CHAPTER 1

STRUCTURE OF INDIAN BANKING AND TYPES OF BANKS

1.1 OBJECTIVES

After going through this chapter, the readers would be able to understand

- Need of a Bank
- Meaning of a Bank
- Various types of banks in India
- Various functions performed by banks
- Recent trends in Indian Banking

1.2 INTRODUCTION

Indian Banking System for the last two centuries has seen many developments. Till 1955, the commercial banking was in the hands of private corporates. Setting up of State Bank of India and its subsidiaries and, thereafter nationalization of banks changed the structure of banks. With the start of financial reforms in 1991-92, new private banks came into existence and the full use of technology by these banks improved customer service in banks to a great extent. Today, all banks are competing with each other in regard to the development of new products matching with global standards. Banks offer savings, remittance, credit and other ancillary products to their customers. In addition, customers are also offered insurance and other risk management products. There are a large number of commercial bank branches and cooperative societies which are offering banking services to the people of India.

1.3 NEED OF BANKING SERVICES

Now-a-days, banking services are not a luxury but a necessity of life for everyone. The financial needs of the excluded are varied and distinct. They need access to savings, insurance and most importantly credit. In equal measure, they also need counselling as to how to access and use financial services. Given the poor economic status of the excluded, it is evident that the individual credit requirement could be small and initial demand for remittance and other facilities offered by the banks may not be much. Also, these accounts may not have regular and high turnover. Typically, this is low volume, low turnover and high number market. Needless to say, however, that these people must be given access to formal financial services so that the overall development goals can be achieved.

However, it was felt that the branch banking and electronic banking may not be appropriate models to reach the excluded people as financial inclusion involves financial education, counselling and building up of close relationship with people. In this background and in order to take banking services to the people living in unbanked and under banked areas, the Business Facilitator/Business Correspondent (BF/BF) Model was introduced.

The person or institution/company appointed as BF/BC will function as an extended arm of the bank branch in the area. The individual appointed by the bank or a BC company is known as Business Correspondent Agent (BCA)[1]. As a result of this arrangement, the targeted population can access various financial services and financial education from the banks through these agents. It is, therefore, necessary for a BCA to be familiar with the basic/general banking knowledge, his/her roles and responsibilities in financial inclusion, technical and soft skills to perform his duties. As a first step, it is important to have a working knowledge about a bank and its basic functions.

1.4 MEANING OF A BANK

A bank is a financial institution which acts as an intermediary between savers and investors or users of funds. A bank offers a number of financial services and products to its clients. It is easy to understand a bank from the various services it offers. The following is the illustrative list of services normally extended by banks to their customers:

(*i*) A bank accepts deposits from the public in the form of Savings, Current and/ or Term Deposits.

1. In this book an Individual BC/BF is also referred as a BCA

(*ii*) It allows a customer to remit money or funds from one place to another in the form of Demand Draft or Money transfer. These days, banks also offer to remit funds through electronic channels.

(*iii*) It accepts instructions from the customer and makes, on their behalf, payment for utilities such as electricity bill, school fees etc.

(*iv*) It accepts, on behalf of Government, tax payments.

(*v*) It lends money for business, agriculture, purchase of house, purchase of vehicles etc.

(*vi*) It transacts (buying and selling of foreign currency) in foreign exchange and helps business people and others receive or pay in Foreign currency for their export or import respectively. It buys and sells foreign currency as per the customer's needs.

(*vii*) It offers safe deposit vault facilities for safe keeping of the customer's valuables.

(*viii*) It operates ATM machines which allow the customers to withdraw funds from their accounts round the clock.

(*ix*) It offers credit/debit card facilities which help customers make payments for their purchases. It is also possible to borrow money by using credit cards.

(*x*) Banks also sell mutual fund units and insurance products.

