[Academic Script]

Various Developments in Banking Sector

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Academic Script

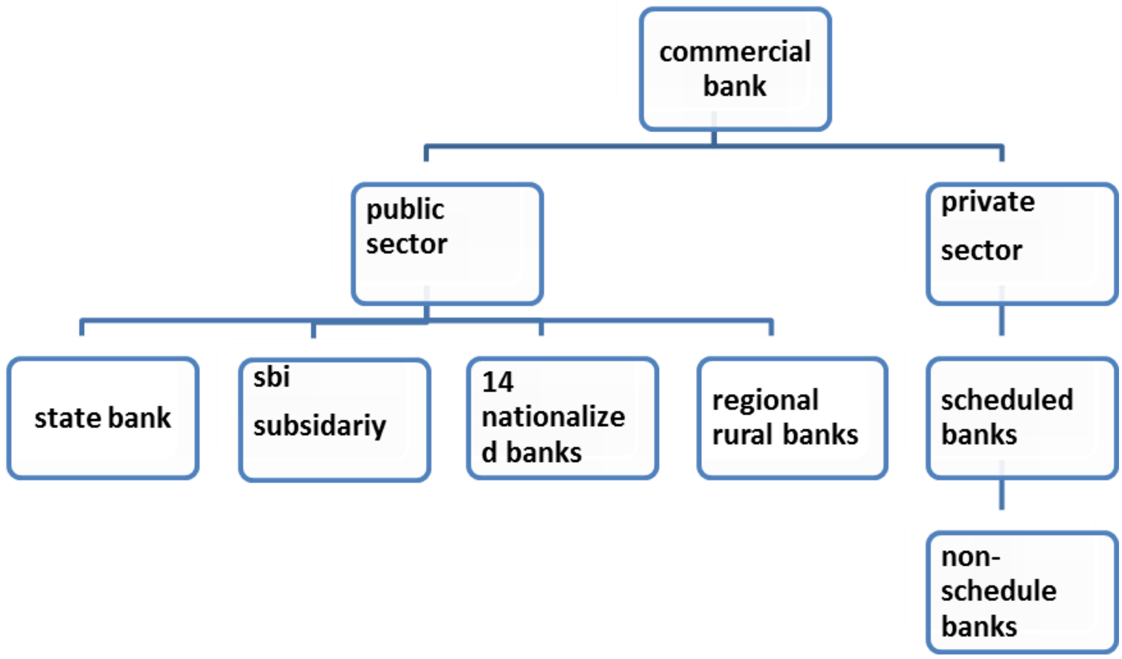
1. Introduction

Commercial banks

(1)Meaning

❖ Commercial banks are the most important constituents of banking system. These are the banks which do banking business to earn profit.

Structure of commercial banks in India



(2)Functions

Basically, there are two essential functions of commercial banks:

- Borrowing of money: they borrow money from all kinds of deposits. Commercial banks deposits money in all kinds of account like savings, current and fixed.
- Lending of money: commercial bank receives deposits which has to be repay according to its promise and makes them available to those who are really in need of them by lending the money.

- Besides these two functions there are various other functions of commercial banks:

1. Agency function.

Bank act as an agent in the various functions carried out by it. It provide all services to its customers by acting as an agent like insurance, I.T. products offered by banks.

2. General services utility functions.

These services are those in which the bank's position is not that of an agent for his customer. They include the issue of credit instruments like letter of credit and traveller's cheques, the acceptance of bills of exchange, the safe custody of valuable documents and many more…

(3) Challenges ahead for the commercial banks:

In spite of these many achievements there are several challenges which need to be faced by commercial banks like:

1. As competition is increasing day by day in banking sector therefore, it is necessary that banks equip themselves with the right organizational structure and even more importantly the right personnel and systems to cope with the challenges.
2. Need to develop excellence in management. Hence, management need to develop in communication channel, performance, customer- driven business orientation, investment, leadership, personnel, information system and strong credit risk management.
3. Need to improve corporate governance standards and adaption of uniform accounting standards and disclosure requirements.
4. There is need to develop human resources with the changing environment. As, it facilitate performance improvement,

measured not only in terms of financial indicators of operational efficiency but also in terms of quality of financial service provided.

