

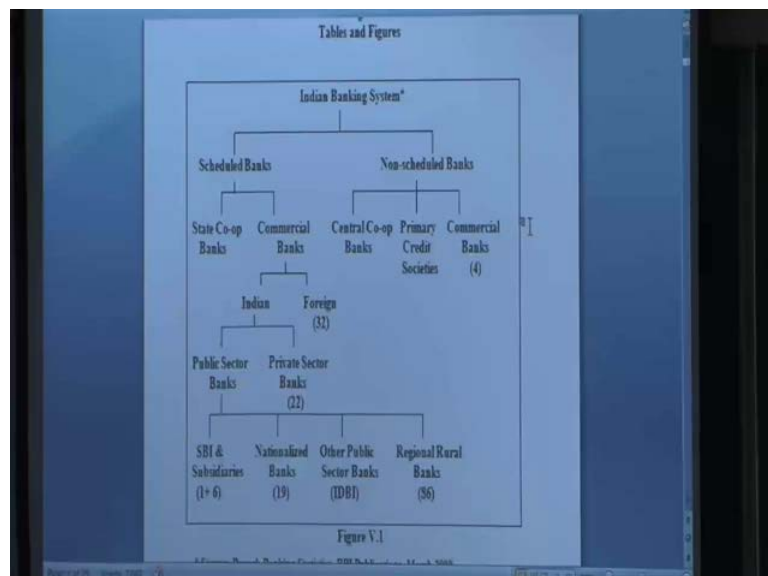
Money and Banking
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Lecture - 35

This is the last topic banking institutions, now look how complex our banking institutions are (()). The Indian banking system this is the data that I collected in the year, this is from couple of old couple years of old branch banking statistics 2009, 3 years old. What you have here is very interesting the first line in scheduled banks, non scheduled banks I will explain that to you, there are some banks in India called scheduled banks some are non scheduled banks; non scheduled banks hardly exists, except for the cooperative banking sector.

Now, under scheduled banks you have a group of banks I will talk about them called state cooperative banks, the first branch state cooperative banks. They exist these cooperative banks exist in India, since the early 20th century 1907 I think, they were first formed. 1907 state cooperative banks you do have no idea about these banks except somebody coming from semi urban areas or rural areas would know.

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Then of course you have the commercial banks. Now, if you follow the commercial bank tree it is very obvious what you have is there are two types of commercial banks in India.

Indian and foreign in 2009, there were 32 foreign commercial banks I have the number in a bracket there.

Then under Indian there are two groups again, public and private [FL] Kotak, Mahindra, ICICI bank; these are all private commercial banks. So, you have public sector banks, which are government nationalized banks and this, private sector banks in 2009 as per this branch banking statistics banking statistics data of RBI there were 22 of them. It is very interesting, Indian private banks were only 22, foreign banks were 32 ten more 10 more private banks, foreign banks are all private banks 32 and Indian private banks were only 22.

Earlier before independence there were lots of private banks, they were all put together and they were nationalized. Private banks did not exist in India for a long time now they are coming up again. Then public sector banks you have very funny four items probably you know some of that, SBI and subsidiaries I have written 6 plus 1 earlier it is to be 7 7 plus 1 or something. But SBI and its subsidiaries like the State bank of Hyderabad, State bank of Travancore [FL], etcetera, etcetera.

There are all State Bank of Mysore subsidiaries of State Bank 6 plus 1. Earlier when I started teaching this course the data was 7 plus 1, but now it has reduced 6 plus 1, so the numbers keep on changing. Then you have the nationalized banks all the nationalized banks which are called the public sector banks other than State bank, Bank of Baroda, Punjab National Bank, United Bank of India, United Commercial Bank, so many of them.