The above list would show the important role played by the banks in our day-to-day life. Banks are able to do all the above activities because they are financial intermediaries. It is important to note that the primary function of banks is acceptance of money in the form of deposits and lending it to borrowers. A part of the deposits collected by the banks are also invested in bonds and securities. Thus, deposit taking, lending and investment are the basic functions of a bank. The other activities listed above could be treated as other functions of a bank.

1.5 STRUCTURE OF INDIAN BANKING SYSTEM

Banks in India are generally classified into various categories as follows.

1.5-1 Scheduled Banks

Banks can be either scheduled or non-scheduled. Banks which are listed in the second schedule of the Reserve Bank of India are known as scheduled banks. These banks are further classified as:

(*i*) Public Sector banks : These are further classified as:
- (*a*) State Bank of India
- (*b*) Nationalised Banks
- (*c*) Other Public Sector Banks : IDBI Bank

(*ii*) Private Sector Banks:
- (*a*) Old Private Sector Banks
- (*b*) New Private Sector Banks
- (*c*) Foreign Banks
- (*d*) Payment Banks
- (*e*) Small Finance Banks
- (*f*) Local Area Banks

(*iii*) Regional Rural Banks

(*iv*) State Cooperative Banks and District Central Cooperative Banks

(*v*) Urban Cooperative Banks

A brief description of these banks is as follows :

1.5-2 Public Sector Banks

These banks are characterized by majority ownership (51% or more share capital) by the Government of India. About 72% of the banking business in India is performed through these banks. They can further be classified as under:

(*a*) **State Bank of India**:

State Bank of India is the largest bank in India State Bank of India has many financial subsidiaries such as SBI Life Insurance Company, SBI Mutual Funds, SBI Factors, SBI Capital Markets, SBI Cards etc. The list of subsidiaries is indicative of the variety of services that the bank renders.

(*b*) **Nationalised Banks**

Nationalised Banks have the largest number of branches in metro/urban/semi-urban/rural areas through-out the country. The nationalized banks have a very large branch network spread over the entire country, large deposits and assets base and perform all kinds of financial services.

(*c*) **Other Public Sector Bank**: At present IDBI Bank is under this category.

1.5-3 Regional Rural Banks (RRBs)

Regional Rural Banks have been established with a focus on rural development. These are also scheduled banks sponsored by public sector banks. But unlike commercial banks, their area of operations was restricted to a few districts. Also, they do not offer all the financial services that are offered by commercial banks. Their ownership/capital is provided jointly by Central Government (50%), concerned State Government (15%) and the sponsoring bank (35%). In order to ensure better viability of these RRBs, sponsor banks have started merging their RRBs at State level. After the merger, the number has been reduced from 196 to 56 as on 31st March, 2017.

1.5-4 Private Sector Banks

(*a*) **Indian Private Sector Banks** :

These are banks incorporated in India whose shares are held by public. Majority of these banks belong to the category of old generation private banks characterized by small balance sheet size, regional operations, traditional style of management and business activities. The other category of private sector banks is the new generation banks, incorporated post-1993. These banks are better capitalized, technology- driven, aggressive in business development and adopt a style of functioning comparable to foreign banks operating in India. These banks adopt a variety of delivery channels. Though a number of new private sector banks were started, there are only five of them operating today on account of merger of some of these banks among themselves. In 2014, two more banks *viz.* IDFC Bank and Bandhan Bank were given license by RBI.

(*b*) **Foreign Banks** :

These are the banks incorporated abroad but granted license by RBI to do banking business in India through their Indian branches. While there are many foreign banks operating in India, their branch network is smaller and the most of them operate in metropolitan cities and State Capitals. Their operations are technology driven and a good part of their business comprises of corporate banking, foreign exchange, export/import finance and merchant banking etc.

(*c*) **Local Area Banks**:

These are banks which have been given license to function in a given area. They operate with a low level of capital and cannot offer all the financial services of a commercial bank. There are only four Local Area Banks in the country as of now.