5. Information Technology has immense untapped potential in banking. These challenges call for a new, more dynamic, aggressive and challenging work culture to meet the demands of customer relationships, product differentiation, reputation, corporate governance etc. Technology holds the key to the future success of our banks.
6. Apart from current profits, an important indicator performance of banks is provided through the level of NPAs (non-performing assets). Since this reflects on the quality of loan portfolio. So, NPAs level needs to bring down by banks.
7. Other challenges are:

- Need to improve customer services.
- Need to improve credit administration and management: strengthening risk management strategies.
- Need to raise the banking system to a global level.
- Need to formulate a long-term policy keeping in view the growth expectations of the economy.

Still there are much more challenges ahead in developing banking sector in India.

2. Development banks

Meanings:

Development banks are financial agencies that provide medium and long-term financial assistance and act as catalytic agents in promoting balanced development of the country.

Development banks are unique financial institutions that perform the special task of fostering the development of a nation, generally not undertaken by other banks.

- Role

  Here we are dividing its role into two parts that is traditional role and new roles.

  Traditional roles:

1. After independence the trend of development banks came in India.
2. Before it, only commercial banks were there who provide short-term financial requirement. So, there was need to develop one bank for covering medium and long term financial requirement in the country.
3. The first development bank in the country is Indian financial corporation of India was setup in 1948. This institutions was setup by act of parliament with a view to providing medium- and long- term credit to units in the corporate sector and industrial concerns.
4. In a view of immensity of the task and vast size of the country, it was not possible for a single institution to carter to the financial needs of small industries spread in different states. Hence, the necessity for setting up regional development banks to carter to the needs of small and medium enterprise was recognised. Hence, many other institutions came up.

Changing role of development banks:

1. With globalisation and liberalisation, the financing requirements of the corporate sector had undergone a tremendous change.

2. Many foreign players have entered into the strategic alliances with Indian firms. There was an increase in research and development activities as well as the diversification plans of firms.
3. Investment in technology and infrastructure became crucial. With a view of taking advantage of new opportunities, the financial institutions started offering a wide range of new products and services.
4. Development banks and financial institutions are in process of converting themselves into universal banks.
5. ICICI has become a universal bank by a reverse merger with its subsidiary ICICI bank.

3. Non-performing assets in banking sector

- Meaning:
- NPAs are loans given by a bank or financial institutions where in the borrower defaults/ delays interest/ principal payments
- According to the RBI Norms any interest/loan repayment delayed beyond 90 days has to be identified as NPA.
- NPA is that assets which is not paid for a period of two quarters.
- The Narsimhan Committee report notes “no other single indicator reflects the quality of assets and their impact on banks viability than the NPA figure in relation to advances”.
- We can categorize NPA into two types:
  - Standard category: the asset would classify as standard assets if it remain non-perform since 12 months.
  - Sub-standard/ doubtful category: the asset would classify as sub-standard category if it remains non-perform for since 18 months.

Measures to reduce NPAs:

Banks manage NPA by saddled with bad loans have multiple options like direct settlement across the table, legal recourse in the form of approaching the high court or Debt recovery tribunals, enforcement of the new securitisations law (where securities pledged with them could be attached and subsequently sold) and lastly selling it to asset reconstructions companies (ARCs).

4. Universal banking

Other concept of banking:

Universal banking

- A universal bank's offers the entire range of financial service within the bank or through subsidiaries.
- It is a combination of investment banking, commercial banking, and other various activities including insurance.
- Mostly in European countries these system is common.
- Universal banking is set to dominate world financial scene.
- On April 2000 the policy regarding universal banking was issued.
- In "Narasimhan committee-2" and "the khan working group" mentioned the development of financial institutions should convert ultimately into either commercial banks or non-bank finance companies.
- Scope of universal banking in India: a recent trend in the Indian banking system has been the diversification of the activities of the banks by providing a length of financial services within the banks themselves or through the subsidiary route. Hence, it can convert into "financial service supermarket".

