904. Amongst the prominent credit societies were the Pioneer Urban in Bombay established on November 11th, 1905), Cosmos in Poona established on 18th January, 1906, Gokak Urban was formed on 15th February, 1906 and Belgaum Pioneer was formed on 23rd February, 1906 in the Belgaum district, the Kanakavli-Math Co-operative Credit Society and the Varavade Weavers' Urban Credit Society on March 13th,1906 in the south Ratnagiri district. The early in this area was the Bombay Urban Co-operative Credit Society, sponsored by Vithaldas Thackersey and Lallubhai Samaldas established on 23rd January, 1906. The Co-operative Credit Societies Act, 1904 was amended in 1912, with a view to broad basing it to enable organization of non-credit societies. The Maclagan committee of 1915 was appointed to review their performance and suggest measures for strengthening them.

The main objectives of these banks are:

a. To attract deposits from members and non-members
b. To advance loan to members
c. They aim to raise funds for lending money to its members
d. To arrange for the safe custody of valuable documents of members
e. To undertake collection of bills, accepted or endorsed by member
f. To provide other facilities as provided by commercial banks.

   The area of operation of urban banks is restricted by its bye laws to a municipal area or a town. In some occasions it exceeds the limits.
g. To act as the age for the joint purchase of domestic and other requirements of the members.

8.6 FUNCTIONS OF URBAN BANKS

The functions of these banks are similar to any other banks. The main functions of the urban banks are:

1. To accept deposits from the members and non-members
2. To lend to members for useful purposes
3. Loans are also given to non-members on the security of their deposits.
4. To undertake purchase and supply of essential consumer's goods on an agency basis
5. To promote thrift

6. To advance loans on personal security or on mortgage of house property, on pledge of gold and silver, produce, merchandise, Government securities, fixed deposit receipts, life insurance policies, land mortgage and bank debentures.
7. To provide banking and subsidiary services
8. To give vehicle loans to the members of the banks
9. To arrange safe custody of valuables and documents of members and constituents
10. To provide guidance to the traders, artisans who are the members of the banks.
11. To undertake every kind of banking and sheriff business and also give bank guarantee ad letters of credit on behalf of members.

8.7 GROWTH OF URBAN BANKS

Historically, the urban bank movement is older than that the Indian cooperative movement which was launched in 1904 when the cooperative societies Act was enacted. The first urban cooperative credit society formed in Baroda in 1889 still exists and is now a full-fledged urban cooperative bank. After the cooperative societies Act of 1912, the scope for organization of cooperative banks was widened. The growth pattern of urban cooperative banks in India till 1948-49 could not be studied in detail as published data are not available separately for urban credit societies. From 1948-49 separate figures are published.

The table below shows the growth of urban cooperative banks in India from 2007 to 2013. The data has been taken from Reserve bank of India.

PROGRESS OF URBAN COOPERATIVE BANKS IN INDIA

(Rs in crores)

Sl.No	Particulars	2007	2009	2011	2012	2013	2020
1	No. of banks	1092	1014	1614	1645	1645	1482
2	Owned funds	720	734	888	1000	3800	
3	Deposits	19427	20848	21203	23860	27690	
4	Working capital	19823	21543	22091	24860	31490	
5	Loans and advances	14364	16548	13634	15780	18100	

Sources: Report of R.B.I, Mumbai

The table above shows the overall progress of UCBs in India during the break up period from 2007 to 2013. The number of banks in India has increased from 815 in 1948 to 1340 in 1987. Subsequently, it has slowly decreased to 1645 in 2013 due to poor management of the banks. The same position also had in the working funds of the UCBs in India. The total deposits position has increased from Rs.17 Crores in 1948 to Rs.20,247 crores in 1977. In 2007, it has slowly increased from Rs.19427 crores to Rs.27690 in 2013. The working capital of UCBs was increased from Rs.22 crores in 1948 to Rs.7000 crores in 1987. It was suddenly decreased to Rs.2146 crores in 1997, subsequently it was increased to Rs. 31490 in 2013. The loans and advances was 19 crores in 1948 18100 crores in 2013 in all India level.

8.8 COMPARATIVE STUDY OF RURAL AND URBAN BANKS

Sl. No	Rural Banks	Urban Banks
1	The aim of the rural banks is to develop the rural and backward areas in the country	They provide loans to the urban population
2	Its objective to is provide banking facility to the rural population	They are spread mainly in the urban areas of the country
3	They provide finance to agriculture, small sector loans, handicrafts and other small sector loans	They provide non-agricultural loans to the members and non- members
4	They are in the rural and semi urban areas only	They are in the urban areas
5	The stakeholders are the government of India, state government and the commercial banks	Corporate Governance recognizes the rights and responsibilities of various stakeholders in the enterprise, namely the board of directors, managers, the customers, and particularly the shareholders, depositors, and other stakeholders including the regulators.
6	It is regulated by NABARD	It is regulated by RBI

8.9 SUMMARY

The real growth of the economy lies in the freeing the rural masses from poverty, unemployment and other problems. This can be made possible by providing the rural poor with credit facilities. And this is done by the rural banks which are also known as Gramin banks. The Rural Banks were established on the recommendations of Narsimha Committee on Rural Credit. The committee viewed that rural banks would be much better to meet the needs of rural areas. Urban Banks have an important place in the Non-Agricultural Credit Society. They look into the credit needs urban areas. They issue loans to the small traders, monthly income groups etc. They also advance loans against gold, silver and produce. Urban Banks accept deposits and issue loans to the needy. These banks provide various kinds of Banking facilities like Commercial and Nationalized Bank to their members and customers. They are very important in the financial system of the country.

8.10 TERMINOLOGY

Rural Banks : They are the Gramin banks. They are located in the rural and semi- urban areas. They provide loans to the rural population. They are established to develop the rural and backward areas of the country.

Urban Banks : Urban Banks have an important place in the Non-Agricultural Credit Society. They look into the credit needs urban areas. They issue loans to the small traders, monthly income groups etc. Urban banks refer to the banks that are located in the urban and semi urban areas.

8.11 SELF ASSESSMENT QUESTIONS

Long Answers

1. What are rural banks? Explain the function of rural banks in India.
2. Define urban banks and briefly describe its objectives.
3. Explain the difference between rural and urban banks.

Short Answers

1. What are the objectives of rural banks in India?
2. What are the functions of the urban banks?
3. Briefly describe the growth of urban banks in India.

Very Short Answers

1. Rural banks
2. Urban banks

8.12 REFERENCE BOOKS

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Lesson - 9

RESERVE BANK OF INDIA

9.0 OBJECTIVES

After going through this lesson student can know about:

- The establishment and organization structure of RBI
- Functions of RBI
- Role of RBI in development of India

Structure

9.1 Introduction

The Reserve Bank of India (RBI) is India's central bank, which controls the issue and supply of the Indian rupee. RBI is the regulator of the entire Banking in India. RBI plays an important part in the Development Strategy of the Government of India.RBI regulates commercial banks and non-banking finance companies working in India. It serves as the leader of the banking system and the money market. It regulates money supply and credit in the country. The RBI carries out India's monetary policy and exercises supervision and control over banks and non-banking finance companies in India.

The Reserve Bank of India was founded on 1 April 1935AD to respond to economic troubles after the First World War.RBI was conceptualised as per the guidelines, working style and outlook presented by Dr. B. R. Ambedkar in his book titled "The Problem of Rupee

- Its origin and its solutions" and presented to the Hilton Young Commission. Eventually, the Central Legislative Assembly passed these guidelines as the RBI Act 1934. Eventually, the Central Legislative Assembly passed these guidelines as the RBI Act 1934. The original choice for the seal of RBI was the East India Company Double Mohur, with the sketch of the Lion and Palm Tree. However, it was decided to replace the lion with the tiger, the national animal of India. The Preamble of the RBI describes its basic functions to regulate the issue of banknotes, keep reserves to secure monetary stability in India, and generally to operate the currency and credit system in the best interests of the country. The Central Office of the RBI was established in Calcutta (now Kolkata) but was moved to Bombay (now Mumbai) in 1937. The RBI also acted as Burma's (now Myanmar) central bank until April 1947 (except during the years of Japanese occupation (1942–45), even though Burma seceded from the Indian Union in 1937. After the Partition of India in August 1947, the bank served as the central bank for Pakistan until June 1948 when the State Bank of Pakistan commenced operations. Though set up as a shareholders' bank, the RBI has been fully owned by the Government of India since its nationalisation in 1949 AD.

9.2 Establishment of Reserve Bank of India:

The Reserve Bank is fully owned and operated by the Government of India. The Preamble of the Reserve Bank of India describes the basic functions of the Reserve Bank as:

- Regulating the issue of Banknotes
- Securing monetary stability in India
- Modernising the monetary policy framework to meet economic challenges

The Reserve Bank's operations are governed by a central board of directors, RBI is on the whole operated with a 21-member central board of directors appointed by the Government of India in accordance with the Reserve Bank of India Act.

The Central board of directors comprise of:

- Official Directors – The governor who is appointed/nominated for a period of four years along with four Deputy Governors
- Non-Official Directors – Ten Directors from various fields and two government Official.

9.3 Organisation Structure

9.4 Objectives:

The primary objectives of RBI are to supervise and undertake initiatives for the financial sector consisting of commercial banks, financial institutions and non-banking financial companies (NBFCs).

Some key initiatives are:

i. Restructuring bank inspections

ii. Fortifying the role of statutory auditors in the banking system

Legal Framework

The Reserve Bank of India comes under the purview of the following Acts:

- Reserve Bank of India Act, 1934
- Public Debt Act, 1944
- Government Securities Regulations, 2007
- Banking Regulation Act, 1949
- Foreign Exchange Management Act, 1999
- Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002
- Credit Information Companies(Regulation) Act, 2005
- Payment and Settlement Systems Act,

9.5 FUNCTIONS OF RBI:

The Preamble of the Reserve Bank of India 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 monetary stability in India and generally to operate the currency and credit system of the country to its advantage; to have a modern monetary policy framework to meet the challenge of an increasingly complex economy, to maintain price stability while keeping in mind the objective of growth." The following points highlight the seven main functions of the RBI. The functions are:

1. Monopoly of Note Issue
2. Banker's Bank
3. Banker to the Government
4. Controller of Credit
5. Exchange Management and Control
6. Miscellaneous Functions
7. Promotional and Developmental Functions

1. Monopoly of Note Issue:

Like any other central bank, the RBI acts as a sole currency authority of the country. It issues notes of every denomination, except one-rupee note and coins and small coins, through the Issue Department of the Bank. One- rupee notes and coins and small coins are issued by the Government of India. In actuality, the RBI also issues these coins on behalf of the Government of India. At present, notes of denominations of rupees two, five, ten, twenty, fifty, one hundred and five hundred are issued by the RBI. Prior to 1956, the principle of note issue of the RBI was based on proportional reserve system. This system was replaced by the minimum reserve system in 1956 under which the RBI was required to hold at least Rs. 115 crores worth of gold as backing against the currency issued. The rest (Rs. 85 crores) should be in foreign securities, so that together with gold and foreign exchange reserve the minimum value of these assets is Rs. 200 crores.

2. Banker's Bank:

As bankers' bank, the RBI holds a part of the cash reserves of commercial banks and lends them funds for short periods. All banks are required to maintain a certain percentage (lying between 3 per cent and 15 per cent) of their total liabilities. The main objective of changing this cash reserve ratio by the RBI is to control credit. The RBI provides financial assistance to commercial banks and State cooperative banks through rediscounting of bills of exchange. As the RBI meets the need of funds of commercial banks, the RBI functions as the

Tender of the last resort'. The RBI has been empowered by law to supervise, regulate and control the activities of commercial and cooperative banks. The RBI periodically inspects banks and asks them for returns and necessary information.

3. Banker to the Government:

The RBI acts as the banker to the government of India and State Governments (except Jammu and Kashmir). As such it transacts all banking business of these Governments.

These are the following: The RBI:

(i) Accepts and pays money on behalf of the Government.

(ii) It carries out exchange remittances and other banking operations.

As the Government's banker, the RBI provides short-term credit to the Government of India. This short-term credit is obtainable through the sale of treasury bills. Not only this, the RBI also provides ways and means of advances (repayable with 90- days) to State Government. It may be noted that the Central Government is empowered to borrow any amount it likes from the RBI.

The RBI also acts as the agent of the Government in respect of membership of the IMF and World Bank. Furthermore, the RBI acts as the adviser of the Government not only on banking and financial matters but also on a wide range of economic issues (like financing patterns, mobilisation of resources, institutional arrangements with regard to banking and credit matters, arrangements with regard to banking and credit matters, international finance) etc.

4. Controller of Credit:

The RBI controls the total supply of money and bank credit to sub serve the country's interest. The RBI controls credit to ensure price and exchange rate stability. To achieve this, the RBI uses all types of credit control instruments, quantitative, qualitative and selective. The most extensively used credit instrument of the RBI is the bank rate. The RBI also relies greatly on the selective methods of credit control. This function is so important that it requires special treatment.

5. Exchange Management and Control:

One of the essential central banking functions performed by the Bank is that of maintaining the external value of rupee. The external stability of the currency is closely related to its internal stability the inherent economic strength of the country and the way it conducts its economic and monetary affairs. Domestic, fiscal and monetary policies have, therefore, an important role in maintaining the external value of the currency. Reserve Bank of India has a very important role to play in this area.

The RBI has the authority to enter into foreign exchange transactions both on its own account and on behalf of the Government. The official external reserves of the country consist of monetary gold and foreign assets of the Reserve Bank, besides SDR holdings. The Reserve Bank, as the custodian of the country's foreign ex- change reserves, is vested with the duty of managing the investment and utilisation of the reserves in the , most advantageous manger.

6. Miscellaneous Functions:

The RBI collects, collates and publishes all monetary and banking data regularly in its weekly statements in the RBI Bulletin (monthly) and in the Report on Currency and Finance (annually).

7. Promotional and Developmental Functions:

Apart from these traditional function, the RBI performs various activities of promotional and developmental nature. It attempts to mobilise savings for productive purposes. This is done in various ways. For instance, RBI has helped a lot in building the huge financial infrastructure that we see now. 'This consists of such institutions as the Deposit Insurance Corporation (to safeguard the interests of depositors against bank failure), the Agricultural Refinance and Development Corporation (to meet the needs of agriculturists), IFCI, SFCs, IDBI, UTI (to meet the long and medium term needs of industry), etc. Thus, it is clear that RBI is not a typical Central Bank as is traditionally understood. It is something more than a Central Bank. It regulates not only currency and credit but aids the development of the Indian economy by conducting various types of promotional activities. As such, in RBI we see many activities combined into one.

9.6 Role of RBI in the development of India:

The central bank is regarded as the supreme monetary authority in every country, and accordingly it has to perform various useful functions for ensuring smooth functioning of the economy. Besides the discharge of certain traditional functions the central bank in a developing economy can play a special role, as is true of the Reserve Bank.

This role can be understood from the following functions performed by the RBI:

1. Expanding currency supply for financing development plans:

A developing country like India is to undertake massive development plans and programmes for accelerating the pace of development. The government requires a vast amount of finance for this purpose, for which the country is to rely on the method of deficit financing (i.e., the issue of new paper-notes) in addition to using other methods.

The banking sector is to provide adequate finance for this purpose. The central bank, being the sole note-issuing authority can assist the government by expanding the supply of currency to enable the government to finance its massive plan outlays. Actually the Reserve Bank of India has been assisting the Government of India by expanding the supply of currency. But, the supply of currency (and credit) is to be properly regulated for enabling the economy achieves faster growth with reasonable price stability.

2. Resource mobilisation and supply of adequate credit:

The mobilisation of resources for development purposes is an essential requirement in a developing economy. In such an economy, the central bank can assist the government in mobilising domestic resources for financing the development plans through such activities as the floating of new loans of the government, strengthening the banking structure for mobilising resources even from the rural areas, and so on. Apart from these the central bank s to make necessary arrangements for the supply of adequate bank credit which is so essential for developmental activities.

3. Increasing the flow of bank credit to the priority sectors:

The formulation of development priorities is an essential characteristic of development planning. The central bank of a developing country is to frame its monetary and credit policy in such a fashion that larger and desired quantities of bank credit go to the priority sectors, such as agriculture, cooperatives, small industries and export trade. Furthermore, for social and economic along with economic growth achieving, it has to formulate a policy for extending liberal bank credit to the weaker and hitherto neglected sections of the community.

At the same time it can follow the policy of credit restraint for maintaining price stability and for ensuring proper use of bank credit. For this reason the Reserve Bank of India has been following a monetary and credit policy what is known as the policy of controlled expansion of bank credit. Through it the R.B.I. can undertake the direct financing of development projects by lending liberally to those institutions which provide development finance.

4. Controlling inflation and containing cost escalation:

The rising price level is regarded as a concomitant of economic development. The central bank in a developing economy is required to take necessary steps in holding the price line at a desired level so that plan-estimates are not totally upset due to cost-escalation. In a developing economy various traditional and new measures of monetary controls, especially selective credit controls, are used to check the inflationary rise in prices. The measures like higher margin requirements for speculative bank advances, higher CRR and incremental CRR, higher statutory liquidity ratios, penal rates of interest on excessive borrowings differential interest rate policy, higher bank rates and lending rates, etc. may be adopted by the central bank, as done by the Reserve Bank of India, for controlling inflation and for containing, or at least moderating, cost escalations of development projects.

5. Creation of a strong infrastructure and expansion of institutional facilities for agricultural and industrial finance:

For creating a strong and integrated infra-structure a developing economy is to extend institutional facilities for agriculture and industry, as such facilities are grossly inadequate. The central bank in such a country can take some positive steps for extending the institutional facilities for agricultural and industrial finance. Thus, the Reserve Bank of India has taken active steps in reorganising the rural credit structure through co-operatives, the National Bank for Agriculture and Rural Development (NABARD), regional rural banks, lead banks. Similarly, in developing institutional facilities for industrial finance it played a very significant role by establishing some specialised institutions like the Industrial Finance Corporation, the Industrial Development Bank, etc. The central bank in a developing economy usually sponsors the establishment of these institutions by subscribing to their shares and debentures by a large amount.

6. Operating exchange control:

Foreign exchange constraint is often found to be a serious obstacle to the growth of a developing economy. Accordingly, the central bank in such an economy can serve the best cause of growth by making proper arrangement for the judicious use of the country's scarce foreign exchange, as had been done by the Reserve Bank of India at the early years of planning.

7. Development oriented monetary policy:

The central bank in a developing economy can formulate a development-oriented monetary and credit policy like the policy of controlled expansion of bank credit as followed by the Reserve Bank of India for promoting economic growth with stability. Through this monetary policy the central bank can bring about a desired allocation of resources especially capital.

This task is a very delicate one as it has to strike a balance between two apparently conflicting objectives:

(i) Expansion of the economy, and

(ii) Control of such expansion for achieving price stability.

8. Developing sound banking structure:

The central bank in a developing economy can also take various positive steps and adopt various measures such as deposit insurance, nationalisation of banks, creation of a suitable bill market scheme and so on for building a sound banking structure, or financial infrastructure which is essential for achieving faster economic growth.

9. Advising government on plan matters:

The central bank in a developing economy like India, can also advise the government not only on banking and financial matters but also on a wide range of economic issues related to national economic planning and resource mobilisation. Besides, a central bank should keep a strict watch over any possible sign of misdirection of the economy and accordingly it should give timely and proper advice to the government.

10. Economic surveys and collecting basic statistics: Finally, the central bank in a developing economy like the R.B.I, often conduct surveys on various uncovered sectors and supply valuable data on national economic plans and policies to the government for formulating development plans.