(*d*) **Payment Banks** :

Payment Banks can accept demand deposits - current deposits and savings bank deposits - from individuals, small businesses and other entities, but there is an upper limit of ₹ 1 lakh per customer. Customers will earn interest on their savings account balance. They can accept and send remittances. The payments banks are also allowed to undertake utility bill payments and can distribute MF, insurance and pension products. They cannot lend to customers or issue credit cards. Payments banks can only park money in government papers and bank deposits.

(*e*) **Small Finance Banks** :

The small finance banks are essentially scaled down versions of commercial banks, with both deposit-taking and loan-making functions. They are required to provide at least 75 per cent of their loans to borrowers classified as priority sector and at least 50 per cent of their loans must be below ₹ 25 lakhs. Small Finance Banks (SFBs) are different from existing banks as they have to serve local areas to meet credit and remittance needs of small businesses, unorganised sector, low income households, farmers and migrant work force. It is intended that they should fulfil the needs of micro and small enterprises (MSEs) with significant contribution to employment, value addition and exports in the Indian economy.

1.5-5 Cooperative Banks

Cooperative banks are registered under the State Cooperative Act with the Registrar of Cooperative Societies. Their main regulator is the State Government (or Central

Government in cases of the cooperative banks operating in more than one State). The organizational structure and management set-up of cooperative banks is based on the cooperative principles. Cooperative Banks are classified into Urban Cooperative Banks, District Central Cooperative Banks, and Land Development Banks.

Cooperative Banks' balance sheets are much smaller as compared to commercial banks. Not all the cooperative banks enjoy the scheduled status. Cooperative Banks operate through their branches and through the societies. Societies are not banks though some of them accept all types of deposits.

1.6 FUNCTIONS OF BANKS

1.6-1 Traditional Functions

(*a*) **Acceptance of Deposits** :

A bank accepts money from its customers (members of the public). A customer can keep his/her monies in current accounts where no interest is payable or in savings accounts (also known as savings deposit accounts) where nominal interest is paid. Normally, business firms/companies open current accounts which facilitate large number of transactions. In the case of individuals, and where commercial transactions may not be involved, savings accounts are opened. In both these cases, the amount deposited is repayable back to the customer as and when demanded/needed. Because of this aspect, current accounts and savings accounts are also known as demand deposits and customers can withdraw the funds by issuing cheques. Savings account holders are issued ATM cards by using which they can withdraw cash in the ATMs. The accounts, where the customers/savers can keep their funds for a longer time are called term deposits. Term deposits could be in the form of fixed deposits, recurring/cumulative deposits, monthly income deposits, etc. Unlike current and savings bank deposits, wherein the amount deposited with the banks are repayable on demand, in the case of term deposits, the amounts deposited are, normally, repayable only after the expiry of the agreed term/period for which it is kept. There are, however, provisions for closing the deposit account pre-maturely and withdrawing the amount subject to certain penal interest stipulations. Term deposits constitute the largest portion of a bank's funds.

(*b*) **Loans and Advances**

Banks have to pay interest on the deposits at agreed rates of interest. In addition, they have to meet their operational expenses. Therefore, banks have to invest/lend the monies and earn interest. Lending money by way of loans and advances of various kinds is thus an important traditional function of a bank. The funds mobilized, in the form of deposits, and monies borrowed are deployed by a bank as loans and advances to earn profits by way of interest spreads, i.e. the differential between the average interest rates on loans and on deposits. The interest income from loans and advances forms a major source of a bank's operating profit.

Banks lend in the form of Cash Credits, Overdrafts, Demand Loans and Term Loans. Based on the borrower profile, loans can be classified as Corporate Loans, SME advances, Agricultural Loans, Retail Loans, Foreign Currency Loans, Educational Loans, Vehicle Loans etc. Loans are also classified on the basis of security. Security could be in the form of surety, pledge of Bank's Deposit receipts, shares and debentures, assignment of Life Insurance policies, Mortgage of immovable property, hypothecation of plant and machinery, raw material etc. A loan account with security is known as secured loan whereas a loan without security is known as clean loan (clean advance).