And the number there is 19, so that is interesting it has gone down by one earlier it used to be 20, 28 in total. State bank and other public sector banks together and subsidiaries of State bank there were number was 28 it has gone down, maybe they are merged it is not they liquidated the banks. A wind up of banking no banks were wind up, then other public sector banks there are some public institutions others I I know only of one the IDBI i d b I is a public sector organization it has a bank also IDBI bank it is called. So, I know only of one name you may find out sometimes I am wrong.

So, I know of only one and then you have regional rural banks 56, 86 of them they use to be over 100 when I started teaching this course regional rural banks have gone down in

number. So, what is happening in the banking sector, the numbers are changing gone down means what, they were merged.

Regional rural banks are the ones whom we I think we call them in local language gramin bank. They were created at some point they were not there during the independence or during the planning era they were created. And how they were created I will talk about them they primarily served there are there commercial bank they primarily served the rural population. So, this is something in excess of NABARD and in extra in excess of or beside the state cooperative banks and other cooperative banks, they also served primarily the rural areas, cooperative banks.

So, in rural areas therefore, you have three kinds of banks there are branches of public sector banks, then you have regional rural banks, then you have cooperative banks. And on top of that there is a non bank which is famous NABARD, it is a non bank. NABARD is a financing organization, development organization previous topic I talked about that. So, this is what you have, but if you go to the non scheduled banks there are three types the commercial non scheduled banks were only 4 commercial non scheduled banks were only four.

Non schedule banks, commercial banks if you see the row there commercial banks were only four non scheduled banks, what is schedule, non scheduled banks I will explain that to you. And then you have very active non scheduled banks they are called non schedule banks though the names are not always banks because cooperative societies even if it is a bank from the name it is not a bank.

For instance you have central co operative bank is alright the word bank is there, but you have Primary Credit Societies PCS, primary credit societies a Primary Agricultural Credit Society PACS, these are banks in the cooperative sector, in the cooperative banking department or sector I will talk about them also at the end of this topic. So now, let us start talking about the other features details. The first thing you would like to know which I have been referring to often is watch is what is a scheduled bank and what is a non scheduled bank alright.

The scheduled commercial bank etcetera all refer to the second chapter or second schedule of the Reserve Bank of India act of 1934, Reserve bank of India act act is like a book it has a chapter, chapter chapter, but they are not called chapters they are called

schedule etcetera. So, this is schedule second schedule of the Reserve bank of India act which says that to be eligible to become, to eligible for what to eligible for being a scheduled commercial bank.

There are certain conditions you have to satisfy, you have to have a minimum paid up capital those days it was only rupees 5 lakhs minimum share capital of your bank must be 5 lakhs those days. It must have been reduced paid up capital is nothing but, the share capital of the company or of any organization and I told you commercial banks are corporate entities. Then it must satisfy the RBI, the bank must satisfy the RBI that its affairs that how it runs the bank how it conducts its performance itself and how the performances are that they are detrimental to the interest of the depositors that they are not harmful for the depositors, because depositors are supposed to be the god to them.

Because depositors deposit money and therefore, you run your banking business. Now often what you find in Indian banks is that depositors take a back seat, banks misbehave with you you lose your money sometimes they do not open on time all sorts of problems were there now they have gone away a lot of that, but they used to be there. So, second point is the general qualification is that you need a certificate from RBI, that RBI is happy the way you perform.

So, RBI must have sent staff to check inspectors like people to check how the bank is being run. And then finally, it is important which is in connection with the first point that the paid up capital must be rupees 50 lakhs, which must have changed now, in the Reserve bank of act it was 50 lakhs.

Now, a bank cannot open with 50 lakhs individuals have more than 50 lakhs, depositors bank share capital 50 lakhs is nothing, even 5 crores is nothing. So, maybe 100 crores or 200 crores or something they require as a paid up capital, I do not know. So, there it says that it must not be a single ownership or partnership company. So, I and you cannot open a bank, it has to be a corporation a corporate company, where there is a paid up capital share capital is subscribed to by whoever etcetera.