9.7 Summary

The central bank is an independent apex monetary authority which regulates banks and provides important financial services like storing of foreign exchange reserves, control of inflation, monetary policy report. A central bank is known by different names in different countries. The functions of a central bank may vary from country to country and are

autonomous or body and perform or through another agency vital monetary functions in the country. A central bank is a vital financial apex institution of an economy and the key objects of central banks may differ from country to country still they perform activities and functions with the goal of maintaining economic stability and growth of an economy.

It has to play a special role in developing countries, viz., for promotion (expansion) of growth with stability. In most developing countries, at least at the early stage of development, there is unlikely to exist a sound commercial banking system which can make adequate provision for the growing need for finance. In such a situation, the central bank should come forward to fill in the credit gaps.

9.8 Self Assessment Questions

I. Essay Type Questions

1. Explain the Chief Function of Reserve Bank of India
2. Write an essay on the role of RBI in the Economic development of India

II. Short Answer Questions

3. Write about organization structure of RBI
4. What are the objectives of RBI
5. Write about Establishment of RBI

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Lesson – 10

RBI CREDIT CONTROL SYSTEMS

10.0 Objectives

After completing the you will be able to understand:

- The meaning and objectives of RBI Credit control systems
- Methods of credit control along with limitations
- The various measures to make the credit control system more effective

Structure

10.1 Introduction:

Probably the most important of all the functions performed by a central bank are that of controlling the credit operations of commercial banks. In modern times, bank credit has become the most important source of money in the country, relegating coins and currency notes to a minor position. Moreover, it is possible for commercial banks to expand credit and thus intensify inflationary pressure or contract credit and thus contribute to a deflationary situation. It is, thus, of great importance that there should be some authority which will control the credit creation by commercial banks. As controller of credit, the central bank attempts to influence and control the volume of Bank credit and also to stabilize business condition in the country.

10.2 Meaning and Objectives:

The term 'credit control' refers to the adjustment made by the central bank in bank advances to the needs of trade and commerce for price and exchange stability.

It has two major aspects:

(a) credit expansion i.e., increase of the total volume of bank credit and

(b) credit contraction, i.e., decrease of the total volume of bank credit.

The broad objectives of credit control policy in India have been-

- Ensure an adequate level of liquidity enough to attain high economic growth rate along with maximum utilisation of resource but without generating high inflationary pressure.
- Attain stability in the exchange rate and money market of the country.
- Meeting the financial requirement during a slump in the economy and in the normal times as well.
- Control business cycle and meet business needs.

So long we have described the central bank's controls from the standpoint of combating inflation by contraction of the money supply. The controls can, however, be used equally well to expand the supply of money. Thus, if the government wishes to stimulate trade it can instruct the bank to reduce the cost of borrowing by increasing the availability of loans through releasing special deposits, and buying securities in the open market, by issuing directives encouraging adoption of a generous lending policy and by reducing the level of interest rates.

10.3 Need for Controlling the credit:

Controlling credit in the economy is amongst the most important functions of the Reserve Bank of India. The basic and important needs of credit control in the economy are-

- To encourage the overall growth of the *"priority sector"* i.e. those sectors of the economy which is recognized by the government as "prioritized" depending upon their economic condition or government interest. These sectors broadly totals to around 15 in number.[1]
- To keep a check over the channelization of credit so that credit is not delivered for undesirable purposes.
- To achieve the objective of controlling inflation as well as deflation.
- To boost the economy by facilitating the flow of adequate volume of bank credit to different sectors.
- To develop the economy.

10.4 Methods of Credit Control:

The various methods employed by the RBI to control credit creation power of the commercial banks can be classified in two groups, viz., quantitative controls and qualitative controls. Quantitative controls are designed to regulate the volume of credit created by the banking system qualitative measures or selective methods are designed to regulate the flow of credit in specific uses. Quantitative or traditional methods of credit control include banks rate policy, open market operations and variable reserve ratio. Qualitative or selective methods of credit control include regulation of margin requirement, credit rationing, regulation of consumer credit and direct action.

Some of the methods employed by the RBI to control credit creation are:

I. **Quantitative Method**

II. **Qualitative Method.**

The various methods employed by the RBI to control credit creation power of the commercial banks can be classified in two groups, viz., quantitative controls and qualitative controls. Quantitative controls are designed to regulate the volume of credit created by the banking system qualitative measures or selective methods are designed to regulate the flow of credit in specific uses. Quantitative or traditional methods of credit control include banks rate policy, open market operations and variable reserve ratio. Qualitative or selective methods of credit control include regulation of margin requirement, credit rationing, regulation of consumer credit and direct action.

I. Quantitative Method:

(i) Bank Rate:

The bank rate, also known as the discount rate, is the rate payable by commercial banks on the loans from or rediscounts of the Central Bank. A change in bank rate affects other market rates of interest. An increase in bank rate leads to an increase in other rates of interest and conversely, a decrease in bank rate results in a fall in other rates of interest. A deliberate manipulation of the bank rate by the Central Bank to influence the flow of credit created by the commercial banks is known as bank rate policy. It does so by affecting the demand for credit the cost of the credit and the availability of the credit.

An increase in bank rate results in an increase in the cost of credit; this is expected to lead to a contraction in demand for credit. In as much as bank credit is an important component of aggregate money supply in the economy, a contraction in demand for credit consequent on an increase in the cost of credit restricts the total availability of money in the economy, and hence may prove an anti-inflationary measure of control. Likewise, a fall in the bank rate causes other rates of interest to come down. The cost of credit falls, i. e., and credit becomes cheaper. Cheap credit may induce a higher demand both for investment and consumption purposes. More money, through increased flow of credit, comes into circulation. A fall in bank rate may, thus, prove an anti-deflationary instrument of control. The effectiveness of bank rate as an instrument of control is, however, restricted primarily by the fact that both in inflationary and recessionary conditions, the cost of credit may not be a very significant factor influencing the investment decisions of the firms.

(ii) Open Market Operations:

Open market operations refer to the sale and purchase of securities by the Central bank to the commercial banks. A sale of securities by the Central Bank, i.e., the purchase of securities by the commercial banks, results in a fall in the total cash reserves of the latter. A fall in the total cash reserves is leads to a cut in the credit creation power of the commercial banks. With reduced cash reserves at their command the commercial banks can only create lower volume of credit. Thus, a sale of securities by the Central Bank serves as an anti-inflationary measure of control.

Likewise, a purchase of securities by the Central Bank results in more cash flowing to the commercials banks. With increased cash in their hands, the commercial banks can create more credit, and make more finance available. Thus, purchase of securities may work as an anti-deflationary measure of control. The Reserve Bank of India has frequently resorted to the sale of government securities to which the commercial banks have been generously contributing. Thus, open market operations in India have served, on the one hand as an instrument to make available more budgetary resources and on the other as an instrument to siphon off the excess liquidity in the system.

(iii) Variable Reserve Ratios:

Variable reserve ratios refer to that proportion of bank deposits that the commercial banks are required to keep in the form of cash to ensure liquidity for the credit created by them. A rise in the cash reserve ratio results in a fall in the value of the deposit multiplier. Conversely, a fall in the cash reserve ratio leads to a rise in the value of the deposit multiplier.

A fall in the value of deposit multiplier amounts to a contraction in the availability of credit, and, thus, it may serve as an anti-inflationary measure. A rise in the value of deposit multiplier, on the other hand, amounts to the fact that the commercial banks can create more credit, and make available more finance for consumption and investment expenditure. A fall in the reserve ratios may, thus, work as anti-deflationary method of monetary control.

The Reserve Bank of India is empowered to change the reserve requirements of the commercial banks. The Reserve Bank employs two types of reserve ratio for this purpose, viz. the Statutory Liquidity Ratio (SLR) and the Cash Reserve Ratio (CRR). The statutory liquidity ratio refers to that proportion of aggregate deposits which the commercial banks are required to keep with themselves in a liquid form. The commercial banks generally make use of this money to purchase the government securities. Thus, the statutory liquidity ratio, on the one hand is used to siphon off the excess liquidity of the banking system, and on the other it is used to mobilise revenue for the government. The Reserve Bank of India is empowered to raise this ratio up to 40 per cent of aggregate deposits of commercial banks. Presently, this ratio stands at 25 per cent. The cash reserve ratio refers to that proportion of the aggregate deposits which the commercial banks are required to keep with the Reserve Bank of India. Presently, this ratio stands at 9 percent.

Which is Superior? Either variable cash reserve ratio or open market operations:

From the analysis and discussions made above of these two methods of credit, it can be said that the variable cash reserve ratio method is superior to open market operations on the following grounds:

(1) Open market operations is time consuming procedure while cash reserves ratio produces immediate effect in the economy.

(2) Open market operations can work successfully only where securities market in a country are well organised and well developed.

While Cash Reserve Ratio does not require such type of securities market for the successful implementation.

(3) Open market operations will be successful where marginal adjustments in cash reserve are required.

But the variable cash reserve ratio method is more effective when the commercial banks happen to have excessive cash reserves with them. These two methods are not rival, but they are complementary to each other.

II. Qualitative Method:

The qualitative or selective methods of credit control are adopted by the Central Bank in its pursuit of economic stabilisation and as part of credit management.

(i) Margin Requirements:

Changes in margin requirements are designed to influence the flow of credit against specific commodities. The commercial banks generally advance loans to their customers against some security or securities offered by the borrower and acceptable to banks. More generally, the commercial banks do not lend up to the full amount of the security but lend an amount less than its value. The margin requirements against specific securities are determined by the Central Bank. A change in margin requirements will influence the flow of credit. A rise in the margin requirement results in a contraction in the borrowing value of the security and similarly, a fall in the margin requirement results in expansion in the borrowing value of the security.

(ii) Credit Rationing:

Rationing of credit is a method by which the Central Bank seeks to limit the maximum amount of loans and advances and, also in certain cases, fix ceiling for specific categories of loans and advances.

(iii) Regulation of Consumer Credit:

Regulation of consumer credit is designed to check the flow of credit for consumer durable goods. This can be done by regulating the total volume of credit that may be extended for purchasing specific durable goods and regulating the number of installments through which such loan can be spread. Central Bank uses this method to restrict or liberalise loan conditions accordingly to stabilise the economy.

(iv) Moral Suasion:

Moral suasion and credit monitoring arrangement are other methods of credit control. The policy of moral suasion will succeed only if the Central Bank is strong enough to influence the commercial banks. In India, from 1949 onwards, the Reserve Bank has been successful in using the method of moral suasion to bring the commercial banks to fall in line with its policies regarding credit. Publicity is another method, whereby the Reserve Bank marks direct appeal to the public and publishes data which will have sobering effect on other banks and the commercial circles.

10.5 The limitations of selective credit control are as follows:

1. Selective credit control is applicable, when everything is considered to commercial banks and to bank credit only. Non-banking financial institutions generally remain out of the purview of the central bank, and, to that extent, the desired objectives of selective credit control is also weakened by alternative sources of credit, outside the organised money sector, such as moneylenders, black (or unaccounted) money with the people, etc.
2. It is very difficult for banks to ensure advances made to the borrowers are not spent on unintended purposes. Thus, qualitative credit control cannot materialise, in its real sense.
3. Bank money also has its velocity. Thus, an amount once lent for a genuine purpose may next be spent on undesirable purposes.
4. Moreover, there are no restrictions on clean credit under the selective control policy as a result of which measures like higher margin requirements can be adjusted by the borrowers through a clean loan. Thus, "the comparative lack of efficacy of the selective measures by themselves results in the difficulties of securing compliances by banks when control imposed after excessive lending has already taken place, or the difficulties of adopting the controls on advances to the future pattern of production, that is to say, of imparting the requisite

flexibility in relation to changing credit demands in system of control which is primarily regulated with reference to a base period of curbing accumulation of inventories through alternative sources of finance, so long as the initiating cause of a speculative wave, viz., scarcity of supplies in relation to demand, persists.”

5. Commercial banks, motivated by profit, may play mischief by manipulating accounts and sanctioning loans for forbidden uses. These malpractices defeat the very objective of selective credit control.

Many economists oppose selective credit control on various grounds:

(1) It interferes unduly with the freedom of borrowers and lenders;

(2) It prevents allocation of resources and output in accordance with buyer’s wishes and there by restricts freedom of choice;

(3) It is superfluous in general monetary management;

(4) It serves as a substitute for more general and more widely effective measures; and

(5) It is difficult to administer, particularly in respect of consumer credit, where the number of entities to be regulated is very large.

On the other hand, economists are agreed that selective credit control can be a useful supplement to general credit control, especially when the misuse of credit is confined only to one or a few sectors of the economy. Despite all these limitations, selective credit control serves as an important tool of monetary management by the central bank. For effective result, quantitative and qualitative instruments of credit control must be combined used. However, the attitude of economists towards selective credit control varies widely.

10.6 Effectiveness of Credit Control Measures:

The effectiveness of credit control measures in an economy depends upon a number of factors. First, there should exist a well-organised money market. Second, a large proportion of money in circulation should form part of the organised money market. Finally, the money and capital markets should be extensive in coverage and elastic in nature.

Extensiveness enlarges the scope of credit control measures and elasticity lends it adjustability to the changed conditions. In most of the developed economies a favourable environment in terms of the factors discussed before exists, in the developing economies, on the contrary, economic conditions are such as to limit the effectiveness of the credit control measures.

Advantages and Disadvantages of Monetary Policy:

There are several advantages and disadvantages in using monetary policy as a tool for correcting the problems of inflation and unemployment. A primary advantage is the speed with which changes can be implemented. Unlike fiscal policy — which could take months to implement — the first steps toward changing the money supply can be taken the day the decision to do so is made.

A second advantage of using monetary policy is its flexibility with regard to the size of the change to be implemented. Reserves can be increased or decreased in small or large increments. One of the major disadvantages of monetary policy is the loan-making link through which it is carried out. That is, the R.B.I. can increase reserves to stimulate economic activity as much as it wants, but the reserves themselves do not alter the money supply.

For the money supply to increase someone must be willing to borrow and a bank must be willing to lend. Because the R.B.I. cannot force the loan-making process, it has only indirect control over increasing the money supply. This loan-making link may reduce the effectiveness of monetary policy in fighting unemployment during a deep and serious recession. If economic conditions are severe, no expansion of reserves or lowering of the interest rate may be enough to induce borrowers to take loans.

A second problem with monetary policy occurs during inflation. As the Reserve Bank tightens the money supply and forces the interest rate higher, it raises the price for borrowed money. Businesses that borrow at this high rate may, in turn, raise prices on their products to compensate. Thus, fighting inflation with monetary policy could worsen it.

10.7 Summary

Credit control is most important function of Reserve Bank of India. Credit control in the economy is required for the smooth functioning of the economy. By using credit control methods RBI tries to maintain monetary stability. There are two types of methods, namely, Quantitative control to regulate the volume of total credit. And Qualitative Control to regulate the flow of credit. The quantitative measures of credit control are Bank Rate Policy, Open Market Operations, Cash Reserve Ratio, Statutory Liquidity Ratio. With respect to Qualitative measures are used by the RBI for selective purposes, some of them are Margin requirements, Consumer Credit Regulation, RBI Guidelines, Rationing of credit Moral Suasion and Direct Action.

10.8 Self Assessment Questions

I. Essay Type Questions

1. Explain the various credit controlling methods adopted by RBI
2. Write about selective credit controlling methods

II. Short Answer Questions

3. What is the need for controlling credit?

4. What are the limitations of selective credit controlling methods

5. Write about effectiveness of credit control measures

III. Very short answers

1. Credit expansion vs credit contraction
2. Objectives of credit control policy in India
3. Bank Rate
4. Open Market operations
5. Variable reserve requirements
6. Margin requirements
7. Credit rationing
8. Why many economists oppose selective credit control

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Lesson – 11

AGRICULTURAL BANKS IN INDIA

11.0 Objectives

After going through this lesion you will be able to understand the following:

- The nature and trends of agricultural credit in India
- Evolution and major policy milestones in agricultural credit in India
- The various sources of agricultural credit
- Requirements of sound agricultural finance in India

Structure

11.1 Introduction

Agriculture is a key sector of Indian economy in view of its contribution to employment and GDP. Agricultural credit plays a vital role in farm sector development and facilitates adoption of new technologies. However, any amount of credit even at the most reasonable rates cannot guarantee higher productivity or adequate income among the farmers, as the success depends upon many other supporting factors including the availability of agricultural inputs, services and remunerative markets for the products.

The agricultural credit policies designed and implemented in India are mainly supply driven through targeted ground level credit, interest subvention scheme and directed lending by way of regulatory prescription under Priority Sector Lending guidelines. These policies along with other policy interventions at the level of Government and RBI have yielded commendable results in the field of agricultural credit. However, agricultural sector still faces challenges such as lack of capital formation, regional disparity, dependence of farmers especially small and marginal farmers, tenant farmers, landless labourers and share croppers on non-institutional sources of credit at significantly higher rates, non-realization of the fair price for agricultural produce causing farmers' distress and farm loan waivers impacting credit culture and weakening state finances. Indian agriculture and allied sector broadly covers four activities, viz., crop, livestock, forestry and fisheries. To stimulate the productivity of these activities, Government of India (GoI) has, from time to time, given policy thrusts which led to the various agricultural revolutions, viz., green revolution in cereal production (late 1960s-early 1980s) which was succeeded by the white revolution in milk production (starting in the 1970s), the gene revolution in cotton production, (in early 2000) and the blue revolution which focused on increasing fisheries production and productivity (1973-2002). As a result, the agriculture sector has not only become self-sufficient but has emerged as the net exporter of several agricultural commodities like rice, marine products, cotton etc.

Such a phenomenal achievement would not have been possible without the agricultural credit related policy interventions by GoI and RBI. Realising the importance of institutional credit in fostering the growth and development of the agriculture sector, the All India Rural Credit Survey Committee (AIRCSC, 1951-54) had laid the foundation of the institutional framework to establish a sound credit delivery system for financing agriculture and allied activities. Till the end of the 1960s cooperative structure had assumed the responsibility of providing production credit to the farmers. With the objective of imposing social control, commercial banks were nationalised in 1969 and 1980. Further, in 1976, RRBs were set up as alternative agencies to provide rural credit. These developments brought in a sea change in the flow of institutional credit to the farm sector. As a consequence, the farmers' credit requirements were increasingly met by the formal institutional sources. Gradually the country moved towards a multi-agency approach to meet the credit needs of the farmers.

11.2 Nature of Agricultural financing:

Generally, in India the volume of farm credit is being influenced by the farm size as well as family activities. Some activities require less credit while some other activities require higher amounts of credit. The credit needs of the farmers vary depending upon the nature of production, availability of inputs and the technology employed. The credit needs of the farmers are usually classified on the basis of purpose, time period, nature of security etc.

11.2.1 On the Basis of Time:

The All India Rural Credit Survey Committee has adopted a classification based on time period. According to this classification, the credit requirements of the farmers are classified into short, medium and long term needs.

1. Short Term Credit : Farmers require short term loans to meet the working capital expenses like expenditure on seeds, fertilizers, pesticides, wages, transport charges etc. The period for a short term loans varies from 6 months to 10 months. The loans are also known as crop loans. They need to be repaid immediately after getting income from crops.
2. Medium Term Credit : Farmers need medium term credit to purchase live stock, farm tools etc. The period of this credit ranges from 1 to 5 years. These loans can be repaid in easy instalments.
3. Long Term Credit : Farmers need long term loans to purchase new farm lands, heavy farm machinery like tractors, pump sets, oil engines and for other land development activities. This period generally varies from 5 to 20 years. These loans will be repaid in number of instalments spread over a long period of time.