In order to repay depositors on demand and pay interest on borrowed funds and deposits, banks expect that all the borrowers who take the loans are prompt in payment of interest and repayment of principal amount. However, it is possible that on account a number of reasons, the interest and principal may get defaulted and become overdue. Loans and advances which remain overdue for more than a stipulated period is known as 'non-performing assets' (NPAs). NPAs cause loss of income (interest not being paid or recovered) and in some cases loss of the principal (amount lent). Lending, therefore, calls for good credit appraisal and requires adequate care, caution and supervision/ monitoring by the bank to prevent loans turning overdue and eventually into NPAs. Collection or recovery of dues/overdues is important for sustaining the viability of banks.

(*c*) **Remittance services** :

Customers have to make payment for purchases in the place of their business or in the place of business of the vendor/seller. This calls for movement of money from place to place. However, it may not be possible for a buyer to travel from one place to another for making payments. Nor will it be convenient to carry large sums of money from one place to another place. It is, therefore, necessary that a good payment and settlement system should exist for enabling trade and commerce in the country. Banks perform the job of payment and settlements in the financial market. In this regard, Banks have branch network spread across various cities/regions/states. Some banks have branches and correspondent banks overseas as well. This network enables the banks to remit funds of their customers, if needed, from one place to another in the same country or overseas by mail/telegraphic/electronic funds transfer or by issuing bank drafts. Banks charge appropriate fee from the remitting person for the service rendered. Remittance of funds by banks is fast, safe, secure and cheap as compared to other modes of funds transfer, like post office money order (which is generally for small sums of money for personal use), physical transfer of money etc.

1.6-2 Other Functions

(*a*) Miscellaneous Services:

In addition to the above-mentioned core functions, banks also render other services, which are useful to customers, business firms and members of the society. These services include safe deposit lockers, safe custody of valuables; letters of credit and bank guarantees; collection of out-station cheques/bills/hundies; furnishing opinion reports on their customers; agency services for Government business, correspondent, trusteeship and executor's business. Banks charge a commission or fee on such services, which provides them with non-interest income adding to their profits.

(*b*) Electronic Banking:

In the wake of the recent strides in information and communication technologies, almost all banking operations have now been computerized. Information Technology and IT driven systems have been adopted by most commercial banks both in private and public sectors and most of the banks in the cooperative sector also. In fact, the new generation private sector banks started their operations with IT advantage. Today, IT and computerization have been adopted for front-office operations where interaction with customers takes place, back-office operations such as internal accounting and books balancing and settlement of transactions with other branches and banks/institutions. Electronic banking has opened new vistas in service delivery by adopting new banking channels like phone banking, internet banking, credit/debit cards, ATM etc. In this background, modern banks look quite different from the traditional 'brick and mortar' branch banking.

Information Technology has, thus brought 'any where and any time banking' and contributed to the speed, accuracy and confidentiality of customers' transactions while enhancing customers' convenience resulting in customer delight. The funds transfer and cheques clearing and collection of bills of exchange are also done electronically with accuracy, speed and safety. Internal house-keeping is done accurately and much faster. These new banking channels have ensured that the customer need not necessarily go to the branches for cash withdrawal, deposit of cheques, obtaining account statement etc., but has access to other channels such as ATM, Credit/Debit Card or internet.

The Information and Communication Technology (ICT) is playing an important role in financial inclusion efforts. It will also ensure that a large number of accounts are handled by the banking system more easily than in the past.