So, it cannot be ownership firm it is important. So, among these three the technical things are like it cannot be ownership firm since it is a corporate company and therefore, there is a paid up capital that you subscribe to is all right. The most important feature is

that it must satisfy the RBI that its affairs are not detrimental to the interest of the depositors. Then the depositors function properly alright.

I mean that banks are functioning properly, once you have the status of being a scheduled bank, which some cooperative banks have and most commercial banks have then you get many benefits out of it you get concessional remittance facilities from RBI and other SBI, other fellow banks. Then you have borrowing facilities from the RBI, but it also becomes strict, but the CRR obligations have to be met, if you become a scheduled bank; met means what if seven percent is CRR and your net deposits show some rupees that rupee amount has to be deposited.

Now, you compare this with a non scheduled bank CRR is still there, but they do not have to keep the cash with the RBI, neither RBI bothers to help them out much. Quid pro quo exchange relationship you keep your CRR with me I give you the status of scheduled commercial bank, because how you perform etcetera is alright then also I help you out in distress when you need money, but non scheduled banks are usually not helped out, so much helped by RBI.

And they cannot borrow on a day to day basis, any emergency they may borrow I do not know, non scheduled banks from RBI still they borrow, but day to day basis they do not borrow funds from RBI. So, SLR you know SLR you do not have to you have to show you do not have to keep with the RBI, but CRR you have to keep the cash in India. So, SLR is the same thing for scheduled banks and non scheduled commercial banks its more or less the same thing alright. Now, I come to the other part what is a commercial bank somebody can ask, I explained scheduled commercial banks first because I often refer to that.

And hardly there are non scheduled banks in India today, except for the cooperative banking sector commercial banks [FL] you will find two or three non schedule bank. I am not talking about the unorganized sector remember, there are lots of non scheduled banks I am talking about the organized sector not unorganized sector, not the shettys and the you know the others multans and shroffs etcetera. I am not talking about their banks. Gujarat, Tamil Nadu they have age old, century old banks now what is the function of a commercial banks, what do you mean by a commercial bank. Essentially commercial banks interact with the public at large you know. So, it interacts with

everybody household firms other non banks etcetera other banks fellow banks etcetera. And even government they interact.

And the interactions takes various forms it may be accepting deposits, it may be creating credits told you they have a corpus of this much, they create a credit of that much. Because they release the funds to the borrower slowly expect expecting the funds also will come out in in between in the mean time. So, this much money creates credit like a multiplier effect it has called credit multiplier. So, they give out loans various kinds of loans term loans, demand loans, just like deposits term deposits. Demand deposits they give out loans term loans, long term loans 15 years loan, housing loan etcetera [FL] or even durable goods loans is cars you even have an EMI for 10 years alright. Long term loans, demand loans are there companies usually borrow them. Then they offer remittance facilities these are typical commercial bank activities, remittance facilities.

They offer safe deposit vaults to keep your precious items some people prefer to have a safe deposit vault not keep ornaments at home, but keep them in the locker if they do not need it often do that people do that. You know from money market chapter that they do sell CD is to mobilize short term funds certificate of deposits you have learned that. They sell CD is then a very important banking activity in India of today and has been throughout is the call market activities, they participate in the call market by either borrowing money or lending money.

And one of the biggest lender in the call market I told you is the SBI it has huge amount of cash usually it is the largest commercial bank in India. So, they often act as a lender not a borrower other commercial banks borrow alright. Then there is discount bills for instance commercial bills, commercial papers which are not their jurisdiction, but they discount them. You I talked about talked about commercial papers they can have a secondary market commercial bills, bill being created in Kanpur somebody buying goods from madras. So, commercial bank comes into the picture they discount it etcetera alright.