11.2.2 On the basis of Purpose :

Agricultural credit needs of the farmers can be classified on the basis of purpose into the following categories.

1. Productive Needs : Under Productive needs we can include all credit requirements which directly affect agricultural productivity. Farmers need loans for the purpose of seeds, fertilizers, manures, agricultural implements, live stock, digging and repair of wells and tubewells etc. Repayment of these loans is generally not difficult because the very process of production generally creates the wherewithals or repayment.
2. Unproductive Needs : Farmers often require credit for consumption needs also. During off-season, droughts or floods they wont get sufficient. To meet the gap they have to take loans. Institutional sources wont provide such loans. Hence they get loans from money lenders at a higher rates of interest. In addition to consumption, farmers also require some loans for a multiplicity of other unproductive reasons like litigation, functions, festivals,, rituals etc. Repayment of these loans is difficult as they donot contribute to the productivity of farmer.

11.3 Evolution of Agricultural Finance in India and Policy Milestones

The institutional framework of agricultural finance was shaped by the overarching demands of the nation. The evolution of agricultural credit policies and milestones can be broadly categorised into three distinctive phases.

1 Phase 1 (1951 – 1969)

i. The Government of India initiated the first five-year plan in 1951 with the thrust on developing the primary sector. The National Credit Council in a meeting held in July 1968 emphasised that commercial banks should increase their involvement in the financing of priority sectors, viz., agriculture and small-scale industries, sectors deemed as 'national priority'.

ii. In 1969, when the first phase of nationalisation of banks took place, there were 6955 public sector bank branches and the average population per branch office was 64,000. To boost rural development, the Reserve Bank of India had then prescribed 1:3 ratio for opening of branches in urban and rural/semi-urban centres.

2 Phase 2 (1970-1990)

i. The channel for institutional credit to agriculture during the first two decades of independence was the cooperative sector. With the nationalisation of commercial banks in 1969, the decade of 1970s marked the entry of commercial banks into agricultural credit. This period saw the introduction of the Lead Bank Scheme and regulatory prescription of Priority Sector Lending – two landmark development policies that have not only survived till date but have also served as the fuel for channelling agricultural credit and rural development.

ii. The Regional Rural Bank Act, 1976 was enacted to provide sufficient banking and credit facility for agriculture and other rural sectors.

iii. The National Bank for Agriculture and Rural Development (NABARD) came into existence in 1982, with the enactment of NABARD Act 1981, to promote agriculture and rural development.

iv. NABARD, in 1992 introduced the Self-Help Group (SHG) model to further financial inclusion of the excluded segments.

v. In 1989, the Reserve Bank introduced the service area approach (SAA) and Annual Credit Plan (ACP) system as tools for reaching out to the rural areas.

3 Phase 3 (1991 onwards)

i. The economic reforms of the 1990s, started with the implementation of the first Narasimham Committee Report of 1991, emphasising financial soundness and operational efficiency of the financial sector – including that of rural financial institutions. The Reserve Bank of India gradually deregulated the interest rate regime to aid improvement in the operational efficiency of banks.

ii. The first major nationwide farm loan waiver was announced in 1990 and the cost to the national exchequer was around ₹100 billion.

iii. Pursuant to the 1995 Union Budget announcement, GoI established the Rural Infrastructure Development Fund (RIDF) with NABARD. RIDF was mainly meant for funding of rural infrastructure projects which in turn were supposed to deepen the credit absorption capacity in a state by giving loans to state governments and state-owned corporations. Scheduled commercial banks contribute to the corpus of the fund to the extent of their shortfall in achieving the priority sector lending target.

iv. During 1992-93, NABARD started the pilot project on SHG-Bank Linkage programme - a partnership model involving SHGs, banks and NGOs. In the initial years, the scheme progressed slowly but picked up gradually.

v. The Kisan Credit Card (KCC) was introduced as a financial product in 1998 to provide hassle free credit to farmers.

vi. The Union Government introduced the Ground Level Credit (GLC) policy in year 2003-04. Under this policy, GoI announces GLC targets for agriculture and allied sector in the Union budget every year which banks are required to achieve during the financial year. These targets are set region-wise, agency-wise (SCBs, RRBs & Cooperative banks) and loan category wise (crop and term loan).

vii. Another policy initiative, introduced in 2004–2005, was to double the volume of credit to agriculture over a period of three years and expand the reach of formal finance.

viii. The year 2006 saw a host of developments. Pursuant to the budget announcement for 2006-07, the Union Government introduced the interest subvention scheme (ISS) for short term crop loans to enable farmers to avail farm credit at reduced interest rates. The Business Correspondents (BCs) and Business Facilitators (BFs) were rolled out for the first time by the Reserve Bank of India to further the cause of financial inclusion. NABARD introduced the Joint Liability Group (JLG) model, an extension of the earlier SHG model for reaching out to tenant farmers and share-croppers with access to credit.

ix. Agricultural Debt Waiver and Debt Relief Scheme (ADWDRS), 2008 announced by the Union Government involved waiving institutional debt for small farmers and a one-time settlement opportunity with 25 per cent rebate to other farmers. This massive write-off of agricultural loans involving ₹525.16 billion was envisaged to provide relief to the persistent problem of farmers' indebtedness and alleviate the financial pressure faced by the farmers.

x. In 2009-10, the Government introduced the prompt repayment incentive (PRI) of 3 per cent under the ISS to bring down the effective rate of interest to 4 per cent to those farmers who repaid their loans on or before the due date to inculcate repayment habits.

xi. In July 2012, the Priority Sector Lending (PSL) guidelines were revised by the Reserve Bank to widen the eligible activities. Again in April 2015[7], the guidelines were revamped based on the recommendations of the Internal Working Group (IWG). The salient features of the revamped PSL guidelines relating to agricultural sector are:

a. The distinction between direct and indirect agricultural credit was dispensed with.
b. A sub-target of 8 per cent of ANBC or Credit Equivalent Amount of Off-Balance Sheet Exposure, whichever is higher, was prescribed for small and marginal farmers.
c. Focus shifted from 'credit in agriculture' to 'credit for agriculture'.

11.4 Trends in Agricultural Credit

The ratio of Agri-Credit outstanding to Agri-GDP jumped from 0.6 per cent in 1950-51 to 9.81 per cent in 1971-72. Post 1972, the ratio shows an upward trend upto 1987- 88 increasing to 21.76 per cent. The impressive achievement of agricultural credit against agricultural GDP during 1950s-1980s is on account of nationalisation of banks and introduction of RRBs which expanded the reach of formal credit in the country. However, the reverse trend in the ratio started from 1990-91 onwards and it fell to 13.34 per cent in 1998-99. Post 1999 the ratio increased steeply and reached upto 39.55 per cent in 2006-07, which indicates that introduction of KCC was a big booster for agricultural credit and brought about a sea change in improving the reach of credit to the farming community. Many of the other policy initiatives started in 2004-05 also played an important role. In later years, despite a fluctuating trend, it rose to 49.63 per cent in 2015-16 and 51.56 per cent in 2017-18. The chart reveals that the trend of both the agri-credit outstanding as well as disbursement as percentage of agri-GDP are largely similar except in certain periods where there is divergence between the two. The reasons could be announcement of loan waivers which negatively impacted the repayment behavior of the borrowers and also made the banks averse to fresh lending.

11.5 Institutional vis-à-vis Non-Institutional Agricultural Credit

In the 1950s, the rural agrarian credit needs were traditionally met from the non-institutional sources largely through the local money-lenders. While the rural farmers had easy access to finance for their immediate needs, the steep interest rates, coupled with high illiteracy levels and the subsequent lack of awareness put them into a spiralling debt trap leaving them at the mercy of the money-lender. The evolution of the institutional structure through various Government policy interventions changed the scenario, whereby institutional sources, primarily through commercial banks became the major source for rural credit.

According to AIDIS report, non-institutional sources were dominant in 1951, accounting for 90 per cent of the outstanding debt of cultivator households, but their share declined sharply to 37 per cent in 1981. After 1981, the rate of decline slowed down, and the share of non-institutional sources was 35 per cent in 1991. Thereafter a reversal of this pattern resulted in higher share of 39 per cent in 2002 which again dropped to 36 per cent in 2013. As per NAFIS Report 2016-17, the share of non-institutional credit in 2015 was 28 per cent. As against this, the share of institutional credit in agriculture increased from 10.2 per cent in 1951 to 63 per cent in 1981 and thereafter the share of institutional credit was hovering in the range of 63-65 per cent during 1981 to 2013. As per NAFIS, in 2015 the share of institutional credit was approximately 72 per cent.

Further, NAFIS Report 2016-17 has revealed that agricultural households avail credit from sources other than banks such as NBFC/MFI, financial companies, financial corporations, provident fund, insurance, relatives, friends, moneylenders, landlords, etc. The chart below shows the distribution of agricultural households according to type of sources of loans

11.6 Agricultural Loans in India

Agriculture is the backbone of Indian economy and it definitely comes as no surprise to see financial institutions offer monetary aid to farmers all across the country. Agricultural loans are available for different kinds of farming-related activities.

Types of Agricultural Loans in India

One can avail a loan for the following activities related to agriculture:

- Running day to day operations
- Buying farm machinery such as tractors, harvesters, et cetera
- Purchasing land
- Storage purposes
- Product marketing loans
- Expansion

Moreover, these financial aids can be offered in form of grants and subsidies too, which are usually meant to protect the farmer in an event of crop damage or loss of crops.

Agricultural loans in India are not only offered to farmers working towards the cultivation of food crops, but they are available to anyone who is engaged in other agriculture-related sectors like horticulture, aquaculture, animal husbandry, silk farming, apiculture and floriculture.

The NABARD has also helped greatly in developing a couple of other schemes, targeting specific sectors. A few of them are listed below:

- Dairy Entrepreneurship Development Scheme: This scheme is meant to promote the dairy sector, specifically by setting up modernized dairy farms, promoting calf rearing, provide infrastructure, upgrading logistical operations to improve the product on a commercial scale, and generate self-employment.
- Rural Godowns: The main objective of this scheme is to help farmers throughout the country by providing them with godowns. This will, in turn, improve their holding capacity drastically and as a result, they will be able to sell their produce at fair rates, rather than selling them under distress. In addition to this, with a nationalised warehouse system in place, the marketing of agricultural produce becomes simpler.
- Loan Against Warehouse Receipts: Warehouse receipt financing serves as a foolproof way to prevent distress sales. When a farmer needs funds, post-harvest, all he has to do is store his produce in a Warehousing Development and Regulatory Authority (WDRA) accredited warehouse, which in turn issues him a receipt. This warehouse receipt mentions important details like quality and quantity of the produce, and can be used to get credit from banks, up to 70 percent of the collateral value.
- Solar Schemes: These schemes were implemented in order to reduce dependence on grid power by promoting the use of solar equipment. The idea here is to replace diesel pumps with solar ones, considering that they have low operating costs and are environment-friendly.

The official website of NABARD can be visited for more details on these schemes, along with the information on how to apply for them. Since many of these are subsidy based schemes, your bank will adjust your loan repayments against the corresponding subsidy you are entitled to, through the funds released by NABARD.

11.7 Leading Banks that offer Agricultural Loans in India

Coming to the public-sector banks in India, there are several leading financial institutions who are known for their exceptional credit services in agriculture-related sectors. Some of these banks are mentioned below.

State Bank of India Agricultural Loans

State Bank of India is a leader in financing projects in the agriculture sector. They have helped millions of farmer across the country through their 16,000 plus branches. They offer a variety of products like Kisan Credit Card, gold loan for crop production and multi-purpose gold loan for agriculture activities. SBI also offers agriculture loans for mechanisation of farms. The funds from these loans can be used to purchase combine harvesters, tractors and install drip irrigation. Moreover, loans for activities related to dairy, poultry or fisheries can also be availed. Credit can be taken against warehouse receipts. The bank also offers Debt Swapping Scheme, wherein financial aid is offered to farmers to help them clear their dues that have been produced by taking loans from non-institutional lenders like loan sharks, money lenders, et cetera. The main goal of this scheme is to help farmers become debt free and clear their loans coupled with atrocious interest rates.

Lastly, one can look to SBI for financial help if they are looking to boost their agricultural marketing, establish agribusiness and agri clinic centres or purchase land. State Bank of India offers these loans and services through their parent branches, as well as their seven associate subsidiaries - State Bank of Bikaner and Jaipur, State Bank of Hyderabad, State Bank of Mysore, State Bank of Patiala, State Bank of Travancore, State Bank of Indore and State Bank of Saurashtra. If you are looking to avail any of these agricultural loans offered by the State Bank of India, then all you have to do is visit your nearest SBI branch for more details and application.

HDFC Bank Agricultural Loans

The HDFC Bank offers a variety of agriculture loans for farmers and agriculturists. The purpose of these loans varies across a broad spectrum, starting from installation of orchards and plantations to promotion of commercial horticulture and production of field crops. Furthermore, the HDFC bank also offers warehouse receipt financing to all farmers and small traders.

Allahabad Bank Agricultural Loans

Allahabad Bank is another nationalised bank in India which offers the Kisan Credit Card under its Akshay Krishi scheme. Needless to mention, the features of the plan are the same as that of the KCC scheme. All farmers, tenant farmers, and cultivator owners, et cetera. In fact, Allahabad Bank has gone the extra mile to come up with its own version of Kisan Credit Card. This one is known as the Allahabad Bank Potato Growers Credit Card Scheme and its main objective is to provide sufficient financial support in a timely manner to farmers, to help them meet their cultivation requirements. Just like the State Bank of India, Allahabad

Bank offers other services like warehouse receipt financing, debt swapping scheme, construction of rural godown, et cetera.

Bank of Baroda Agricultural Loans

Bank of Baroda is another leading name people look to when it comes to availing loans for agricultural purposes. They have various schemes, covering almost all the sectors in agriculture. For instance, one can take loans to purchase tractors and heavy machinery needed for day to day operations. Moreover, Bank of Baroda also offers working capital and funds required for either setting up units, or running units occupied with dairy, pig farms, poultry, sericulture, rearing of sheep and goat, et cetera. Farmers can also look to the bank if they are in need of a four-wheeler to help them manage their farm activities better. Bank of Baroda offers four-wheeler loans with a maximum quantum of Rs. 15 lakh.

Punjab National Bank Agricultural Loans

Punjab National Bank has myriad financial products related to agriculture. For example, one can avail loans from the PNB to establish biogas units, develop wastelands, set-up minor irrigation apparatus, et cetera. In addition to this, people who are interested in pursuing the field of apiculture (beekeeping) can approach Punjab National Bank for financial support. The bank also offers warehouse receipt financing, along with insurance coverage and financial support to farmers in the event of crop failure, owing to natural disasters, diseases, and pests. This scheme is known as Pradhan Mantri Fasal Bima Yojana. All of this is in addition to the regular financial services offered to farmers like Kisan Credit Card, debt swapping, et cetera.

ICICI Bank Agricultural Loans

The ICICI Bank offers a variety of agricultural loans. Their top selling product is the Kisan Credit Card, which is a convenient way for farmers to meet their daily requirements. They also offer long-term loans to purchase equipment or cattle, which can be repaid over a period of 3-4 years. The ICICI Bank also offers instant gold loans to meet financial requirements for agriculture-related projects. In addition to this, they also offer the facility of overdraft against Fixed Deposits, also known as Kisan Kalpvriksha. For more information on these agricultural loans offered by the ICICI Bank, visit the official website.

Axis Bank Agricultural Loans

Axis Bank has done well to earn a splendid reputation in the world of agricultural finance. Over the years, they have greatly helped farmers through their diversified financial products such as gold loans, Kisan Credit Card, tractor loans, warehouse receipt financing, loans for developing rural godowns and many more. Axis Bank also offers a product known as Contract Farming, wherein loan agreements are made between farmers and corporates. The amount is provided by the lender instantly for production and supply of the produce, and all of it is governed by the Fair Practices Lending Code. Before taking any kind of loan, it is recommended that you research carefully and figure out the type of loan works best for you. Since a huge variety of agricultural loans are offered, finding the one that fits suits your purpose is absolutely crucial.

11.8 REQUIREMENTS OF SOUND AGRICULTURAL FINANCE IN INDIA

A sound system of agricultural finance should have the following features :

1. Dependence on private credit should be completely eliminated and there should be only institutional finance which should be available for both rich and poor peasants and which should help in raising agricultural efficiency and production.
2. To make a success of institutional finance, there should be trained, devoted and committed personnel to manage and run cooperative societies and regional rural banks.
3. Agricultural credit should be used only for productive purposes which means that the farmers should be discouraged from borrowing for consumption purposes. Agricultural credit should generally be in kind rather than in cash – that is in the form of seeds, fertilizers, pesticides etc.
4. Consumption loans will, however, be necessary in the case of small and marginal farmers and landless labourers. Necessary provisions will have to be made for such loans.
5. Interest and repayment of the principal are two important aspects of a sound financing system. Low or No rate of interest for agricultural loans and differential rates of interest for different classes of peasants as well as for different uses to which Agricultural credit is put are called for.
6. Regular repayment of principal should be insisted upon to prevent mounting agricultural indebtedness. Arrangements can be made to modify the conditions of repayment of loans to suit different categories of peasants.

11.9 Regional Disparity in Agricultural Credit

The IWG opined that disparity can be better brought out by analysing states individually instead of analysing region-wise. This is because in many cases, states within the same region are not very similar in various aspects relating to agricultural credit. Moreover, IWG suggested to combine all eight states (Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim and Tripura) under NE States as they have a miniscule share in the country's overall output as well as loans to agricultural and allied sector. Further, as most of the UTs are predominantly urban areas and do not have significant potential for agriculture and allied activities, it was decided to exclude UTs from the analysis related to regional disparity.

1. Agricultural Credit under Priority Sector Lending

Priority Sector Lending is a major policy intervention/initiative through which credit is directed to sectors of national priority. The objective of the PSL has been to ensure that vulnerable and weaker sections of the society get access to credit and that there is adequate flow of credit to employment intensive sectors like agriculture and MSME.

At present, all Scheduled Commercial Banks are required to meet a target of 40 per cent of their Adjusted Net Bank Credit (ANBC) or credit equivalent of Off Balance Sheet Exposure, whichever is higher for Priority Sector Lending. RRBs and SFBs are required to meet a target of 75 per cent towards PSL. Besides the overall PSL targets, banks are required to achieve agriculture target of 18 per cent and a sub-target of 8 per cent of ANBC for small and marginal farmers. Under the revised PSL guidelines of 2015, direct and indirect agricultural lending has been dispensed with. The eligible activities include farm credit, agri-infrastructure and ancillary activities. As per the new guidelines, the approach of agriculture under priority sector is to focus on 'credit for agriculture' instead of 'credit in agriculture' in order to give impetus to financing of supply value chain in the sector. Though at the aggregate level banks have been able to achieve the overall PSL target of 40 per cent, so far they have failed to achieve the agriculture target of 18 per cent at system-wide level. However, public sector banks have achieved 18.12 per cent as against private sector banks' achievement of 16.30 per cent in 2018 - 19.

At the aggregate level, banks have been able to achieve the sub-target of small and marginal farmers under PSL. Though this reflects a satisfactory performance in terms of achievement of target by banks, a large proportion of SMF have not been covered by SCBs. As per PSL Returns (2015-16), the number of accounts under the small and marginal category are 5,13,88,257 and the total number of small and marginal farmers in the country as per Agriculture Census, 2015-16 was 12,56,35,000. This means, despite so many initiatives aimed at financial inclusion, only 40.90 per cent of small and marginal farmers could be covered by SCBs. There is a need to increase the coverage of SMF by banks as they constituted 86.21 per cent of total operated holdings and have 47.34 per cent share in the operated area.