1.7 REGULATION AND SUPERVISION OF BANKING IN INDIA

Reserve Bank of India:

The activities of the banking sector are supervised, controlled and regulated by the Reserve Bank of India. It plays an important role in the monetary and banking structure of the country. The Reserve Bank of India (RBI) was established on April 1, 1935 as the central bank of the country. It acts as the note issuing authority, banker's bank and banker to Government, and to promote the growth of the economy within the framework of the general economic policy of the Government consistent with the need for maintenance of price stability. Considering the dominance of agriculture in the Indian economy, the Reserve Bank was assigned a greater role to expand and coordinate the credit facilities available to the agricultural sector. The Reserve Bank of India's role in rural credit relating to its promotional, finance and regulatory functions has undergone a change with the formation of NABARD in 1982. The Reserve Bank continues to retain its essential regulatory controls.

NABARD: The Committee to Review Arrangements for Institutional Credit for Agriculture and Rural Development (CRAFICARD) under the Chairmanship of Shri B. Sivaraman recommended the establishment of a separate bank at the national level under the umbrella of RBI to be known as National Bank for Agriculture and Rural Development (NABARD) as a refinancing agency for the entire rural credit system. 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). Functions of NABARD categorized broadly into three heads: Financial, Developmental and Supervision. Financial function includes both Direct Finance and Refinance functions. More than 50% of the rural credit is disbursed by the Co-operative Banks and Regional Rural Banks. NABARD is responsible for regulating and supervising the functions of Co-operative banks and RRBs.

1.8 RECENT TRENDS IN BANKING

The Indian banking system presently consists of public sector banks, private sector banks, foreign banks, regional rural banks, urban cooperative banks and rural co-operative banks. The major market share is that of the public sector banks.

The banking sector is laying greater emphasis on providing improved services to their clients and also upgrading their technology infrastructure, in order to enhance the customer's overall experience as well as give banks a competitive edge.

(*a*) Greater Operational Freedom given to Banks:

RBI has deregulated interest rates and given operational freedom to banks for fixing interest rates on advances as well as deposits as per their Assets- Liabilities Management (ALM) policies. RBI expects banks to be more transparent in regard their base rates and other policy matters.

(*b*) Emergence of Universal Banking

Universal banking means offering all banking products & services (both fee based and fund based services) under one roof. Banks are making lower profit margins on their lending business with increased competition. Therefore, banks are increasingly focusing on fee-based income to make up for this falling interest income. Some popular fee-based services in India include investment banking activities, advisory services, wealth management, selling insurance and mutual fund products

(*c*) Increased Thrust on Financial Inclusion

Financial Inclusion implies bringing low income and disadvantaged groups under the coverage of banking by providing them access to banking services at affordable cost. Introduction of Pradhan Mantri Jan Dhan Yojana (PMJ-DY), Pradhan Mantri Jeevan Jyoti Scheme, Pradhan Mantri Suraksha Bima Yojana are aiming to provide financial products to all such people who have been excluded so far. Using services of Business Correspondents and Business Facilitators for providing banking services in the remotest areas have been a success attempt in this regard. Setting up of new Payment Banks and Small Finance Banks would boost financial inclusion to a great extent. The entry of a substantial number of new, differentiated banks is an overarching growth driver for the financial distribution segment. The other three growth drivers for the segment include providing an impetus to change in the delivery and consumption of financial services, demographic factors, technology changes and regulation. As non-banking digital companies and new banks, premised on low cost-high tech models to deal with low value-high volume customers, make their mark in the banking universe, the delivery of financial services must be reimagined by the supply side.

(*d*) Increased Use of Technology:

Adoption of new technology in banks has considerably changed the banking culture itself. Technological evolution increased automation of banking operations which enabled off-site banking through ATMs, internet banking, payment of utilities through banks, travel reservation through banks, etc. Core Banking Solution (CBS) implemented in almost all banks has enabled anywhere, anytime banking. Use of mobile banking is increasing day-by-day. Remittances of funds through RTGS and NEFT have facilitated the individuals and also the traders. Banks are also entering into the "wallet" banking business for penetrating its outreach to the vast population of the country. Use of plastic money like credit cards, debit cards and other pre-paid instruments at the "point of sale" are becoming popular.