Then an important activity I am coming to those activities and data also commercial bank data I will show you, is that they invest in government securities often it is a captive market because SLR requires all kind of securities, government security is one of them. So, they invest and also they invest in government securities, because banks

cannot invest in the stock market, that is speculative investment you cannot play around like a lucky draw [FL] stock market [FL] you cannot go for speculative investment with public money, because if you lose you lose public money people's money, your money you can play around with it's not your money you have it is people's deposits you have.

So, they invest therefore naturally they like to make some money on idle cash instead lying it lying around. So, they invest often more than what is required in government securities there are you know gilt edge market, zero risk market. So, there is always the no question of default, no question of nonpayment. So, they go for government market and semi government organizations alright [FL]. Then they set up mutual funds schemes they have also what you call in microeconomics they have diversified their activities, just not commercial banking activities.

Then commercial banks have also gone by through subsidiaries, they open a subsidiary account subsidiary company to specialize in activities. What are the specialized activities commercial banks have been doing, not all of them some of them.

Mutual funds number one, primary dealers they have become there are stand alone primary dealers there are bank operated primary dealers also. I told you in the last topic primary dealers have become very important money market, RBI does not do the job RBI has given it to the primary dealers you do it. Earlier RBI used to do that open market operation RBI would conduct selling of government treasury bills, RBI will conduct government needs funds.

Now, primary dealers do it banks have also gone into that alright. Then they do a very interesting thing there is something called National housing bank, which has which is no bank is called National housing bank, here loans come money comes from various sources, RBI, government etcetera housing loans. You know how the housing loans are actually disbursed, National housing bank housing loans through commercial banks. So, commercial banks give you money to construct a house which is national housing bank loan, they execute that alright.

And they are I am coming to that they have had and they are performing a very important function is that, the commercial bank in India particularly the public sector commercial banks, have been instrumental not only in providing funds, but in many ways in setting

up all these Gramin banks. Where do the Gramin banks come into existence, they were the children of primarily the public sector banks in India alright primarily. But, public sector banks alone did not do it they had help from RBI they had also help from government. So, I will talk about the creation of Regional Rural Banks RRB's. So, commercial banks are involved not only in conventional commercial banking activities, but also in many non conventional activities these days or for a while or quite a while.

Another one I have mentioned here let me mention before I go over commercial banks where the one of the commercial banks; I think the Canara commercial bank. Canara bank was one of the earliest commercial banks were the first commercial banks, first institution to set up what is known as the venture capital funds, have you heard of VCF Venture Capital Funds no.

Venture capital funds are when the normal lending institutions are shy to lend money, because suppose you are trying to develop a product which is not known, which is completely new or very new and you are unsure about the market. When you go to the bank and say I need some finances to set up a unit to manufacture this item.

Commercial banks etcetera who are the conventional lending agencies in a country, in any country just not India in any country often say sorry I do not know your market I do not know what the return is going to be. So, I rather not put my money risk my money in it. Then where do they go a country and economy often depends upon these kind new products, because tomorrow they will become famous products who knows today they are absolutely new, but tomorrow they might become famous products alright.

Say for the early generation computers I do not know who invested in computers there must be institutions if you look up US economic history will see they have been very, very few institutions, lending institutions who invested money in it. People were scared, they did not know how much computers would sell whether they are good or not. For instance that xerox machine, xerox had the earliest computer who invested nobody probably alright.

So, now venture capital funds exactly do this, they are organizations who have come to develop in the world, who risk their money because they have a very specialized specialist specialized skilled special skilled people whom they hire. Who can foresee what kind of a market this product can have and whether to put in money there or not,

which normal staff of a bank like the managers etcetera that you see are not equipped trained to deal with alright.

So, they may have a couple of IIT engineers they may have a couple of IIM graduates Harvard graduates or whatever who can judge, what kind of a market it can have what what future this product has and then they go and invest. So, one of the earliest venture. In fact, the first venture capital fund funds or firm that was created was a subsidiary of one of the commercial banks which is the Canara bank. I forgotten the name there is a book in the library you can get it where the names are mentioned.