2 Interest Subvention Scheme for Short term Crop Loans

The Union Government had introduced the interest subvention scheme (ISS) for short term crop loans in 2006-07. It has been continuing since then with minor modifications. Interest on short term crop loans up to ₹0.3 million are fixed at 9 per cent per annum by banks and made available to farmers at a reduced rate of 7 per cent per annum to farmers. The 2 per cent interest subvention is reimbursed to banks (through RBI and NABARD) based on the funds released by the government against their claims. Besides 2 per cent interest subvention, 3 per cent prompt repayment incentive (PRI), introduced in 2009-10, is given reducing the cost of loan to 4 per cent. To prevent distress sale of produce, the interest subvention benefit is extended for a period of up to six months (post-harvest) to small and marginal farmers having Kisan Credit Card (KCC) on loan against negotiable warehouse receipts issued on the produce stored in warehouses accredited with Warehousing Development Regulatory Authority (WDRA). The scheme also provides for 2 per cent interest subvention to farmers for the first year on loans restructured due to natural calamities. The ISS was meant for providing short term crop loans, i.e. production credit to farmers at a sub-vented rate of interest. However, it has resulted in skewed distribution of agricultural credit in favour of production credit against crop-related investment credit. As a result, the share of short term crop loan is on a consistent rise whereas the share of crop-related investment credit is on a decline.

3 Kisan Credit Card

The Kisan Credit Card (KCC) scheme, introduced in 1998, aimed at providing adequate and timely credit support from the banking system under a single window with flexible and simplified procedure for the farmers for their overall credit requirements such as cultivation of crops, post-harvest expenses, marketing of produce, maintenance of farm assets, activities allied to agriculture and also consumption requirements of farmer households. As per 2019 data, there were total 66.2 million operative KCC accounts,

4 Improving KCC scheme - Scale of Finance

RBI guidelines on KCC scheme prescribe that the crop-wise Scale of Finance (SoF) as decided by District Level Technical Committee (DLTC) should be used to arrive at the short term limit for the crop loan. The guidelines on SoF are issued by NABARD. As per the guidelines, the district is the unit for determining the crop-wise scale of finance per unit of area because of different agro-climatic characteristics and separate SoF are to be fixed for irrigated and unirrigated areas. DCCBs are the convenors of DTLC and they play a major role in fixing the SoF.

A short study was conducted to understand the effectiveness of the scale of finance and to ascertain whether it is realistic keeping in view the cost of cultivation and expected price to be realised. The study was carried out in states of Punjab, Haryana, Uttar Pradesh, Madhya Pradesh, Maharashtra, Gujarat, Karnataka, Tamil Nadu, Andhra Pradesh, Telangana, Kerala, Bihar, West Bengal and Assam. In each state, five districts with the highest credit off-take were selected and rural branches with significant crop loans were visited on random sample basis.

The findings of the study indicated that different approaches were used to arrive at the scale of finance for sanctioning of crop loans. Complaints were received in the past from farmers regarding crop loans not being in tandem with the cost of cultivation. This may be on account of lower SoF fixed by the DLTC. Further, there are issues of huge variation in SoF for a single crop across districts within the same state. This may be on account of differences in geographies, climatic conditions, farming practices, usage of machines, irrigation facilities and labour charges etc. This leads to difficulty in implementation and monitoring by banks with regard to adherence by their branches. Hence, there is a need to have a uniformity and transparency in scale of finance.

DCCBs are the convenors of DTLC and they play a major role in fixing the SoF. However, they lack the resources and technical capabilities to carry out such exercises which need a more scientific approach. Moreover, as the financial health of most of the DCCBs is not sound, they fix the SoF at a lower level. The banks are required to follow the SoF fixed by DLTC, though they have the flexibility to have a higher SoF. Consequently, this leads to further variations in SoF for a crop within the same district. This issue can be addressed by assigning the responsibility of fixing the SoF for crops to SLBC at the state level which is justifiable as banks have emerged as the main purveyors of credit to the farming community.

5. SHG-Bank Linkage Model

Self Help Group - Bank Linkage Programme (SHG-BLP) launched in 1992 was an innovation harnessing the synergy of flexibility of an informal system with the strength and affordability of a formal system. The SHG-BLP model has the following three main features:

i. Acceptance of informal groups as clients of banks – both deposit and credit linkage
ii. Introduction of collateral free lending
iii. Permission to lend to groups without specification of purpose/activity/project

6. Joint Liability Groups

The Joint Liability Groups (JLG) scheme was initiated by NABARD in 2006 with the expectation of enhancing credit flow to share croppers/tenant farmers who do not have land rights.

7. Farmer Producer Organisations (FPOs)

Small holders often suffer from poor access to quality inputs, institutional credit and other resources like storage, organised markets, modern farming technologies etc. making small holding-based agriculture unviable. There is an inherent weakness in a fragmented land holding model as on the one hand overheads on inputs and services purchased are very high, while on the other bargaining power in the marketplace for output remains limited by the very low levels of individual marketable surplus. This is resulting in higher production cost and lower price realisation, threatening sustainability of farming as an economic activity. Fragmented land holding also restricts mechanisation and economies of scale in farm production.

Collectivising farmers into Producer Organisations (POs) has the potential to overcome the challenges faced by the small and marginal farmers in terms of breaking the farmers' dependency on intermediaries through improved bargaining power. Benefits of Farmers' Collectives include reduction in cost of production and marketing cost, access to modern technologies, greater access to storage, efficient management of value chain, easier access to financial resources without collaterals and other support services by service providers.

8. Priority Sector Lending Certificate

Priority Sector Lending Certificate (PSLC) instrument was introduced on the recommendations of the Internal Working Group (IWG) to review PSL in April 2016. The Reserve Bank provides the platform to enable trading in the certificates through its core banking solution portal (e-Kuber). All scheduled commercial banks (including RRBs), urban co-operative banks, small finance banks and local area banks are eligible to participate in trading. There are four kinds of PSLCs: Agriculture, Small and Marginal farmers (SMF), Micro Enterprises and General which can be bought and sold via the said platform. The total trading volume of PSLCs grew from ₹498 billion in 2016-17 to ₹1842 billion in 2017-18 and further to ₹3,274.3 billion in 2018-19 recording a Y-o-Y growth of 78 per cent in 2018-19 as compared to 2017-18. Among the four PSLC categories, the highest trading was recorded in the case of PSLC-General and PSLC-SMF, with the transaction volumes at ₹1,324.8 billion and ₹1,125.0 billion, respectively, in 2018-19.

11.10 Measures to Improve the Reach of Institutional Credit

In order to bring the excluded agricultural households into the fold of institutional credit in a structured and sustainable manner, there is a need to build an enabling ecosystem with respect to policy interventions, institutional innovations and digital technologies. The enabling ecosystem would include digitisation of land records, reforming of land leasing framework, creating a national level agency to build consensus among states and the Centre with regard to agriculture-related policy reforms and innovative digital solutions to bridge the information gap between the banks and farmers.

i. Digitisation of Land Records

a. GoI started the Computerisation of Land Records Scheme to digitise all land records in 1988-89. Thereafter, in August 2008, the Digital India Land Record Modernisation Programme (DILRMP) was launched by Government of India, with the aim to minimise scope of land or property disputes and enhance transparency in the land records.

b. The status of CLR, in terms of percentage completion, across states is shown in Table 1.1:

Table 1.1: Status of CLR for states and Union Territories	
CLR more than or equal to 90%	Andaman & Nicobar, Andhra Pradesh, Chhattisgarh, Dadra & Nagar Haveli, Gujarat, Haryana, Himachal Pradesh, Jharkhand, Karnataka, Lakshadweep, Madhya Pradesh, Maharashtra, NCT of Delhi, Odisha, Puducherry, Punjab, Rajasthan, Sikkim, Tamil Nadu, Telangana, Tripura, Uttar Pradesh and West Bengal
CLR from 50% upto 90%	Assam, Bihar, Daman & Diu, Goa, Uttarakhand
CLR less than 50%	Arunachal Pradesh, Chandigarh, Jammu and Kashmir, Kerala, Manipur, Meghalaya, Mizoram, Nagaland
Source: Department of Land Resources, MoRD.	

c. Digitisation of land records has the potential to address various issues relating to agricultural credit, provided banks are given access to view land records online and/or they are given the facility to create charge online over land. This will help in reducing the instances of double or multiple financing on the same piece of land.

ii. Land Leasing Framework

a. Most states ban or restrict leasing of agricultural land leading to informal or concealed tenancy. As per T. Haque Committee (NSSO 2012-13), the tenancy in the country is around 10 per cent. As these tenant farmers lack documentary evidence as well as suffer from fear of eviction, they do not have the incentive to invest in agricultural land, leading to low productivity. Hence, there is a need to reform the land leasing framework by state governments by adopting policies like the Model Land Leasing Act proposed by NITI Aayog and Andhra Pradesh Land Licensed Cultivators Act, 2011.

b. The Model Land Leasing Act recommends that all lease agreements be made formal and farmers cultivating on leased lands be given access to benefits including farm credit. The unified state of Andhra Pradesh was the pioneer to undertake reforms for tenant farmers in the form of Land Licensed Cultivators' Act, 2011 under which Loan Eligibility Cards (LECs) are being issued to tenant farmers, making it possible for them to approach banks for credit. The Certificates of Cultivations (CoC) are issued under executive direction.

iii. Federal Institution in Agriculture

The Union Government in the past has suggested several reforms in the field of agriculture through the Model Agricultural Land Leasing Act, Model Agricultural Produce and Livestock Marketing Act, removing agricultural commodities from Essential Commodities Act, Digitisation of Land Records and e-NAM etc. However, the implementation of such reforms has not been very encouraging as many a times state governments might not be taken on board during the consultation or implementation process to take their concerns into consideration. In order to consult states and build consensus among them over reforms related to agriculture there is need for a federal institution, established on the principle of cooperative federalism, having representation from both Central Government as well as state governments. Such an institution exists in the form of the GST council which has been a success story.

iv. Digital Innovations in Agriculture Sector

The emergence of farm technologies integrated with robust ICT framework and other farm-related innovations hold tremendous potential to positively impact the growth in the agriculture sector. The technological innovations leverage tools like Internet of Things, Cloud, Big Data, etc. Some of the major developments are discussed below:

a. e-NAM - a technology-driven unified national level market platform that integrates the physically dispersed markets enabling better price discovery for the farm produce

b. Digital technologies such as Remote Sensing and Geo-tagging which helps in crop identification, crop production forecasting, crop acreage and yield estimation, assessment of crop progress and crop damage, soil health, soil mapping, water resource mapping and climate change monitoring

c. Weather forecasting companies giving real time weather updates

d. Under the Digital India Initiative the GoI provides mandi prices on real time basis through its ‘Gramseva: Kisan’ app.

e. Corporates through mobile-based apps are providing farm machinery to farmers on rental basis which saves farmers from long-term investments.

f. Movable warehouses and cold storages that help farmers to store their produce in a cost-effective manner

g. State-of-the-art solar powered products for irrigation which will make farmers less dependent on electricity

h. A few banks have launched mobile-based applications to cater to the specific needs of farmers and create an ecosystem for them through which they can purchase products, get weather updates and soil information and apply for loans.

11.11 Summary

Agriculture loans in India are offered to farmers for various purposes, like farming and irrigation equipment purchases, crops for cultivation, and other agriculture-associated activities. Besides farmers, these loans are also available to individuals engaged in other agri-related sectors like animal husbandry, horticulture, apiculture, aquaculture, silk farming, and floriculture. Agriculture loans are offered at lower interest rates compared to other loans available to individuals. The main objective of these loans is to provide a helping hand to farmers to meet their various cash needs. Agriculture Loans are either direct or indirect. Direct agriculture loans include loans to individual farmers [including Self Help Groups (SHGs) or Joint Liability Groups (JLGs), i.e. groups of individual farmers, provided banks maintain disaggregated data on such loans], directly engaged in Agriculture and Allied Activities, viz., dairy, fishery, animal husbandry, poultry, bee-keeping and sericulture. Indirect agriculture loans include loans to corporate including farmers' producer companies of individual farmers, partnership firms and co-operatives of farmers directly engaged in Agriculture and Allied Activities, viz., dairy, fishery, animal husbandry, poultry, bee-keeping and sericulture. NABARD is the Apex in agricultural credit institutions.

11.12 Self Assessment Questions

I. Essay Type Questions

1. Write an essay on Evolution of Agricultural Finance in India and Policy Milestones
2. Write about Trends in Agricultural Credit
3. Examine Institutional vis-à-vis Non-Institutional Agricultural Credit
4. What are requirements of sound agricultural finance in India ?

II. Short Answer Questions

5. Write about Nature of agricultural financing
6. Agricultural loans in India
7. Measures to improve the reach of institutional credit

III. Very Short Answer Questions

1. Agricultural credit on the basis of time
2. Agricultural credit on the basis of purpose
3. Trends in Agricultural credit
4. Kinds of agricultural loans
5. Agricultural credit by SBI
6. SHG-Bank Linkage Model

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Lesson– 12

REGIONAL RURAL BANKS IN INDIA

12.0 Objectives

After completing the lesion you will be able to understand the following

- Objectives and organizational structure of RRBs
- Functions of RRBs
- Progress of RRBs in India
- Role of RRBs in Rural development of Indian Economy, and
- The Problems faced by the RRBs in Indian context

Structure

12.1 INTRODUCTION

Regional Rural Banks or RRBs are government banks operating at regional level in different states of India. These are designed to cater the needs of the rural area people. Regional Rural Banks commercial banks which helps to bring the financial inclusion in the primary level of the nation. Currently there are 43 RRBs in India and each RRB is sponsored by Government of India along with State Government and Sponsor bank. Regional Rural Banks (RRBs) were set up under the provisions of 26 September 1975 ordinance and the RRB Act of 1976 to allocate banking and credit services for agriculture and other rural sectors. They were established on the recommendation of Narshimham Working Group. That time, almost 70% of India's population was based on rural region. After the legislation of the Regional Rural Banks Act, 1976, at the initial stage, five regional rural banks were established on October 2, 1975 at Gorakhpur and Moradabad in Uttar Pradesh, Jaipur in Rajasthan, Bhiwan in Haryana and Malda in West Bengal under the sponsorship of State Bank of India, the Syndicate bank, United Commercial Bank, Pubjab National Bank and United Bank of India respectively. Al these five RRBs have an authorized capita of Rs. 1 crore and paid up capital of Rs. 25 lakh. The share capital of RRB is subscribed in the following manner – as the Central Government – 50 percent, the State Government concerned – 15 per cent and the sponsoring commercial bank – 35 per cent. The regional rural banks are maintaining its special charter it their of operation is very much limited to a definite region, grant direct loan to rural people at concessional rates and receive subsidies and concessions from the RBI and the sponsoring bank.

12.2 Regional Rural Banks Objective

RRBs were created with the following objective in mind:

- To provide banking services to rural and semi-urban areas.
- Locker, debit and credit card facilities to the country side people.
- To enhance employment opportunities by promoting trade and commerce in rural areas.
- To support entrepreneurship in rural areas.
- Pension and MGNREGA wages distribution

12.3 Organisational Structure of Regional Rural Banks

The structure of RRBs differs from one RRB to the other RRB depending on the size and nature of the RRB. The following is the hierarchy of officials in a Regional Rural Bank.

- Board of Directors
- Chairman & Managing Director
- General Manager
- Assistant General Manager
- Regional Manager/Chief Manager
- Senior Manager
- Manager
- Officer
- Office Assistant
- Office Attendant

12.4 Number of Regional Rural Banks in India

Currently, Regional Rural Bank are going through a process of amalgamation and consolidation. We have a list of number of RRBs

Number of RRBs from the initial date

Dec 1975:- 6 RRBs

Dec 1980:- 85 RRBs

Dec 1985:- 188 RRBs

Mar 1990:- 196 RRBs

Mar 2006:- 133 RRBs

Mar 2011:- 82 RRBs

Mar 2013:- 64 RRBs

Mar 2014:- 57 RRBs

Mar 2016:- 56 RRBs

Jan 2019:- 45 RRBs

April 2020:- 43 RRBs

12.5 The Objectives of Regional Rural Banks:

In view of the above preamble of the Act the objects and activities of RRBs can be briefed as under:

1) Bridging the credit gaps in rural areas.

2) To develop such measures this could restrict the outflow of rural deposits to urban areas.

3) To reduce regional imbalances and increase rural employment generation activities.

For achieving its objectives the RRBs provide financial assistance to different segments of rural population engaged in rural activities.

12.6 Area of Functioning of Regional Rural Banks:

The Regional Rural Banks are required to function within a limited area for which they are established. Usually the functional area of Each RRB is confined to a few districts of the state in which they are set up. The area of functioning of RRBs is decided by central government in consultation with NABARD and the Sponsor Banks by way of a notification issued in this regard. It is therefore necessary for RRBs to establish their Head Office in central place of their notified area of functioning because they are also authorized to open their branches or appoint agency within their specified areas.

12.7 Functions of Regional Rural Banks

All the Regional Rural Banks are authorized to carry on to transact the business of a banking as defined in the Banking Regulation Act 1949. RRBs grant loans to small and marginal farmers, Agricultural labourers, Co-operative societies and to individuals including artisans, small entrepreneurs and persons of small means. In brief RRBs do all such functions as are done by domestic banks like accepting deposits from public, providing credit, remittance services etc. They can also invest in Government securities and deposit schemes of Banks and Financial Institutions. Regional Rural Banks may also seek refinance facilities provided by NABARD for the loans sanctioned and disbursed by them. All the RRBs are covered under DICGC scheme and they are also required to observe the RBI stipulations for Cash Reserve Ratio and Statutory Liquidity Ratio. The Reserve bank of India has brought all the RRBs under the ambit of Priority Sector lending w.e.f April 1997. Like all other commercial banks RRB are bound to provide 40% of their Net Bank Credit to Priority Sector. Out of which 25% of PS advances or 10 % of Net Bank Credit is to be given to weaker sectors.

12.8 Progress of Regional Rural Banks in India

In the mean time, the regional rural banks have extended their network throughout the country to a considerable extent. Initially, there were 196 regional rural banks operating in 28 states with nearly 14,700 branches. Till June 1996, these RRBs have been lending annually nearly Rs 1500 crore to the rural people and more than 90 per cent of the loan has been advanced to weaker sections. As on September, 1990, the RRBs had advanced jointly to the tune of Rs 3,560 crore in the form of short-term crop loans, term loans for agricultural activities, for rural artisans, cottage and village industries, retail trade, self-employment projects and consumption loans etc.Among all the states, Uttar Pradesh is the state where larger number of RRB branches has already been opened. Recently, after amalgamation, the number of RRBs has been reduced to 92. During the last 30 years, RRBs have been participating actively in various programmes designed for providing credit assistance to identified beneficiaries included under the new 20 Point Programme, IRDP and other programmes designed for scheduled castes and tribes. RRBs are also advancing loans to weaker sections and physically handicapped persons under differential rate of industrial (DIR) schemes.

At the end of June 2014, there were 92 amalgamated RRBs, covering 518 districts of the country with a network of 18,291 branches. Out of all these branches of RRBs, 4,042 are the rural branches as on June 30, 2014 which constitute about 21.4 per cent of the total branches of RRBs. The loans and advances stood at Rs 7,852.7 crore as at the end of September 1996. Again, Rs 15,423 crore were mobilised as deposits by RRBs at the end of September 1996. Consequent upon the permission of the Reserve Bank of India to determine their own lending rate with effect from 26 August 1996, most of the RRBs have been charging interest rates on their loans varying between 13.5 to 19.5 per cent per annum.