(*e*) Consolidation of banks:

The banking industry in India has witnessed mergers and acquisitions triggered by a combination of Government dictate and synergistic motives. A higher capital base, which could be possible through consolidation, will thus allow higher lending to borrowers. Other perceived benefits from Consolidation are increased efficiency and profitability. It is expected that the Indian Banking sector will witness consolidation through M & A to meet challenges and exploit synergistic benefits.

(*f*) Mobile Banking

The mobile-phone revolution that is transforming the country could also turn into a banking revolution in terms of reach and transaction. The reach of mobile to the remote village and its usage by the common man has become order of the day and it is estimated that around 1/4 of mobile users are residing in villages/small towns. The coverage of mobile phones and the use of such instruments by all section of the population can be exploited for extending financial services to the excluded populations. It enables the subscribers to manage their financial transactions (funds transfer) independent of place and time. The subscriber can approach a retailer of mobile network for withdrawal/deposit of money and the transaction takes place using SMS messages. The Mobile Banking services are generally available through a java application on Blackberry, Android, iPhones and Windows mobile phones. Various banking services like Funds Transfer, Immediate Payment Services, Enquiry Services (Balance enquiry/Mini statement), Demat Account Services, Requests for Cheque Book, Bill Payments, etc. may be carried out through mobile banking. There are transaction limits for mobile banking and these services are free of charge. The mobile banking services are also available over SMS. The basic financial transactions from the Bank accounts can be executed through a mobile based PIN system using "MobileBanking". Mobile banking through mobile wallet was also launched in 2012. Mobile telephony and pre-paid wallets would also be utilized for coverage of households under the Financial Inclusion campaign.

1.9 LET US SUM UP

There are different types of banks based on the ownership and activities. There are Public Sector Banks, Nationalized Banks, Private Banks, Foreign Banks, Co-operative Banks, RRBs, Local Area Banks, Payment Banks and Small Finance Banks functioning in our country. The main activity of all these banks is accepting savings from public in deposits and lending money to various persons who are in need of them for their personal requirements or business requirements. Banks offer remittance facility in the accounts, apart from various other functions. Reserve Bank of India and NABARD are the apex banks controlling and supervising the banking sector in India. Banking is changing very fast with the adoption of latest technology. There is tough competition amongst bank for capturing new banking business. New products are being launched.

1.10 KEY WORDS

Electronic Banking. Mobile Banking, Remittances, Safe Deposit Lockers, Differentiated Banking

1.11 CHECK YOUR PROGRESS

1. Principal functions of banks are:
   (*a*) accepting deposits
   (*b*) lending and investing
   (*c*) non-fund business and remittance services
   (*d*) All of above
2. IDBI is a---------
   (*a*) Private Bank
   (*b*) Nationalised Bank
   (*c*) Public Sector Bank
   (*d*) Development Bank

3. Payment Banks can accept deposits----------
   (*a*) of any type and also without any ceiling
   (*b*) term deposits only
   (*c*) demand deposit only but there is no upper limit for it
   (*d*) demand deposits having balance not exceeding ₹ 1 lakh per customer
4. Small Finance Banks are required to give finance
   (*a*) maximum upto ₹ 25 lakhs
   (*b*) 50% of its total advances portfolio should be at least upto ₹ 25 lakhs per borrower
   (*c*) to any borrower without any ceiling
   (*d*) only to priority sectors as defined by RBI
5. Regional Rural Banks can open its branches:
   (*a*) anywhere in the state wherein it has its Head Quarters
   (*b*) anywhere in the state but non-customer related offices can be opened anywhere in the country
   (*c*) anywhere in the country
   (*d*) only in the Govt. notified area (Districts)

1.12 ANSWERS TO CHECK YOUR PROGRESS

1. (*d*) 2. (*c*) 3. (*d*) 4. (*b*) 5. (*d*)