Example of universal banking:

Deutsche bank, Citibank and ING bank

Mergers and Acquisitions in the banking sector in India.

- Between 1950 and 1970 the number of functioning non-scheduled banks declined from 474 to 15 and that of scheduled banks from 92 to 72.
- The banks that were weaken get merge with other banks for better footing.
- By M & A no. of deposits in banks has been increased.
- Banks merger have been considered as a possible avenue for the improving the structure and efficiency of the banking industry.

It is possible to categorise the motivations for banks merger into four parts:

1. Cost benefits (economies of scale, organization efficiency, funding cost and risk diversification)
2. Revenue benefits (economies of scope, enhancing monopoly rents)
3. Economics conditions
4. Other motives (include all kind of commercial benefits that bank will receive)

- Earlier section 22 was there in Banking regulation act where RBI helps the weaker bank to pursue business but as number of weaker bank increasing day by day as lastly banks gets merged with the other banks who were stronger.
- So, as on September 1960, a new section 45 was inserted empowering the RBI to formulate with the approval of the government schemes of reconstruction and amalgamation by Banks.

- Example of banks:

  (1) HDFC Bank acquires centurion bank of Punjab (May 2008)

  (2) Bank of Baroda acquires south Gujarat local area bank ltd. (June 2004)

5. Securitization

Meaning

- The term securitization is defined as acquisition of financial assets by any securitization company or reconstruction company from any organization whether by raising of funds by such securitization company or reconstruction company from qualified institutions buyers by issue of security receipts representing undivided interest in such financial assets or otherwise.
- Securitization Company is a company formed and registered under the Companies Act, 1956 for the purpose of securitization/assets reconstruction respectively.
- Securitization is one of the financial innovations of the financial sector reforms.
- The RBI considering the evolving situation in this area and the need of reducing risk for the banks, appointed and in house working group on assets securitization (chairman being Shri. V.S.N. Murty) in June 1999 to examine the applicability of securitization to the higher financial system.

Conversion of financial institutions into banks

- NBFCs (non-banking finance companies)
- Those institution which want to provide the banking services are been converted into banks.

- For acquiring better market share And several others reasons from point of view of financial and economic benefits.
- NBFCs supplement the role of the banking sector in meeting the increasing financial needs of the corporate sector delivering credit to the unorgainzed sector and to small local borrowers.
- NBFCs have more flexible structure than banks.
- Provide a range of services such as hire purchase, equipment lease finance, loans and investment.
- Example:
- HDFC Bank, Standard charted bank and many more…

6. Prime lending rate and PLR

- PLR is the rate of interest at which banks lend to the borrowers with highest creditworthiness.
- Loans up to rupees 2 **lakhs** carried the prescription of "not exceeding PLR and on loans rupees 2 **lakhs, the PLR was the minimum lending rate.**
- A set of measures was announced in the April, 1999 statement to provide more operational flexibility to banks in the applicability of PLR.
- Norms regarding the PLR:
- It was decided that banks would be given the freedom to charge interest rates without reference to PLR, in respect of the following categories:
  a) Loans covered by refinancing schemes of term lending institutions
  b) Lending to intermediary agencies
  c) Discounting of bills

d) Advances/overdraft against domestic/NRE/FCNR (B) deposits.

7. Summary

1. Commercial banks are the most important constituents of banking system. These are the banks which do banking business to earn profit.
2. Basically there are two functions of commercial bank that is accepting deposit and lending money.
3. There are various challenges ahead commercial bank that is to compete the private sector in Indian and developed various functions of management.
4. Development banking are the financial institutions which developed various other sector of the economy.
5. Universal bank are those bank which provide all kind of banking services under one roof.
6. Merger and acquisition of bank are scheduled and non-scheduled bank fail due to some reason and get merge with some commercial banks.
7. According to the RBI Norms any interest/loan repayment delayed beyond 90 days has to be identified as NPA.
8. PLR is the rate of interest at which banks lend to the borrowers with highest creditworthiness.