In recent years, under the softer interest regime, interest rates on loans advanced by RRBs have also declined considerably. Again, total amount of credit advanced to the agriculture by the RRBs increased considerably from Rs 6,069.79 crore in 2002-03 to Rs 43,968 crore in 2010-11. As on March 31, 2002 total outstanding deposits of RRBs stood at Rs 44,327.81 crore and total outstanding advances stood at Rs 18,586.97 crore. Out of the 196 RRBs, 170 RRBs are making profit in recent years after introducing measures under banking reforms. Chalapathi Rao Committee on Regional Rural Banks has also recommended privatisation of profit making RRBs in a phased manner.

In order to make Financial Inclusion Plan of the government effective and to expand the penetration of banking network in unbanked and under-banked rural areas, regional rural banks (RRBs) also worked out its branch expansion plan for 2011-12 and 2012-13 with 10 per cent increase over the previous year. Accordingly, RRBs could open 913 branches in 2011-12 against its target of opening 1247 branches. This figure compares favorably with that of opening of 521 branches in 2010-11 and 299 branches in 2009-10. For 2012-13, a target of opening 1845 new branches has also been set. Subsequent to review of the financial status of RRBs by the Union Finance Minister in August, 2009, it was felt that a large number of RRBs had a low Capital to Risk weighted Assets Ratio (CRAR). A committee was therefore constituted in September, 2009 under the Chairmanship of K C Chakrabarty, Deputy Governor, RBI to analyse the financials of the RRBs and to suggest measures including re-capitalisation to bring the CRAR of RRBs to at least 9% in a sustainable manner by 2012. The Committee submitted its report in May, 2010. The following points were recommended by the committee:

- RRBs to have CRAR of at least 7% as of 31 March 2011 and at least 9% from 31 March 2012 onwards. recapitalisation requirement of Rs 2,200.00 crore for 40 of the 82 RRBs. This amount is to be released in' two installments in 2010–11 and 2011–12.
- The remaining 42 RRBs will not require any capital and will be able to maintain CRAR of at least 9% as of 31 March 2012 and thereafter on their own.
- A fund of ₹100 crore to be set up for training and capacity building of the RRB staff.

The Government of India recently approved the recapitalization of Regional Rural Banks (RRBs) to improve their Capital to Risk Weighted Assets Ratio (CRAR) in the following manner:

- Share of Central Government i.e. Rs.1, 100 crore will be released as per provisions made by the Department of Expenditure in 2010-11 and 2011–12. However, release of the Government of India share will be contingent on proportionate release of State Government and Sponsor Bank share.

- A capacity building fund with a corpus of Rs.100 crore to be set up by Central Government with NABARD for training and capacity building of the RRB staff in the institution of NABARD and other reputed institutions. The functioning of the Fund will be periodically reviewed by the Central Government. An Action Plan will be prepared by NABARD in this regard and sent to Government for approval.
- Additional amount of ₹700 crore as contingency fund to meet the requirement of the weak RRBs, particularly those in the North Eastern. and Eastern Region, the necessary provision will be made in the Budget as and when the need arises.
- Amalgamation : Currently, RRB's are going through a process of amalgamation and consolidation. 25 RRBs have been amalgamated in January 2013 into 10 RRBs. This counts 67 RRBs till the first week of June 2013. This counts 56 as of March 2015. On 31 March 2016, there were 56 RRBs (post-merger) covering 525 districts with a network of 14,494 branches. All RRBs were originally conceived as low cost institutions having a rural ethos, local feel and pro poor focus. However, within a very short time, most banks were making losses. The original assumptions as to the low cost nature of these institutions were belied. This may be again amalgamated in near future. With the third phase of amalgamation of RRB bringing down the number of such entities to 38 from 56. As of 1st April 2020, there are 43 RRBs in India.

12.9 ROLE OF REGIONAL RURAL BANKS IN RURAL DEVELOPMENT OF ECONOMY

RRBs plays a pivotal role in the economic development of the rural India. The main goal of establishing regional rural banks in India was to provide credit to the rural people who are not economically strong enough, especially the small and marginal farmers, artisans, agricultural labours, and even small entrepreneurs. The role of these banks in economic development is examined, their policies and progress are assessed, and suggestions are given on how they can help improve and uplift the weaker sections of society. This latter objective has been largely achieved by the RRBs. They have succeeded in extending their branch network to the unbanked or under-banked rural areas, and they have made significant progress in deposit mobilization, and in extension of credit particularly among the poor. Furthermore, RRBs have played an important role in the implementation of various special schemes such as the Integrated Rural Development Programme.

In rural areas, RRBs account for a substantial 37% of total offices of al lscheduled RBBs. In semi-urban areas, their share comes to 15%. It goes without saying that exclusion is more severe in rural areas 91% of the total workforce in RRBs is posted in rural and semi-urban areas as compared to 38% for other scheduled RBBs . Even in absolute terms out of a total workforce of 179,423 deployed by all scheduled RBBs in rural areas, RRBs share is 25% (45,062). This is significant considering that at all India level, manpower of RRBs constitute only 7% of the total manpower of all scheduled RBBs. At all India level, RRBs account for 18% of loan accounts of all scheduled RBBs and 3% of loans outstanding. However in rural areas the share of RRBs in loan accounts is an impressive 38%. More significantl, despite having 38%of all loan accounts, RRBs account for only 21% of total credit outstanding in rural areas implying thereby their better reach to small borrowers. The microfinance services provided through self help groups bank linkage has so far been the most successful initiative in financial inclusion. Therefore RRB's involvement in these Self help groups have increased financial inclusion at more than faster rate than it was before. RRBs have not only provided financial services to the SHG-Bank Linkag Program me, but have also played a significant role as self help promotional institution. As many as 104 RRBs(31 March 2006) are also functioning as SHPIs with grant assistance from NABARD.

12.10 PROBLEMS FACED BY RRBs

Apart from the high cost of their operations, RBBs find it difficult to post the clerical staff to rural centres since the latter prefer to work in urban centers. Even in. respect of transferable cadres like branch ,the banks face a problem in finding the required staff for rural centres .One of the important reasons for the unsatisfactory functioning of many rural branches is the unwillingness of the urban-oriented staff to get involved in rural lending to the fullest extent. Both the clerical staff and supervisory staff who have joined the RBBs with expectations of urban posting and the attendant comforts, are often averse to staying and touring in villages. On balance, the advantage would seem to lie in encouraging RBBs to transfer the eligible of their rural branches to RRBs by them, wherever possible. Rural bank loans to weaker sections may be given priority for such transfer. Similarly, rural branches which have not been able to develop adequate business seven after a reasonable period, so as to cover their own costs of establishment deserve to be considered for this purpose. On the other hand, where the bigger categories of borrowers are substantial in numbering any rural branch and account for bulk of the business; it may be retained by the RRBs

The willingness to allow the RRBs these specific considerations notwithstanding, there were serious attempts to redress the prevalent problems of these banks, the principal one at the time being the low recovery rates and loan over dues. These had not only led to capital erosion but more importantly had resulted in non-recycling of funds, which in turn necessitated increasing dependence on external sources of refinancing. The internal factors identified as contributing to low recovery were: weak monitoring and supervision, apathy towards recovery, failure to link lending with development and to ensure end use of the loan. The external factors were: political interference, willful default, drought and floods, underdevelopment, lack of legal and administrative support from the state government in the matter of recovery, etc. Generally, recovery was low in respect of loans sanctioned under IRDP and other poverty alleviation programmes. Besides there were certain organizational problems such as low capital base, multiple ownership and divided responsibility, lack of adequate training for the RRB staff, etc. which called for intervention.

It was estimated that the RRBs would need about seven years to become viable, though for the RRBs with a large number of infant branches even this period might not be adequate. Between 1980 and 1987, while the number of RRBs increased a little more than two-fold, the number of branches of RRBs increased more than four-fold. It was not totally unexpected therefore that by the end of the 1980s several of these banks were showing losses on their books.

12.11 Summary

From this above discussion, we can analyse that the Regional Rural Banks which are been set up are good for the development of the rural sector and good for the economy. As they are generally focusing on the term financial inclusion which generally means to make the unbanked regions banked which will help the people living in the rural sectors. By analyzing their performance we can say that they are growing but with not faster pace because of some problems which are faced by them which include lack of staff for the branches in rural sector secondly the big problem is of repayment of loans which are taken by farmers for their development plus for the development of the village. From a beginning of 6 RRBs with 17 branches covering 12 districts in December 1975, the numbers have grown into 196 RRBs with14,446 branches working in 518 districts across the country in March, 2007. RRBs have a large branch network in the rural area forming around 43 per cent of the total rural branches of RBBs. so from this we can say that the people are accepting the types of services provided by the regional rural banks.

12.12 Self Assessment questions

I. Essay type questions

1. Explain the functions of RRBs
2. Examine the role of RRBs in Rural development of economy
3. What are the problems faced by RRBs.

II. Short Answer

1. The Objectives of Regional Rural Banks
2. Area of Functioning of Regional Rural Banks
3. Functions of Regional Rural Banks
4. Progress of Regional Rural Banks in India

III. Very Short Answer

1. Major objectives of RRBs
2. Organizational Structure of RRBs
3. Areas of functioning of RRBs

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Lesson – 13

NABARD

13. 0 Objectives:

After completing the lesion you will be able to understand the following:

- Functions and role of NABARD
- Financial initiatives of NABARD
- Major achievements of NABARD

Structure

13.1 Introduction

The importance of institutional credit in boosting rural economy has been clear to the Government of India right from its early stages of planning. Therefore, the Reserve Bank of India (RBI) at the insistence of the Government of India, constituted a Committee to Review the Arrangements For Institutional Credit for Agriculture and Rural Development (CRAFICARD) to look into these very critical aspects. The Committee was formed on 30 March 1979, under the Chairmanship of Shri B. Sivaraman, former member of Planning Commission, Government of India. The Committee's interim report, submitted on 28 November 1979, outlined the need for a new organisational device for providing undivided attention, forceful direction and pointed focus to credit related issues linked with rural development. Its recommendation was formation of a unique development financial institution which would address these aspirations and formation of National Bank for Agriculture and Rural Development (NABARD) was approved by the Parliament through Act 61 of 1981.

NABARD came into existence on 12 July 1982 by transferring the agricultural credit functions of RBI and refinance functions of the then Agricultural Refinance and Development Corporation (ARDC). It was dedicated to the service of the nation by the late Prime Minister Smt. Indira Gandhi on 05 November 1982. Set up with an initial capital of Rs.100 crore, its' paid up capital by 50: 50 contribution of government of India and Reserve bank of India stood at Rs.14,080 crore as on 31 March 2020. Consequent to the revision in the composition of share capital between Government of India and RBI, NABARD today is fully owned by Government of India. It is an apex institution in rural credit structure for providing credit for promotion of agriculture, small scale industries, cottage and village industries, handicrafts etc.

13.2 Functions of NABARD

NABARD was established as a development bank to perform the following functions:

1. To serve as an apex financing agency for the institutions providing investment and production credit for promoting various developmental activities in rural areas;
2. To take measures towards institution building for improving absorptive capacity of the credit delivery system, including monitoring, formulation of rehabilitation schemes, restructuring of credit institutions and training of personnel;
3. To coordinate the rural financing activities of all institutions engaged in developmental work at the field level and liaison with the Government of India, the State Governments, the Reserve Bank and other national level institutions concerned with policy formulation; and
4. To undertake monitoring and evaluation of projects refinanced by it.
5. NABARD gives high priority to projects formed under Integrated Rural Development Programme (IRDP).
6. It arranges refinance for IRDP accounts in order to give highest share for the support for poverty alleviation programs run by Integrated Rural Development Programme.
7. NABARD also gives guidelines for promotion of group activities under its programs and provides 100% refinance support for them.
8. It is setting linkages between Self-help Group (SHG) which are organized by voluntary agencies for poor and needy in rural areas.
9. It refinances to the complete extent for those projects which are operated under the 'National Watershed Development Programme' and the 'National Mission of Wasteland Development'.

10. It also has a system of District Oriented Monitoring Studies, under which, study is conducted for a cross section of schemes that are sanctioned in a district to various banks, to ascertain their performance and to identify the constraints in their implementation, it also initiates appropriate action to correct them.
11. It also supports “Vikas Vahini” volunteer programs which offer credit and development activities to poor farmers.
12. It also inspects and supervises the cooperative banks and RRBs to periodically ensure the development of the rural financing and farmers’ welfare.
13. NABARAD also recommends about licensing for RRBs and Cooperative banks to RBI.
14. NABARD gives assistance for the training and development of the staff of various other credit institutions which are engaged in credit distributions.
15. It also runs programs for agriculture and rural development in the whole country.
16. It is engaged in regulations of the cooperative banks and the RRB’s, and manages their talent acquisition through IBPS CWE conducted across the country.

13.3 Role of NABARD

1. It is an apex institution which has power to deal with all matters concerning policy, planning as well as operations in giving credit for agriculture and other economic activities in the rural areas.
2. It is a refinancing agency for those institutions that provide investment and production credit for promoting the several developmental programs for rural development.
3. It is improving the absorptive capacity of the credit delivery system in India, including monitoring, formulation of rehabilitation schemes, restructuring of credit institutions, and training of personnel.
4. It co-ordinates the rural credit financing activities of all sorts of institutions engaged in developmental work at the field level while maintaining liaison with Government of India, and State Governments, and also RBI and other national level institutions that are concerned with policy formulation.
5. It prepares rural credit plans, annually, for all districts in the country.
6. It also promotes research in rural banking, and the field of agriculture and rural development.

NABARDs initiatives are aimed at building an empowered and financially inclusive rural India through specific goal oriented departments which can be categorized broadly into three heads: Financial, Developmental and Supervision. Through these initiatives they touch almost every aspect of rural economy. From providing refinance support to building rural infrastructure; from preparing district level credit plans to guiding and motivating the banking industry in achieving these targets; from supervising Cooperative Banks and Regional Rural Banks (RRBs) to helping them develop sound banking practices and on boarding them to the CBS platform; from designing new development schemes to the implementation of GoI's development schemes; from training handicraft artisans to providing them a marketing platform for selling these articles. Over the years NABARDs initiatives have touched millions of rural lives across the country. their milestone achievements have been India's achievements as well. The SHG Bank Linkage Project launched by NABARD in 1992 has blossomed into the world's largest micro finance project. Kisan Credit Card, designed by NABARD has become source of comfort for crores of farmers. NABARD has financed one fifth of India's total rural infrastructure. They were pioneers in the field of watershed development as a tool for sustainable climate proofing. As reported by National Bank for Agriculture and Rural Development (NABARD), total Agriculture Credit Disbursement during the year 2015-16, 2016-17 and 2017-18 was Rs. 9,15,509.92 crore, Rs. 10,65,755.67 crore and Rs. 11,68,502.84 crore respectively.

13.4 Financial Initiatives of NABARD

Let us take a look at the financial initiatives from the National Bank for Agriculture and Rural Development:

Direct Finance

This includes the following categories of credit:

1. Loans for food parks and food processing units in specific food parks

In 2014, the government announced a special fund for the provision of term loans at attractive interest rates to Designated Food Parks (DFP) and food processing units at food parks. An amount of Rs.2,000 crore was set aside through NABARD for the same.

Purpose

- Development of the food processing sector
- Reduction in wastage of agricultural goods
- Creation of employment opportunities in rural India

Eligible entities for the loan

- State Governments
- Institutions promoted by the government
- Joint ventures (JVs)

- Cooperatives
- Federations of Cooperatives
- Special Purpose Vehicles (SPVs)
- Farmers' Producer Organisations
- Companies
- Corporates
- Entrepreneurs

Extent of term loan

- For state governments and institutions promoted by state governments, up to 95% of the eligible total project outlay will be provided.
- For all other types of borrowers, up to 75% of the eligible total project outlay will be offered.

Interest rate

- For state governments and state-promoted entities guaranteed by the state government, the interest rate will be the Bank Rate (on the date of loan disbursal) minus 1.50%.
- For private sector entities and state-promoted entities not guaranteed by the state government, the interest rate is linked to the Prime Lending Rate (PLR) that NABARD fixes.

2. Loans to warehouses, cold chain infrastructure, and cold storage

This initiative supports the creation of infrastructure that can help in the storage of agricultural produce.

Loan details – Loans are provided for the funding of projects that create storage infrastructure (with minimum aggregate capacity of 5,000 metric tonnes) for agricultural goods storage. This includes the following activities:

- Construction of silos
- Construction of warehouses
- Construction of cold storage, bulk coolers, controlled atmosphere stores, reefer vans, quick freezing units, etc.
- Upgradation or construction of Marketing Infrastructure Facilities of the APMC (Agricultural Produce Marketing Committee)

The improvement of existing storage infrastructure facilities will be considered based on the merits of the case.

Eligible entities for the loan:

- State Governments

- Government owned/assisted institutions, Cooperatives, Farmers' Producers' Organisations (FPOs), Federation of Cooperatives, Federation of Farmers' Collectives, SPVs that are created under PPP mode, etc.
- Cooperative Marketing Societies (CMS), Primary Agricultural Credit Societies (PACS), or other such entities
- Companies, corporates, or individual entrepreneurs
- Agricultural Produce Marketing Committees (APMCs)

3. Loans to marketing federations

Marketing federations undertake the following activities:

- Procurement of agricultural products, including milk
- Collection, storage, and value addition in select commodities
- Marketing of these commodities

NABARD provides short-term loans to marketing federations to support their daily operations.

Loan details – This is a short-term credit facility (for less than 12 months) offered to meet the working capital requirements of marketing federations. The activities eligible for this loan are:

- Marketing and procurement of agricultural commodities
- Marketing and processing of agricultural produce
- Collection, processing, and marketing of milk
- Supply of agricultural inputs, such as animal feed

Eligible entities

The following entities are eligible for NABARD loans:

- State or Central Government Agricultural Marketing Federations and Corporations
- Dairy Federations and Cooperatives
- Agriculture Federations and Cooperatives
- Registered Companies

Interest rate

The interest rate charged on the loan will be as decided by the Asset-Liability Management Committee (ALCO) of NABARD. It varies based on the type of borrower, security type, availability of guarantee, project type, and credit rating of the borrower.

Security

This varies based on the borrower's rating and type of activity. The primary security is the hypothecation of stocks, assets, book debts, and receivables. The lender may request for additional security such as fixed deposits, unencumbered assets, guarantees, etc.

4. Rural Infrastructure Development Fund (RIDF)

The eligible categories under RIDF include:

- Agriculture and related industries
- Social sectors
- Rural connectivity

Eligible entities

The following entities are eligible for RIDF loans:

- State governments or union territories
- State-owned corporations
- Government supported organisations
- Panchayat Raj institutions, NGOs, Self-Help Groups (SHGs)

The projects should be submitted for approval through the nodal department of the government.

Loan amount – The rural connectivity and social/agricultural projects are eligible for loans that come up to 80%-95% of the project cost.

Interest rate – The interest rates are linked to the Bank Rate at the time of loan disbursal.

Loan tenure– All loans availed can be repaid in equal annual installments within 7 years from the disbursal date. This is inclusive of a 2-year grace period. The interest amount is paid at the end of each quarter.

Security – Loans are secured by mandates registered with the RBI or any other Scheduled Commercial Bank, TPN, unconditional guarantee from state governments, and acceptance of terms and conditions in the sanction letter.