So, they have gone into venture capital funds they have also banks have also gone into subsidiaries through subsidiaries merchant banking activities. Merchant banking activities I told you they essentially deal with underwriting of shares, so a company selling shares. And then you go into Merchant banking activity, there is a whole lot of legal issues involved in selling of new shares not secondary market shares.

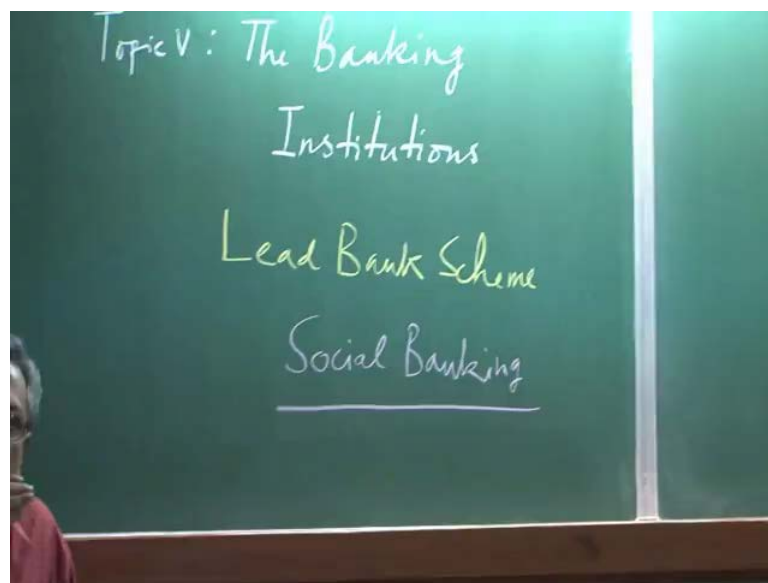
Secondary market shares are not Merchant banking activities or underwriting activities secondary market shares are sold through somebody people called middle men called brokers and dealers. But, primary shares I am talking about they were Merchant banking activities have become important. Banks have gone into that some famous world famous banks are also Merchant bankers you know or investment bankers many world famous banks have also gone into that CITI bank for instance.

Then your specialized Merchant bankers who do many things just not Merchant banking activities like Morgan Stanley etcetera. Then the one of the famous, one of the most successful Merchant bankers I have been told and some of the IIT economics students have joined them they are working there IIT economics students, MSc students first year in particular they joined. Deutsche bank the German bank it is a commercial bank, but it has it is a large business, it has a large business in Merchant banking activities through subsidiaries an IIT Kanpur MSc students have joined, I know some of the people also.

One of them even worked on a 5th year project under me I have with my guidance very little guidance I had to give him because he was very bright, but he did it on his own. So, commercial banks are doing whole lot right they are not, like what our grandfathers saw as commercial banks in India; the world has completely changed.

Now, I come to a couple of very important things, which as a student of Indian economics or Indian banking system you should know. So, I am going to take up one by one one or two things before I go to the cooperative banks etcetera, the banking other other structures, this is something which was floated in late 60 I do not think you were there in late 60 to witness this, but even I was there, but I do not remember, so young. But, later as a student in college I came to know these things exist. This is famous and still running and if you open RBI's site you will get lot of information on that there are reviews and reports still pouring in online.

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This is called the famous RBI's lead bank scheme, this is the famous lead bank scheme RBI's. Now this lead bank scheme was launched in 1969 and essentially what happened in the banking and the non banking sector development both RBI and the central government were together involved. In formulating the project then conceptualizing it then giving it a shape then funding it IDBI was funded both by RBI and central government they all came into existence after independence lead bank scheme is one of the things that they did.

Essentially the objective here is to develop the commercial banking sector in a with an eye on what you what they call, not they are called commercial banks, but they would do something called they would do something called social banking they would become suddenly social animals social banking.