5. Direct refinance assistance to cooperative banks

As part of this scheme, financial assistance is offered to cooperative banks to help in the expansion of their lendable resources. This also assists in the diversification of banks into several types of business operations.

Loan details

The loans under this category can be classified into two types:

- Short Term Multipurpose Credit Product – This includes the fulfillment of working capital requirements, repair, and maintenance of farm equipment. The storage, packaging, and grading of goods and associated marketing activities are covered under this product.

- Assistance to Cooperative Banks to Lend to Sugar Factories - Refinance assistance is offered to cooperative banks so that the funds can be utilised by farmers for the procurement of sugarcane. The funding can be used for meeting other agricultural expenses as well.

Eligible entities

- The sanctioning of credit limit will be done only for financially strong A and B categories of CCBs and StCBs that are RBI licensed.
- Banks should adhere to the following criteria to be eligible for the refinance solutions from NABARD for on-lending to sugar factories:
- Sugar factories should have net worth that is positive
- Accumulated losses should not be seen
- There should be no violations of the CMA norms
- Factories should not have defaulted on repayments historically
- Annual accounts should be regularly audited
- The account should be a standard asset

Loan amount

The maximum limit is 100% of the bank's lending for the Short Term Multi-Purpose Credit Product. For the on-lending product, 75% credit is provided.

Interest rate

The interest rates vary from time to time based on the market conditions. Interest is paid with quarterly rests on the outstanding balance.

Security

- The security will be determined based on the risk rating of the bank. This is usually unencumbered fixed deposit receipts issued by Scheduled Banks.
- For State Cooperative Banks, government guarantee or promissory notes can act as security.

6. Support of producer organisations

The following support initiatives are undertaken by NABARD under the Producers Organization Development Fund (PODF):

- Credit support such as loans and grants for building capacity and linkages to markets.
- Credit support towards share capital.

The key objective of PODF is to meet the continued requirements of Producers Organisations (POs) and to ensure that they are completely sustainable.

Eligible entities

- Loans are offered to Registered Producers Organisations
- Grant components are given to the registered POs or the implementing agency, or both.
- Grants are also given to non-government organisations and registered Community Based Organisations (CBOs).
- Other institutions that are approved by NABARD can also receive grants.

Quantum of finance - The maximum loan amount can be 90% of the total outlay of the project. However, this varies between projects and is dependent on the outlay, project size, financing means, and resource support from various sources.

Interest rate - The interest rate for the loan is determined by ALCO based on risk analysis using the collaterals and risk tools provided.

Repayment period - The repayment tenure of the loan can be 7-10 years. The moratorium period is 1-2 years.

Security - The loan can be secured through hypothecation or the mortgage of assets that are created from the fund assistance, mortgage of any other property (immoveable), hypothecation of moveable property, corporate or personal guarantee, or any other security that is agreed upon with NABARD.

7. NABARD Infrastructure Development Assistance (NIDA)

This is a line of credit support that can be used for financing rural infrastructure projects. NIDA also offers additional products such as annuity-based offerings, PPP, mezzanine capital, etc. based on the borrower's needs.

Interest rate - The interest rate for the loan is variable as it is dependent on the risk profile of the borrower and the specifics of the project. The rates are also linked to the market borrowings of NABARD. Moratorium period of 2-4 years is available, based on project details.

Repayment period - The repayment tenure and schedule of the loan varies based on the borrower's risk profile and the nature of the project.

How to obtain funding under NIDA

- The borrower is required to submit a Detailed Project Report (DPR) that covers the technical details of the project. The business plan will also be indicated there to give an overview of the financial viability of the borrower and the project.
- The loan proposal is submitted to the Chief General Manager of the regional office in the state.

8. Financing and development of PACS

Primary Agricultural Credit Societies (PACS) are registered cooperative societies that offer credit and other types of services to its members. Assistance is available for activities related to the upgradation of agro-storage centres, agro-service centres, agro-processing centres, agri marketing and transportation facilities, and agri-information centres.

Eligibility - PACS can be assisted under PODF, as it is a registered society with farmer memberships.

Interest rate – The interest rate under PODF is a value fixed by ALCO (Asset Liability Committee).

Repayment tenure – The maximum tenure is 9 years; this is inclusive of a 2-year grace period.

9. Umbrella Programme for Natural Resource Management (UPNRM)

NABARD has launched this programme to fund community-managed, sustainable rural livelihood initiatives that are NRM-based. These projects will have to pass an assessment at the Guiding Principles level. The interest rates for the funding under UPNRM will be based on the type of project, target groups, and channel partners.

10. Alternative Investment Funds (AIFs)

NABARD makes contributions to AIFs for the achievement of the following:

- Complementing the current refinance and co-finance products of NABARD and other developmental activities.
- Encouraging entrepreneurship in agricultural and rural development activities.
- Facilitating the development of model units so that the rural poor can emulate it.
- Encouraging investment in innovative activities in the rural development and agricultural sectors.
- To help units that cannot upscale their operations due to lack of funds.
- To assist units that are engaged in infrastructure development or employment generation activities.

Eligible entities

- The AIF should be registered under SEBI Regulations, 2012. Funds falling under Categories I and II of these regulations are eligible.
- The maximum life period of the Fund should be 10 years.
- Sector agnostic funds are usually eligible if these invest at 200% of NABARD's commitment to the Fund in rural and agricultural development projects.
- The investment managers should have been associated with AIF activity for a minimum of 5 years, with a good track record.

- The structure of the Asset Management Company (AMC) should adhere to several statutory and regulatory requirements.

11. Long Term Irrigation Fund (LTIF)

This is an initiative of NABARD aimed at funding and fast tracking the completion of major and medium irrigation projects that have pending work.

Eligible entities

- State governments can borrow funds from NABARD under LTIF.
- National Water Development Agency (NWDA) that functions under the Ministry of Water Resources can borrow from LTIF.

Interest rate and tenure

- The interest rate under LTIF is around 6%.
- Repayment tenure can go up to 15 years. Moratorium period is 3 years.

12. Pradhan Mantri Aawas Yojana

Grameen (PMAY-G) - By the year 2022, the PMAY-G programme aims at setting up pucca houses for all families that are currently staying in kutcha houses. This is an undertaking of the Ministry of Rural Development (MoRD). Out of the complete financial requirement for the construction of these houses, a specific amount is expected to be met from budgetary sources. The remaining amount will be funded by NABARD.

Refinance Offerings

This includes the following categories of credit:

1. Short term refinance

The crop loan system of NABARD was set up for the disbursement of production credit for borrowers in the agricultural sector. This includes the following categories of operations:

- Short-term – Seasonal agricultural operations – Refinance is provided by NABARD at concessional interest rates for production purposes to State Cooperative Banks (SCBs) and Regional Rural Banks (RRBs). Credit limits are sanctioned in this regard. The withdrawals made under the approved credit limit should be repaid in 12 months.
- Short-term – Others – Funding under this category is provided for ST - Agriculture and allied activities, ST – Fisheries, ST – Marketing of crops, ST – Industrial cooperative societies (not including weavers), ST – Labour contract and Forest labour cooperative societies, ST – Rural artisans including weavers, ST – Stocking, purchase, and distribution of chemical fertilisers.

Short-term – Weavers

Refinance support is available as follows:

- Working capital needs of Primary, Apex, or Regional Weavers Coop Society through state coop banks or DCCBs.
- Working capital needs of Primary Weavers Coop Society through Scheduled Commercial Banks.
- Working capital needs of State Handloom Development Corporation through Scheduled Commercial Banks and State Cooperative Banks.
- Working capital and marketing needs of individual weavers, handloom weavers' groups, societies outside the coop fold, mutually aided coop societies, and master weavers through Scheduled Commercial Banks and RRBs.

NABARD also provides medium-term credit limits as relief to farmers facing crop damage from natural calamities. The short-term loans would be converted to these medium-term credit limits when there is a loss of 33% or more.

2. Long term refinance

NABARD offers long-term and medium-term refinance solutions to banks so that it can be passed on to farmers and rural artisans. The following income generating activities will be covered under this refinance product:

- Agriculture and associated activities
- Small scale industries, artisans, handicrafts, non-farm sector, handlooms, and powerlooms
- Initiatives of self-help groups and voluntary agencies that work among the poor people in rural India

The technical feasibility and financial viability of the project is taken into consideration for providing refinance. Credit supervision of the institution is also a criterion for refinance.

Eligible entities

- State Cooperative Agriculture and Rural Development Banks (SCARDBs)
- Regional Rural Banks (RRBs)
- Commercial Banks (CBs)
- State Cooperative Banks (StCBs)
- District Central Cooperative Banks (DCCBs)
- North East Development Finance Corporation (NEDFC)
- State Agricultural Development Finance Companies (ADFCs)
- Scheduled Primary Urban Cooperative Banks (PUCBs)
- Non-Banking Financial Companies (NBFCs and NBFCs-MFIs)

The final borrowers of the loan may be individuals, companies, proprietary or partnership institutions, state-owned corporations, co-operative societies, etc.

Loan tenure

The maximum loan period is 15 years

Extent of refinance

Refinance will be provided to the extent of 95% - 100% of the eligible bank loans based on the purpose of the loan, location of investment, and the borrower.

3. Schemes under off farm sector

This includes the following three schemes:

- Automatic Refinance Facility (ARF) - There are five compact programmes under this scheme:
- Composite Loan Scheme (CLS) - Refinance under this scheme is provided to meet the working capital expenses of micro/small enterprises. The maximum refinance available under the scheme is Rs.10 lakh per unit.
- Integrated Loan Scheme (ILS) - Refinance is provided to working capital and block capital for one operating cycle. Maximum refinance offered under this scheme is Rs.15 lakh per unit.
- Self-Employment Scheme for Ex-servicemen (SEMFEX) - The scheme offers loans to encourage ex-servicemen to participate in agriculture and allied activities. Off-farm activities are also supported under this scheme.
- Soft Loan Assistance for Margin Money (SLAMM) - This scheme provides financial aid to entrepreneurs who have the talent but are short on finances to meet margin requirements under relevant refinance schemes offered by NABARD.
- Small Road and Water Transport Operators (SRWTO) - Financial help is provided under this scheme for the acquisition of transport vehicles that will be used in transporting industrial products or farm produce to marketing centers. This includes water transport units and passenger transport vehicles. Margin money may also be provided for specific cases, up to 10% of the vehicle's cost.
- Rural Housing - Under this scheme, NABARD provides refinance facility to banks to support rural housing for both agriculturists and non-agriculturists. This results in overall rural development.
- Renewable Energy - In order to address India's challenges associated with energy security, the Ministry of New and Renewable Energy (MNRE) has introduced a capital cum interest subsidy scheme. This programme will help in the creation of off-grid solar power harnessing devices through the use of photo voltaic technology. The devices can light up

houses and provide heating. NABARD assesses the feasibility of the project and provides refinance for the same.

13.5 ACHIEVEMENTS

Financial, Developmental and Supervision are three broad heads which enable NABARD to touch almost every aspect of rural economy: providing refinance support, building rural infrastructure, preparing district level credit plans, guiding and motivating the banking industry in achieving credit targets, supervising Cooperative Banks and Regional Rural Banks (RRBs), helping them develop sound banking practices, enabling them to on-board to the CBS platform, designing new projects for rural development, implementing GoI's development schemes, training handicraft artisans and providing them a marketing platform for selling their articles among others.

A) FINANCIAL FUNCTIONS

- Refinance - Short Term Loans

Crop loans are etended to farmers for crop production by financial institutions, which support in ensuring food security in the country. During the year 2018-19, NABARD has disbursed ₹ 90088 crore for Seasonal Agricultural Operations to financial institutions.

- Long Term Loans

NABARD's long-term refinance provides credit to financial institutions for a wide gamut of activities encompassing farm and non-farm activities with tenors of 18 months to more than 5 years. During the year 2018-19, NABARD has disbursed ₹90254 crore to financial institutions.

- Rural Infrastructure Development Fund

RIDF was set up with NABARD in 1995-96 by the Reserve Bank of India out of the shortfall in lending to priority sector by scheduled commercial banks for supporting rural infrastructure projects. NABARD disbursed ₹ 27623 crore during 2018-19. RIDF contributes substantially to the rural infrastructure funding in the country today.

- Long-Term Irrigation Fund

The Long-Term Irrigation Fund (LTIF) was announced in the Union Budget 2016–17 for fast tracking the 99 identified medium and major irrigation projects, spread across 18 states in mission mode by December 2019. Ministry of Water Resources, River Development and Ganga Rejuvenation (MoWR, RD & GR) is the nodal ministry designated to coordinate and facilitate completion of the projects. Subsequently, Government of India has approved funding for four more projects under LTIF viz; Polavaram project in Andhra Pradesh, North

Koel project in Bihar and Jharkhand, Relining of Sirhind and Rajasthan Feeder Canal project of Punjab, and Shahpur Kandi Dam in Punjab. Cumulative loans sanctioned and released under LTIF as on 31st March 2019 are ₹ 75769.90 crores and ₹ 34248.73 crores respectively.

- Pradhan Mantri Awaas Yojana - Grameen (PMAY-G)

NABARD sanctioned an amount of ₹14,645.57 crores and released ₹10,678.80 crores during 2018-19 to the National Rural Infrastructure Development Agency (NRIDA). The cumulative amount sanctioned to NRIDA as on 31 March 2019 was ₹21,975 crore of which ₹18,008.23 crore was released. The financial assistance was channelized towards PMAY-G, which plans to provide a pucca house, with basic amenities, to all houseless households including those living in kutcha and dilapidated houses, by 2022.

- NABARD Infrastructure Development Assistance

During 2018–19, term loan of ₹7,362.76 crore was sanctioned under NIDA through eight credit proposals. Out of this, irrigation projects accounted for 90% (₹6,655.00 crore) and remaining went to renewable energy, roads, and power transmission projects (₹707.76 crore). NABARD and Government of Maharashtra entered into an agreement for completion of 68 incomplete medium/minor irrigation projects to create irrigation potential of 1,82,750 ha across 14 drought prone districts of Maharashtra under the Baliraja Jal Sanjivani Yojana, with a NIDA term loan facility of ₹6,650 crore, during the year.

Cumulatively, 80 projects with term loan of ₹30,574.30 crore have been sanctioned and an amount of ₹11,566.95 crore is disbursed.

- Warehouse Infrastructure Fund

GoI created Warehouse Infrastructure Fund (WIF) in the year 2013- 14 with NABARD with a corpus of ₹ 5,000 crore for providing loans to meet the requirements for scientific warehousing infrastructure for agricultural commodities in the country. The cumulative disbursement as on 31 March 2019 stood at ₹ 5,896 crores.

- Food processing fund

With view to promoting food processing industries in the organised sector on a cluster basis, the Government of India instituted the Food Processing Fund (FPF) in NABARD in 2014–15, with a corpus of ₹2,000 crore. NABARD sanctioned ₹61.8 crore to one project during 2018-19 taking the cumulative loan sanctioned to ₹531.35 crore for 11 mega food park (MFP) projects and three food processing units as on 31 March 2019. During the year, ₹57.07 crore was disbursed, taking the cumulative disbursements to ₹312.85 crore for the sanctioned projects.

- Direct Lending to Central Cooperative Banks

A short-term multipurpose credit product designed for direct lending to CCBs for meeting the working capital and farm asset maintenance needs of the individual borrowers and affiliated PACS had been launched since 2011–12. The outstanding under this line of credit stood at ₹4,449.50 crore as on 31 March 2019 as against ₹2,949.51 crore as on 31 March 2018.

- Credit Facility to Marketing Federations (CFF)

In order to strengthen the arms of Marketing Federations/Cooperatives, we established a separate line of credit, viz. Credit Facility to Federations, which promotes marketing of agricultural produce and other farm activities. During 2018-19, we disbursed an amount of ₹ 29860 crore. The cumulative disbursement under CFF since inception stood at ₹ 33251 crore as on 31 March 2019.

B) SUPERVISORY FUNCTIONS

During 2018-19, NABARD conducted 316 inspections.

C) Developmental Functions

- Kisan Credit Card Scheme for Farmers

The Kisan Credit Card (KCC) scheme was designed by NABARD in association with the Reserve Bank of India (RBI) in August 1998 for providing crop loans. NABARD has been at the forefront of technology revolution by helping rural financial institutions in providing RuPayKisan Cards (RKCs) to all their farmer clients.

To cover all the farmers with RuPay Kisan Credit Cards (RKCs) on mission mode for full coverage of KCC accounts, RRBs and RCBs were supported for Europay, MasterCard, Visa (EMV) chip-based RKCs. Micro ATMs were supported in schools, colleges, milk societies, and other societies to enhance the ability of the farmers to use their RKCs. RRBs and Cooperative Banks issued 1.18 crore and 2.00 crore RKCs respectively as on 31 March 2019.

- Watershed Development

As on 31 March 2019, we have sanctioned 457 watershed projects, 123 KfW-Climate Proofing projects, 147 WDF-Climate Proofing projects, 451 Sustainable Development Plan programm and 47 springshed based watershed development programm in 27 states covering an area of 20.68 lakh ha.

- Tribal Development

The Tribal Development Programme of NABARD is being implemented from the year 2003-04 with a corpus of ₹ 50 crore. 748 projects have been sanctioned covering 5.35 lakh tribal families with a financial commitment of ₹ 2198 crore, of which an amount of ₹ 1563 crore has been disbursed as on 31 March 2019.

- Climate Resilient Agriculture

Under Adaptation Fund, the cumulative sanction for six such ongoing projects stood at USD 9.85 million (₹ 5,911 crore). We have also cumulatively sanctioned 30 projects under NAFCC amounting to ₹ 846.81 crore at the end of FY 2018-19..

- Umbrella Programme on Natural Resource Management

Cumulatively 334 UPNRM projects have been sanctioned across the country covering 10 major natural resource management sectors with a financial assistance of ₹782 crore including grant assistance of ₹ 44 crore. The cumulative disbursement as on 31st March 2019 stood at ₹ 573 crore including grant assistance of ₹ 29 crore.

- Financial Inclusion

As on 31 March 2019, cumulative sanctions under FIF stood at ₹3,903.17 crore. Besides NABARD's digital Financial Literacy Awareness Programmes (dFLAPs), it has extended support to banks for conducting targeted financial literacy programmes (for people newly inducted in the financial system, adults, specified groups and digital financial literacy) in rural areas through their FLCs and rural branches, especially in the 115 aspirational districts identified by the Government of India.

- Microfinance Sector

NABARD had launched the Self Help Group-Bank Linkage Programme (SHG-BLP) in 1992. It covered about 100.14 lakh Self-Help Groups (SHGs) and nearly 12.5 crore poor households in India as on 31 March 2019. Nearly 27 lakh SHGs availed credit support of ₹58,318 crore from various banks during 2018-19, at an average of ₹2.16 lakh per SHG. 16.04 lakh JLGs were promoted and financed by banks during 2018–19.

- EShakti

In a bid to digitise SHGs, project EShakti was launched on 15 March 2015. As on 31 March 2019, a total of 4.34 lakh SHGs were digitised involving 47.91 lakh members across the country. An estimated 5 lakh SHGs covering around 60 lakh members are expected to be digitised in the 100 districts across 22 states and one UT, where EShakti is under implementation during current year.

- Skill Development

Promoting an entrepreneurial culture among the rural youth and encouraging them to start enterprises in the rural off-farm sector has been our strategy for over three decades. The capacity development measures initiated by NABARD have covered 33,812 skill and entrepreneurship development programmes in association with our partner agencies with grant assistance of ₹135.45 crore. These measures have cumulatively covered over 8.71 lakh unemployed rural youth in the country as on 31 March 2019.

- Marketing Initiatives

For providing marketing opportunities to rural artisans and producers and have traditionally facilitated their participation in exhibitions across the country. In 2018-19, we enabled artisans to participate in 360 melas and exhibitions with financial assistance of ₹ 5.28 crore.

- Incubation Centres

To commercialise innovations and to shape agri entrepreneurship in the country, we extended support to Chaudhary Charan Singh Haryana Agricultural University, Hisar and Tamil Nadu Agricultural University, Madurai for establishing Agri Incubation Centres with a total financial commitment of ₹23.99 crore.

13.6 Summary

NABARD role in rural development in India is phenomenal. National Bank For Agriculture & Rural Development (NABARD) is set up as an apex Development Bank by the Government of India with a mandate for facilitating credit flow for promotion and development of agriculture, cottage and village industries. The credit flow to agriculture activities sanctioned by NABARD reached Rs 1,57,480 crore in 2005–2006. The overall GDP is estimated to grow at 8.4 per cent. The Indian economy as a whole is poised for higher growth in the coming years. Role of NABARD in overall development of India in general and rural & agricultural in specific is highly pivotal.

Through assistance of Swiss Agency for Development and Cooperation, NABARD set up the Rural Innovation Fund. Rural Infrastructure Development Fund (RIDF) is another noted scheme for the bank for rural development. Under the RIDF scheme Rs. 51,283 crore have been sanctioned for 2,44,651 projects covering irrigation, rural roads and bridges, health and education, soil conservation, water schemes etc. Rural Innovation Fund is a fund designed to support innovative, risk friendly, unconventional experiments in these sectors that would have the potential to promote livelihood opportunities and employment in rural areas.The assistance is extended to Individuals, NGOs, Cooperatives, Self Help Group, and Panchayati Raj Institutions who have the expertise and willingness to implement innovative ideas for improving the quality of life in rural areas. Through member base of 25 crore, 600000 cooperatives are working in India at grass root level in almost every sector of economy. There are linkages between SHG and other type institutes with that of cooperatives.

13.7 Self Assessment Questions

I. Essay type Questions

1. Explain the role of NABARD
2. Examine the major achievements of NABARD
3. Briefly explain the financial initiatives of NABARD

II. Short Notes

4. What are the functions of NABARD
5. Role of NABARD

III. Very Short Answer Questions

1. Eligible entities for loan from NABARD
2. Rural Infrastructure Development Fund (RIDF)
3. Producers Organization Development Fund (PODF)
4. NABARD Infrastructure Development Assistance (NIDA)
5. Refinance Offerings from NABARD
6. Kisan Credit Card Scheme for Farmers

13.8 References

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Lesson – 14

INTERNATIONAL BANKING

14.0 Objectives:

After completing the lesion you will be able to understand the following:

- Reasons for international banking
- Types of international banking
- Benefits of International banking
- challenges of International banking

Structure

14.1 INTRODUCTION

Globalization and growing economies around the world have led to the development of international banking facility. The world is now a marketplace and each business wants to exploit it. Geographical boundaries are no more a concern. With access to technology, banking facilities have grown vastly. One prime example of it is international banking. In the years to come, such banks would see higher growth and higher profitability. Big business houses are expanding themselves at a rapid pace. To maintain the growth, these businesses will need the financial services of international banking. Therefore, the demand for international banking facilities will increase. Despite similarities between domestic and international activities, banks often conduct international operations in a separate division or department. Large banks typically operate an independent international division, which may include a network of foreign branches, subsidiaries, and affiliates. Smaller banks, or banks with limited international activity, often use a separate section that works with a network of foreign correspondent banks or representative offices. In either case, international activity is usually operated by separate management and staff using distinct accounting systems and internal controls. The following is a list of the largest international banks based on market capitalization. The top five banks include three U.S. banks and two Chinese banks. J.P. Mogan Chase & Co, Bank of America corp, Industrial & Commercial Bank of China, Wells Fargo, China Construction Bank, HSBC Holdings, Citigroup, Bank of China, Royal Bank of Canada, Commonwealth Bank of Australia are the world's Top ten International Banks.

14.2 DEFINITIONS

According to *Lewis & Davis (1987, p. 219)*, international banking is a denotation of cross-border and cross currency facets of banking business. They classify international banking into two main activities; traditional foreign banking and euro currency banking; where traditional banking involves transactions with non-residents in domestic currency to allow trade finance and other international transactions, whilst Euro currency banking involves banks participating in foreign exchange transactions with both residents and non-residents. As discussed earlier banks have the major incentive to go global that is from domestic banks to multi-national banking termed as MNB's.

According to *Grubel's (1977) seminal adaptation of the theory of MNEs,* multi-national banking asserted that potential MNB's must possess or at least perceive themselves to be in a possession of some advantage over their least competitors in foreign markets. According to Grubel's argument banks would be reluctant to expand abroad in the absence of some competitive advantage. Banks without a competitive advantage may obtain an edge through the acquisition of foreign businesses in sophisticated markets. The general idea of explaining about International Banking is to obtain a basic idea of international banking and its activities. Hence, International Banking can be defined as banking transactions crossing national boundaries. The activities involves like international lending; claims of domestic bank offices on foreign residents, claims of foreign bank offices on local residents, claims of domestic bank offices on domestic residents in foreign currency are the major activities involved in International Banking.

14.3 REASONS FOR INTERNATIONAL BANKING :

There's a wealth of reasons for individuals and companies to bank internationally. Many people around the world use international banks to shelter their money from their home country's income and estate taxes. Hosts of banks are based in countries with low or no income and estate taxes, such as the Cayman Islands, Belize, Panama and the Isle of Man. But you can't just put your income in Belize and not pay taxes. Customers must report their income and work with their bank to make sure tax avoidance doesn't turn into tax evasion. Some individuals use international banks to invest in the economies of booming countries and in developing countries, the same way they might invest in a domestic corporation or real estate venture. A number of wealthy individuals keep their wealth in offshore banks and other entities to keep it safe from lawsuits. That doesn't mean these people are criminals; they simply want to avoid losing every penny to a sudden, unexpected or predatory lawsuit. Since international banks lend and borrow on international markets, they're less affected by domestic interest rate fluctuations. For example, when Mr. and Mrs. Platinum want to avoid sinking interest rates in their own country, one thing they might do is move their money into an international bank. Also, some foreign banks might offer better interest rates than domestic banks, providing a money-making opportunity for customers.

International banks also make it easier for a company with an international presence to do business around the world. For one, the company doesn't have to set up a million different bank accounts around the world, then wait to receive money while the banks deal with one another. In addition, international banks offer many financial services to facilitate international trade. Besides offering payroll services for companies with employees and contractors in other countries, they offer letters of credit to ensure that companies in different countries pay one another for goods and services. They also offer financing services to support businesses facing the large costs of importing and exporting products.

14.4 Types of International Banking

1. Correspondent banks - Correspondent banks involve the relationship between different banks which are in different countries. This type of bank is generally used by the multinational companies for their international banking. This type of banks is in small size and provides service to those clients who are out of their country.
2. Edge Act banks - Edge act banks are based on the constitutional amendment of 1919. They will operate business internationally under the amendment.
3. Off-shore banking centre - It is a type of banking sector which allows foreign account. Offshore banking is free from the banking regulation of that particular country. It provides all types of products and services.
4. Subsidiaries - Subsidiaries are the banks which incorporate in one country which is either partially or completely owned by a parent bank in another country. The affiliates are

somewhat different from the subsidiaries like it is not owned by a parent bank and it works independently.

5. Foreign branch bank - Foreign banks are the banks which are legally ties up with the parent bank but operate in a foreign nation. A foreign bank follows the rules and regulations of both the countries i.e. home country and a host country.

14.5 BENEFITS OF INTERNATIONAL BANKING

International banking is just like any other banking service, but it takes place across different nations or internationally. To put in another way, international banking is an arrangement of financial service by a residential bank of one country to the residents of another country. Mostly multinational companies and individuals use this banking facility for transacting.

1. **Flexibility** - International banking facility provides flexibility to the multinational companies to deal in multiple currencies. The major currencies that multinational companies or individuals can deal with include euro, dollar, pounds, sterling, and rupee. The companies having headquarters in other countries can manage their bank accounts and avail financial services in other countries through international banking without any hassle.

2. **Accessibility** - International banking provides accessibility and ease of doing business to the companies from different countries. An individual or MNC can use their money anywhere around the world. This gives them a freedom to transact and use their money to meet any requirement of funds in any part of the world.

3**. International transactions** - International banking allows the business to make international bill payments. The currency conversion facility allows the companies to pay and receive money easily. Also, the benefits like overdraft facility, loans, deposits, etc. are available every time for overseas transactions.

4. Accounts Maintenance - A multinational company can maintain the records of global accounts in a fair manner with the help of international banking. All the transactions of the company are recorded in the books of the banks across the globe. By compiling the data and figures, the accounts of the company can be maintained. An offshore bank offering international banking is a bank located in any country other than the account holder's home country. An account held in an offshore bank is therefore often described as an offshore bank account. While international banking and offshore bank accounts are often negatively perceived as a way to avoid paying tax (which in fact is illegal), they boast legitimate financial advantages for expats over domestic banking arrangements.

5. **Tax efficiency** - Some offshore locations have a reputation for low or zero tax rates, which make them attractive banking options for globe-trotting expats. Taxation can be a tricky area to navigate, not least because tax legislation continually changes across both onshore and offshore jurisdictions. Also, the specific tax advantages to which you are entitled depend on your personal circumstances. Keep in mind there are many international tax intricacies to understand, such as reporting and annual tax filing. To avoid falling foul of fines or penalties when it comes to your offshore savings and tax obligations, always seek professional advice before opening an offshore bank account.

6. **Convenience and greater flexibility** - As with any domestic bank account, you must meet the due diligence requirements of opening an offshore account. However, you won't need to visit the bank in person. You can then access your offshore bank account 24/7 from anywhere in the world either via a web browser or mobile app. International bank accounts are often available in multiple currencies, which is convenient if you need to make or receive payments in different currencies – often a key benefit for expats living and working globally.

7. **Investing** - Investing from an international bank account is relatively straightforward and can give you access to investment opportunities that may not be available in your home country, or where you currently reside. This is an attractive feature for expats leading international lifestyles. Depending on your situation, investing from an offshore account may offer you many advantages including tax benefits, asset protection and greater privacy. Keep in mind, however, that offshore investing attracts greater regulatory scrutiny and higher costs. Most offshore banks offer tools to help you build your investment portfolio. Your choice of offshore bank account, however, needs to be structured around *your* risk profile and financial goals, so it's wise to seek professional advice before making a decision.

8. **Easy transfers and lower exchange risk** - International bank account holders can make transactions in more than one currency including sterling, euros and US dollars. Making transferring funds between countries plain sailing. Offshore accounts also generally offer good exchange rates and allow you to move money between accounts in different currencies without the fees. Of course, fees and exchange rates are dependent on the bank and type of account you hold, but the advantages of having your savings and investments in a secure offshore location with tax advantages is a win-win for expats who move regularly.

9. **Lending and Credit** - International banking is effectively a private banking service, so lending and credit facilities are often more flexible and tailored to your specific needs. You

may find you have access to much more competitive mortgage rates, particularly if the property is in a mainstream market like the UK.

International banking has many advantages for expats and is worth considering; however, as with any financial arrangement, it’s always best to talk to a financial adviser before taking the plunge.

14.6 Challengers to traditional offshore bank accounts

With the rise of fintech companies and multi-currency accounts, more online international bank accounts are available; they take minutes to open and provide easy and secure international money transfers. Of course, different accounts offer different benefits and it’s necessary to do your due diligence before opening an account online, but companies such as Revolut, N26, Monese and Capital One 360 are challenging traditional banks by driving down overseas banking costs and currency exchange costs. There are number of great savings apps that you can use to manage your accounts virtually. We’ve reviewed the most popular savings apps here in our article “6 apps to develop great savings habits“.

1. Opening an international bank account - Before opening an international bank account, there are many factors to consider, so it’s always wise to seek professional advice. At United Advisers Group, we are well-versed in international banking and are experienced in working with expats to open offshore bank accounts, especially in Switzerland, Luxembourg and Spain. The bank account best suited for your needs will depend on your nationality, your tax residency, your employment contract and how long you intend to stay in the country for.
2. Making the most of offshore investments as an expat - Once you have opened your international bank account(s), speak with your adviser about the opportunities available to you when it comes to offshore investments. Offshore investments offer expats a number of benefits, most notably tax efficiency. However, there are several other benefits as we explain in our post on retirement planning for expats.
3. Additional international banking services for expats - Our international banking expertise also extends to International Pension Transfers and Overseas Property Services. We can help you to understand the different pension options available to you as an expat and take you through the common pitfalls’ property buyers face when purchasing abroad.
4. Stay informed - To stay up to date on these and other financial matters important to expats, such as market movements, investment advice and lifestyle financial planning, sign up for our monthly newsletter.

14.7 SUMMARY

Many international banking activities parallel those conducted in domestic banking operations. For example, in both international and domestic markets, a bank may extend credit, issue and confirm letters of credit, maintain cash and collection items, maintain correspondent bank accounts, accept and place deposits, and borrow funds. Other activities are more closely associated with international banking, such as creating acceptances and trading foreign currencies. The most important element of international banking not found in domestic banking is country risk, which involves the political, economic, and social conditions of countries where a bank has exposure. Examiners must consider country risk when evaluating a bank's international operations.

14.8 Self Assessment Questions

I. Essay type Questions

1. Explain the Reasons for International Banking
2. Examine the major benefits of International banking
3. Briefly explain the Challengers to traditional offshore bank accounts

II. Short Notes

4. What are the various types of International banks

5. What do you mean by International banking

III. Very short answer questions

1. Define international banking
2. Types of international banking
3. Reasons for international banking
4. Opening an international bank account

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Lesson – 15

WORLD BANK

15.0 Objectives

After going through this lesion you will understand the following:

- History of World Bank
- Organizational structure of World Bank
- Functions and objectives of the World Bank
- Need of the World Bank
- World Bank Group agencies
- Criticisms on World Bank Group
- Role of world bank in developing countries

Structure

15.1 INTRODUCTION

The World Bank is an international organization dedicated to providing financing, advice, and research to developing nations to aid their economic advancement. The bank predominantly acts as an organization that attempts to fight poverty by offering developmental assistance to middle- and low-income countries. It is a provider of financial and technical assistance to individual countries around the globe. The bank considers itself a unique financial institution that sets up partnerships to reduce poverty and support economic development. The World Bank supplies qualifying governments with low-interest loans, zero-interest credits, and grants, all for the purpose of supporting the development of individual economies. Debt borrowings and cash infusions help with global education, healthcare, public administration, infrastructure, and private-sector development. The World Bank also shares information with various entities through policy advice, research and analysis, and technical assistance. It offers advice and training for both the public and private sectors. Currently, the World Bank has two stated goals that it aims to achieve by 2030. The first is to end extreme poverty by decreasing the number of people living on less than $1.90 a day to below 3% of the world population. The second is to increase overall prosperity by increasing income growth in the bottom 40% of every country in the world.

15.2 History of the World Bank

Founded in 1944 at the UN Monetary and Financial Conference (commonly known as the Bretton Woods Conference), which was convened to establish a new, post-World War II international economic system, the World Bank officially began operations in June 1946. Its first loans were geared toward the postwar reconstruction of western Europe. Beginning in the mid-1950s, it played a major role in financing investments in infrastructural projects in developing countries, including roads, hydroelectric dams, water and sewage facilities, maritime ports, and airports.

The Bretton Woods Agreement included several components: a collective international monetary system, the formation of the World Bank, and the creation of the International Monetary Fund (IMF). Since their foundings both the World Bank and the International Monetary Fund have worked together toward many of the same goals. The original goals of both the World Bank and IMF were to support European and Asian countries needing financing to fund post-war reconstruction efforts. Both the World Bank and IMF outlasted the collective international monetary system which was central to the Bretton Woods Agreement. President Nixon halted the Bretton Woods international monetary system in the 1970s. However, the World Bank and IMF remained open and continued to thrive on providing worldwide aid. The World Bank and IMF are headquartered in Washington, D.C. The World Bank currently has more than 10,000 employees in more than 120 offices worldwide.

Though titled as a bank, the World Bank, is not necessarily a bank in the traditional, chartered meanings of the word. The World Bank and its subsidiary groups operate within their own provisions and develop their own proprietary financial assistance products, all with the same goal of serving countries' capital needs internationally. The World Bank's counterpart, the IMF, is structured more like a credit fund. The differing in the structuring of the two entities and their product offerings allows them to provide different types of financial lending and financing support. Each entity also has several of its own distinct responsibilities for serving the global economy. The IBRD has 189 member governments, and the other institutions have between 153 and 184 members. The institutions of the World Bank Group are all run by a Board of Governors meeting once a year. Each member country appoints a governor, generally its Minister of Finance. On a daily basis the World Bank Group is run by a Board of 25 Executive Directors to whom the governors have delegated certain powers. Each Director represents either one country (for the largest countries), or a group of countries. Executive Directors are appointed by their respective governments or the constituencies.

15.3 Organization

The World Bank is related to the UN, though it is not accountable either to the General Assembly or to the Security Council. Each of the bank's more than 180 member states are represented on the board of governors, which meets once a year. The governors are usually their countries' finance ministers or central bank governors. Although the board of governors has some influence on IBRD policies, actual decision-making power is wielded largely by the bank's 25 executive directors. Five major countries—the United States, Japan, Germany, the United Kingdom, and France—appoint their own executive directors. The other countries are grouped into regions, each of which elects one executive director. Throughout the World Bank's history, the bank president, who serves as chairman of the Executive Board, has been an American citizen.

Voting power is based on a country's capital subscription, which is based in turn on its economic resources. The wealthier and more developed countries constitute the bank's major shareholders and thus exercise greater power and influence. For example, in the early 21st century the United States exercised nearly one-sixth of the votes in the IBRD, more than double that of Japan, the second largest contributor. Because developing countries hold only a small number of votes, the system does not provide a significant voice for these countries, which are the primary recipients of World Bank loans and policy advice. The bank obtains its funds from the capital subscriptions of member countries, bond flotations on the world's capital markets, and net earnings accrued from interest payments on IBRD and IFC loans. Approximately one-tenth of the subscribed capital is paid directly to the bank, with the remainder subject to call if required to meet obligations. The World Bank is staffed by more than 10,000 people, roughly one-fourth of whom are posted in developing countries. The bank has more than 100 offices in member countries, and in many countries staff members serve directly as policy advisers to the ministry of finance and other ministries. The bank has consultative as well as informal ties with the world's financial markets and institutions and maintains links with nongovernmental organizations in both developed and developing countries.

15.4 Functions of the World Bank

- It helps the war-devasted countries by granting them loans for reconstruction.
- Thus, they provide extensive experience and the financial resources of the bank help the poor countries increase their economic growth, reducing poverty and a better standard of living.
- Also, it helps the underdeveloped countries by granting development loans.
- So, it also provides loans to various governments for irrigation, agriculture, water supply, health, education, etc.
- It promotes foreign investments to other organizations by guaranteeing the loans.
- Also, the World Bank provides economic, monetary, and technical advice to the member countries for any of their projects.
- Thus, it encourages the development of of-industries in underdeveloped countries by introducing the various economic reforms.

15.5 Objectives of the World Bank

- This includes providing long term capital to its member nations for economic development and reconstruction.
- Thus, it helps in inducing long term capital for improving the balance of payments and thereby balancing international trade.
- Also, it helps by providing guarantees against loads granted to large and small units and other projects for the member nations.