Social banking now let me explain this this whole business of social banking and lead bank scheme they go together what is this social banking. Social banking is like we for instance I work for somebody I earn a money have a decent living now I have I have to do some social work. So, what I do, I do some charity business I meet under privileged children in the weekend and teach them for couple of hours without any pay often without any pay no return I do extra for society.

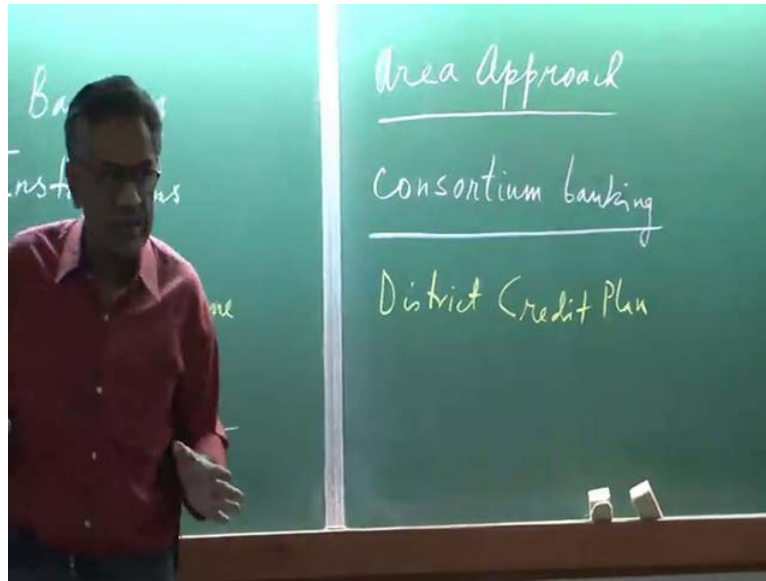
So, in India being an under developed country India is an underdeveloped country, there if you are only profit oriented then you would give money only where you can make profit and you would not look after say the small farmers, marginal farmers, rural artisans the poor somebody is trying unemployed you got together and trying to construct a project or something in the urban areas. And you would not do you would not help alright.

So, now, this headache of how to develop the country concept is alright, but I do not know how successful it has been partly they all become successful with this providing banking services this is what I have written in my notes I will give them to you. Providing banking services to the economically backward areas, socially under privileged sections of the society such as the rural poor the marginal farmers etcetera, the lead bank scheme was conceptualized alright, now what this scheme is, let me explain what this scheme is.

As I told you a number of times RBI's method of operation is like this they form an inter inner group called the working group or something like in at IIT we form committees faculties often form committees, director appoints them, deputy director appoints them whoever this committees is look into this. Suppose a committee was formed to look into the temperature control of the lecture rooms because we found they are very uneven, so committee is formed.

Now, for the lead bank scheme before it was initiated and in a group called the study group or a working group and under famous chairmanship if that person is there the Gadgil group, D R Gadgil was one of the most respectable Indian economist. He was a wonderful writer very bright man I think under him this this is something called a lead bank scheme was initiated which conceptually they called that an area approach conceptually they called it an area approach conceptually they called it an area approach.

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So, what they would do focus on an area [FL] area study like a research student scholar focuses on that area how many people are there, what do the people do there, what is their income, what is their source of livelihood, what kind of crops can they grow, what are the geographical conditions alright. How much of banking help do they have do they know banks, how many of the percentage of the population have an account; often people do not have accounts they have they never had money, so how can they have an account in a bank.

So, they have a very area approach which is the basis of the lead bank scheme where they would take up and do a study. So, what it does is that essentially that the scheduled commercial banks and here it is very interesting the scheduled commercial banks just not lead bank scheme government of India. Or RBI has made it a rule that in case of a lead bank scheme it is like a commitment every commercial bank will have and if you are a deutsche bank or a CITI bank or a Hongkong bank or a Standard Chartered it does not matter you have to do some lead bank scheme here in India, it is like a must like some social work you have to do.