- So, it ensures that the development projects are implemented. Thus, it brings a sense of transparency for a nation from war-time to a peaceful economy.
- Also, it promotes the capital investment for member nations by providing a guarantee for capital investment and loans.
- So, if the capital investment is not available than it provides the guarantee and then IBRD provides loans for promotional activities on specific conditions.

15.6 Purposes of the World Bank

- It wants to create an environment that is a pro-investment.
- Also, it wants to improve the economic stability by reducing poverty.
- So, it is working towards achieving sustainable growth.
- Increasing the opportunities for jobs and business in member nations which are underdeveloped.
- Through investment, it plans to promote the socio-economic status of the society.
- Also, it wants to ensure that the judicial and legal systems are developed and individual rights are protected.
- Strengthing the government of its member nations by promoting education.
- Combating corruption and to ensure that there are adequate training opportunities and research facilities.
- It wants to provide loans with low-interest rates and interest-free credits.

15.7 World Bank Group agencies

Through the years, the World Bank has expanded from a single institution to a group of five unique and cooperative institutional organizations, known as the World Banks or collectively as the World Bank Group. The World Bank Group consists of

- the International Bank for Reconstruction and Development (IBRD), established in 1945, which provides debt financing on the basis of sovereign guarantees;
- the International Finance Corporation (IFC), established in 1956, which provides various forms of financing without sovereign guarantees, primarily to the private sector;
- the International Development Association (IDA), established in 1960, which provides concessional financing (interest-free loans or grants), usually with sovereign guarantees;
- the International Centre for Settlement of Investment Disputes (ICSID), established in 1965, which works with governments to reduce investment risk;

- the Multilateral Investment Guarantee Agency (MIGA), established in 1988, which provides insurance against certain types of risk, including political risk, primarily to the private sector.

The term "World Bank" generally refers to just the IBRD and IDA, whereas the term "World Bank Group" or "WBG" is used to refer to all five institutions collectively. The World Bank Institute is the capacity development branch of the World Bank, providing learning and other capacity-building programs to member countries. The agencies of the World Bank are each governed by their Articles of Agreement that serve as the legal and institutional foundation for all of their work. The activities of the IFC and MIGA include investment in the private sector and providing insurance respectively.

The IBRD offers assistance to middle-income and poor, but creditworthy, countries. It also works as an umbrella for more specialized bodies under the World Bank. The IBRD was the original arm of the World Bank that was responsible for the reconstruction of post-war Europe. Before gaining membership in the WBG's affiliates (the International Development Association, the International Finance Corporation, the Multilateral Investment Guarantee Agency, and the International Centre for Settlement of Investment Disputes), a country must be a member of the IBRD. The International Development Association offers loans to the world's poorest countries. These loans come in the form of "credits" and are essentially interest-free. They offer a 10-year grace period and hold a maturity of 35 years to 40 years.

The International Finance Corporation (IFC) works to promote private sector investments by both foreign and local investors. It provides advice to investors and businesses, and it offers normalized financial market information through its publications, which can be used to compare across markets. The IFC also acts as an investor in capital markets and will help governments privatize inefficient public enterprises. The Multilateral Investment Guarantee Agency (MIGA) supports direct foreign investment into a country by offering security against the investment in the event of political turmoil. These guarantees come in the form of political risk insurance, meaning that MIGA offers insurance against the political risk that an investment in a developing country may bear. Finally, the International Centre for Settlement of Investment Disputes facilitates and works toward a settlement in the event of a dispute between a foreign investor and a local country.

15.8 Debt and Policy Reform

The debt crisis of the early 1980s—during which many developing countries were unable to service their external debt to multilateral lending institutions, because of a slowdown in the world economy, high interest rates, a decline in commodity prices, and wide fluctuations in oil prices, among other factors—played a crucial role in the evolution of World Bank operations. The bank had become increasingly involved in shaping economic and social policies in indebted developing countries. As a condition of receiving loans, borrowing countries were required to implement stringent "structural adjustment programs," which typically included severe cuts in spending for health and education, the elimination of price controls, the liberalization of trade, the deregulation of the financial sector, and the privatization of state-run enterprises. Although intended to restore economic stability, these programs, which were applied in a large number of countries throughout the developing world, frequently resulted in increased levels of poverty, mounting unemployment, and a spiraling external debt. In the wake of the debt crisis, the World Bank focused its efforts on providing financial assistance in the form of balance-of-payments support and loans for infrastructural projects such as roads, port facilities, schools, and hospitals. Although emphasizing poverty alleviation and debt relief for the world's least developed countries, the bank has retained its commitment to economic stabilization policies that require the implementation of austerity measures by recipient countries.

The World Bank and the IMF played central roles in overseeing free-market reforms in eastern and central Europe after the fall of communism there in the 1980s and '90s. The reforms, which included the creation of bankruptcy and privatization programs, were controversial because they frequently led to the closure of state-run industrial enterprises. "Exit mechanisms" to allow for the liquidation of so-called "problem enterprises" were put into place, and labour laws were modified to enable enterprises to lay off unneeded workers. The larger state enterprises often were sold to foreign investors or divided into smaller, privately owned companies. In Hungary, for example, some 17,000 businesses were liquidated and 5,000 reorganized in 1992–93, leading to a substantial increase in unemployment. The World Bank also provided reconstruction loans to countries that suffered internal conflicts or other crises (e.g., the successor republics of former Yugoslavia in the late 1990s). This financial assistance did not succeed in rehabilitating productive infrastructure, however. In several countries the macroeconomic reforms resulted in increased inflation and a marked decline in the standard of living.

The World Bank is the world's largest multilateral creditor institution, and as such many of the world's poorest countries owe it large sums of money. Indeed, for dozens of the most heavily indebted poor countries, the largest part of their external debt—in some cases constituting more than 50 percent—is owed to the World Bank and the multilateral regional development banks. According to some analysts, the burden of these debts—which according to the bank's statutes cannot be canceled or rescheduled—has perpetuated economic stagnation throughout the developing world.

15.9 Millennium Development Goals

Various developments had brought the Millennium Development Goals targets for 2015 within reach in some cases. For the goals to be realized, six criteria must be met: stronger and more inclusive growth in Africa and fragile states, more effort in health and education, integration of the development and environment agendas, more as well as better aid, movement on trade negotiations, and stronger and more focused support from multilateral institutions like the World Bank.

1. Eradicate Extreme Poverty and Hunger: From 1990 through 2004 the proportion of people living in extreme poverty fell from almost a third to less than a fifth. Although results vary widely within regions and countries, the trend indicates that the world as a whole can meet the goal of halving the percentage of people living in poverty. Africa's poverty, however, is expected to rise, and most of the 36 countries where 90% of the world's undernourished children live are in Africa. Less than a quarter of countries are on track for achieving the goal of halving under-nutrition.
2. Achieve Universal Primary Education: The percentage of children in school in developing countries increased from 80% in 1991 to 88% in 2005. Still, about 72 million children of primary school age, 57% of them girls, were not being educated as of 2005.
3. Promote Gender Equality: The tide is turning slowly for women in the labor market, yet far more women than men- worldwide more than 60% – are contributing but unpaid family workers. The World Bank Group Gender Action Plan was created to advance women's economic empowerment and promote shared growth.
4. Reduce Child Mortality: There is some improvement in survival rates globally; accelerated improvements are needed most urgently in South Asia and Sub-Saharan Africa. An estimated 10 million-plus children under five died in 2005; most of their deaths were from preventable causes.
5. Improve Maternal Health: Almost all of the half million women who die during pregnancy or childbirth every year live in Sub-Saharan Africa and Asia. There are numerous causes of maternal death that require a variety of health care interventions to be made widely accessible.

6. Combat HIV/AIDS, Malaria, and Other Diseases: Annual numbers of new HIV infections and AIDS deaths have fallen, but the number of people living with HIV continues to grow. In the eight worst-hit southern African countries, prevalence is above 15 percent. Treatment has increased globally, but still meets only 30 percent of needs (with wide variations across countries). AIDS remains the leading cause of death in Sub-Saharan Africa (1.6 million deaths in 2007). There are 300 to 500 million cases of malaria each year, leading to more than 1 million deaths. Nearly all the cases and more than 95 percent of the deaths occur in Sub-Saharan Africa.
7. Ensure Environmental Sustainability: Deforestation remains a critical problem, particularly in regions of biological diversity, which continues to decline. Greenhouse gas emissions are increasing faster than energy technology advancement.
8. Develop a Global Partnership for Development: Donor countries have renewed their commitment. Donors have to fulfill their pledges to match the current rate of core program development. Emphasis is being placed on the Bank Group's collaboration with multilateral and local partners to quicken progress toward the MDGs' realization.

To make sure that World Bank-financed operations do not compromise these goals but instead add to their realisation, environmental, social and legal safeguards were defined. However, these safeguards have not been implemented entirely yet. At the World Bank's annual meeting in Tokyo 2012 a review of these safeguards has been initiated, which was welcomed by several civil society organisations.

15.10 Criticisms on World Bank Group

While WBG strives to create a poverty-free world, there are groups that are passionately opposed to the international patron. These opponents believe that the fundamental structure of the Bank only exacerbates the already existing imbalance between the world's rich and poor. The system allows the largest shareholders to dominate the vote, resulting in WBG policies being decided by the rich, but implemented by the poor. This can result in policies that are not in the best interests of the developing country receiving assistance, whose political, social, and economic policies will often have to be molded around WBG resolutions. Moreover, even though the Bank provides training, assistance, information, and other means that may lead to sustainable development, opponents have observed that developing countries often have to put health, education, and other social programs on hold in order to pay back their loans.

Opposition groups have protested by boycotting World Bank bonds. These are the bonds that the WBG sells on global capital markets to raise money for some of its activities. These opposition groups also call for an end to all practices that require a country to implement structural adjustment programs (including privatization and government austerity measures), an end to the debt owed by the poorest of the poor, and an end to environmentally damaging projects such as mining or building dams.

It is not surprising that there is a clash of opinion over how aid is given. Indeed, those that offer assistance are going to want to have a say in how the loans are used and what kind of economic policies are fostered in a country's developmental process. Many developing and poor nations, however, are stuck in a quagmire of debt and impoverishment, no matter how much assistance they receive. Given this, we may need to remember that the process of aid is also a developing state, in which both the giver and the receiver should be helping each other reach a poverty-free world.

15.11 The World Bank and developing countries with special reference to India:

The world Bank provides assistance to developing countries subject to the following conditions:

(a) The overall economy of the borrowing country is soundly operated

(b) If the overall economic plans would reinforce the basic soundness of economy, and

(c) The projects which the bank is asked to finance have been carefully prepared and are economically and financially justified.

In order to obtain IBRD loans it is necessary for a developing country to keep a constantly critical eye on the soundless of its budget structure, on healthy relationship between wages and prices, on the effective utilisation of its available productive resources, on the flow of goods within its borders and the volume and character of its imports and exports; and on all the diverse aspects of national life which reflect the health of its economy.

The Bank charter provides that its loans must be for productive purposes and meant to finance foreign exchange requirements of specific projects. Before a loan is granted the merits of the projects to be financed are carefully studied and it is ensured that only the most urgent and useful projects are taken up first. Also, before making or guaranteeing any loan, the Bank must satisfy itself that the borrowing country cannot obtain the loans from private sources at reasonable terms. The Bank makes prudent assessment of the projects to make sure that the loans will be repaid. The broad aim is to help strengthening the economy of the borrowing country and stimulate production activity in general rather than help the production of particular goods. It does not engage in equity financing. The World Bank has become a part of a broadening stream of financial and technical assistance to the less developed countries. Although now other sources and institutions have also joined in the task which the Bank pioneered with such imagination and purposiveness, it has not detracted from the importance of the part which the Bank is playing in mobilizing international assistance to developing countries.

However, there is a definite limit to the amounts that the Bank can lend. Its entire subscribed capital is not really available for lending. Additional funds are raised by issuing bonds and here also there is a limit to the total amount that the Bank can raise by issuing bonds. The capacity of the developing countries to absorb capital for really productive purposes also imposes a limit. The Bank has repeatedly made it clear that the main burden of international finance must fall on private investors or on loans at nominal interest or outright grants by rich countries. It cannot be expected to meet capital requirements of the developing countries in their entirety. There is thus need for other sources or organisations to undertake this all important task. The Bank can render a useful service by providing technical assistance in preparing development plans and by supplying relevant information to the other lenders. Above all, it can serve as a negotiation forum and provide mediation. The World Bank has given a large financial assistance to India for economic development. Special mention may be made of the assistance World Bank has given to India in the development of infrastructure such as electric power, transport, communication, irrigation projects, steel industry. For a long period, India was the signal largest borrower from the World Bank. At present India is the third largest borrower of funds from the World Bank.

15.12 The Role of IBRD (World Bank)

Countries with a per capita income of less than \$ 5,225 that are not IDA-only borrowers are eligible to borrow from IBRD. Countries with higher per capita incomes may borrow under special circumstances or as part of a graduation strategy. It is important to note, however, that the amount that countries can borrow from IBRD depends on their creditworthiness. Thus, countries may be eligible to borrow but may not have access to IBRD resources because of poor creditworthiness. In addition, IBRD loans outstanding to any individual borrower, irrespective of its creditworthiness, may not exceed \$ 13.5 billion.

Seventy-five per cent of poor people who live on less than \$1 per day live in countries that received IBRD lending. IBRD borrowers are typically middle-income countries that enjoy some access to private capital markets. Some countries are eligible for IDA lending due to their low per capita incomes, but they are also creditworthy for some IBRD borrowing. These countries are known as blend borrowers. Even excluding IBRD loans to the blend countries, a full 25 percent of those who live on less than $1 a day live in countries that are IBRD borrowers. IBRD provides important support for poverty reduction by facilitating access to capital in larger volumes on good terms, with longer maturities, and in a more sustainable manner than the market provides.

IBRD is a AAA-rated financial institution—with some unusual characteristics. Its shareholders are sovereign governments. Its member borrowers have a voice in setting its policies. IBRD loans (and IDA credits) are typically accompanied by non-lending services to ensure more effective use of funds. Also, unlike commercial banks, IBRD is driven by development impact rather than profit maximization.

15.12.1 Co-financing: Co-financing describes funds committed by official bilateral partners, multilateral partners, export credit agencies, or private sources to specific Bank-funded projects. Co-financing enables the World Bank to increase its resources with additional financing to benefit the recipient country. Financing provided by multiple sources in support of individual projects also allows harmonization of policies and procedures, thus reducing the administrative burden on the recipient country and improving effectiveness.

15.12.2 Trust Funds: A number of industrial countries, a few of a larger developing countries, the private sector, and non-governmental organizations maintain trust funds with the World Bank that can be used to supplement Bank resources for specific agreed-on initiatives. The trust funds available cover areas that facilitate providing grants for high-priority development needs, including technical assistance and advisory services, debt relief, and post conflict transition.

15.12.3 World Bank's Strategy: Stronger Focus on Results: Development experience over the past 50 years has highlighted the importance of focusing on economic and social outcomes. Donors demand that funds provided by their taxpayers achieve results. The citizens of developing countries are impatient to see tangible improvements in their living conditions within a reasonable time frame. Both expect the World Bank and other development agencies to be able to demonstrate the results of joint efforts. Developing more accurate and timely data on social and economic outcomes and conducting independent evaluations of projects and country programs provide a basis for ensuring accountability and, more importantly, learning from experience. The Bank has, in the last few years, significantly increased its focus on monitoring the quality of implementation, sustainability, and development outcomes of the programs it finances. Its monitoring and evaluation systems have been strengthened to more comprehensively capture the poverty impact of its policy and investment lending as well as its advisory services. This will enable it to more closely track its progress toward meeting the Millennium Development Goals (MDG).

15.12.4 Financing the Poverty Removal: Efforts by World Ban*k:* The World Bank is a cooperative institution that mobilizes financing by means of outright contributions from the richer member countries for IDA, and by borrowing from the international capital markets for IBRD. It channels these resources for the benefit of the poor in borrowing countries. The clients of IBRD, on the other hand, are generally the middle-income countries and, because of the limitation on IDA resources, some of the larger low-income countries that are deemed creditworthy for borrowing from World Bank. IBRD (World Bank) offers loans at near-market terms but with long maturities. The Bank offers an array of customized services through IBRD and IDA – including loans, technical assistance, and advice – to its developing and in-transition member countries. It uses two basic types of lending instruments: investment loans and adjustment loans.

15.12.5 Investment Loans: Investment loans provide finance for goods, works, and services in support of economic and social development projects in a broad range of sectors. The nature of the Bank's investment lending has evolved over time. Originally focused on hardware, engineering services, and bricks and mortar, investment lending has come to focus more on institution building, social development, and the public policy infrastructure needed to facilitate private sector activity as the Bank's priorities have changed.

15.12.6 Adjustment Loans: Adjustment loans provide quick-disbursing external financing to support policy and institutional reforms. Adjustment loans were originally designed to provide short-term balance of payments support for macro-economic policy reforms, including reforms in trade policy. Over time they have evolved to focus more on medium-term structural and institutional reforms in the financial sector, social policy and public sector resource management.

15.12.7 How a Loan is made: Lending by the World Bank is developed in several phases. On the basis of economic and sector work, often supported by the Bank, the borrower identifies and prepares the project, and the Bank reviews its viability. During loan negotiations the Bank and borrower agree on the development objective, components, outputs, performance indicators, an implementation plan, and a schedule for disbursing loan funds. Once the Bank approves the loan and it becomes effective, the borrower implements the project or program according to terms agreed on with the Bank. All loans are governed by the World Bank's operational policies which aim to ensure that Bank-financed operations are economically, financially, socially, and environmentally sound. Fiduciary policies and procedures govern the use of project-related funds, particularly for the procurement of goods and services. Safeguard policies help to prevent unintended adverse effects on third parties and the environment. The Bank therefore supervises the implementation of each loan and evaluates its results. Three-fourth of outstanding loans are managed by country directors located away from the Bank's Washington, D.C., headquarters.

15.13 Summary

As mentioned earlier, the main function of the WBG is to eliminate poverty and to provide assistance to the poor by offering loans, policy advice, and technical assistance. As such, the countries receiving aid are learning new ways to function. Over time, however, it has been realized that sometimes as a nation develops, it requires more aid to work its way through the development process. This has resulted in some countries accumulating so much debt and debt service that payments become impossible to meet. Many of the poorest countries can receive accelerated debt relief through the Heavily Indebted Poor Countries scheme, which reduces debt and debt-service payments while encouraging social expenditure.

Another issue on which the Bank has recently been focusing has presented itself as an endangerment to a country's livelihood: support programs for HIV/AIDS. The WBG has also been focusing on reducing the risk of projects by means of better appraisal and supervision mechanisms, as well as a multidimensional approach to overall development. The Bank encourages all its clients to implement policies that promote sustainable growth, health, education, social development programs focusing on governance and poverty reduction mechanisms, the environment, private business, and macroeconomic reform.

15.14 Self Assessment Questions

I. Essay type Questions

1. Write an essay on functions and objectives of World Bank
2. Examine the major World Bank group agencies
3. Briefly explain the criticisms on world bank group
4. Analyse the role of World Bank with special reference to India

II. Short Notes

5. What is the purpose of world bank
6. Write about Millennium development goals

III. Very Short Answer Questions

1. History of World Bank
2. Functions of World Bank
3. Purpose of World Bank
4. IFC
5. MIGA
6. Types of lending instruments of World Bank

15.15 References

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Lesson Writer

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