You do your business whatever business normal you do in addition you have to do that alright. And often in that lead bank scheme it is just like commercial banks, who were very important in implementing the scheme or formulating the scheme for local conditions for a local banking. Alright, but they have also involved the players of the

ground level, who are the players of the ground level in a rural area cooperative banks. May be NABARD have gone into that at some stage through lending through a branch of a commercial bank, otherwise cooperative banks and there are other important players. In fact, who are notorious ones whom they want to eliminate, they have not been able to eliminate through these lead bank schemes. They have not been able to eliminate, but they want to and you know who are they, the private money leaders the main players at the ground level.

So, I guess you can understand what I am saying they go and study the local conditions. So, there is an expression when a lead bank scheme operates under the guidance of a particular commercial bank and commercial banks are given districts. Say Kanpur district, Kanpur district lead bank [FL] commercial bank [FL] notes [FL] this is 15 years back. I was preparing some notes first time I was asked to teach in an Indian economics course and I hope it is the same thing. Kanpur area lead bank [FL] district lead bank [FL] Kanpur district lead bank Bank of Baroda. Bank of Baroda branch [FL] lead bank very interesting not state bank.

So, every district has a lead bank in India and over 500 districts are there how many banks are there. So, therefore per bank there are about over 500 and how many banks did you see 30 plus private sector banks, public sector 20 plus, 50 plus not even 100. So, at least 5 or 6 districts are there under each bank on an average if you do an average, but not the same place, not in the same state one in Kan one in UP these are National banks.

So, one in up one maybe Madhya Pradesh, one in Himachal who knows, one in Tamil Nadu. Or whatever there are districts to take care of and this banking where it involves not only plans, but takes into account what kind of takes I forgotten to tell you not only takes in to account what are the commercial banks that already exist in helping. So, that they have a consolidated planning one centralized planning about it to go about developing an area a district for an instance.

They not only take into consideration or involve the participants like other commercial banks or cooperative banks or NABARD, but they also bring the non banks if they are around other non banks. There are various kinds of non banks in India to bring them in they involve them too. So, all institutions all all relevant institutions are considered in a

lead bank scheme and this leadership is given by one commercial bank who is allotted a district to do it.

So, this togetherness of an approaching a problem all getting involved is known as using this words because you may come across in books this is known as consortium banking. Again another word has come consortium banking, consortium essentially means that you know big private sector companies, today have use banks in order to fund the private sector companies say a thermal power project somebody is constructing often often the consortium banking concept is used there.

In that funding process financing process of a mega project is often not one bank is involved 2, 3, 4 banks are involved who lend the money to the company who is constructing or who is in that mega project. Alright say take the case of Tatas Nano project alright there must have been a consortium banking or you take the case of big that are Reliances that hydrocarbon that gas etcetera they are exploring must be consortium banking involved.

So, here this is a consortium banking approach. So, what it does it involves a number of parties together under the leadership of one commercial bank. And to go about and develop a particular district which is surely the objective is of course, the district is unbanked means there is no bank. Often in rural areas there is no bank or under banked that means, there are not sufficient branches and of course, underdeveloped and there are credit gaps this much money is required nobody there to help them.

There are credit gaps you require this much money, but there are not players or lenders who are available. So, the lead bank scheme essentially has multiple objectives they are for task it has to not only have a plan chocked out for the development of a district and how it will be funded with the help of all participating agencies there. In order to develop the banking practices it will go into very small accounts small savings account where little little savings of people should come in so, it has to mobilize the deposits whatever little deposits that exist.

Either to maybe they did not have banking local people did not have any banking habits. So, they have never put their money in the banks ever alright. Suppose this this [FL] is often operating through the banks and people who are coming to the banks to open their

account and activate and get their [FL] funds deposited are commercial banks they are involved there alright.

So, it has to mobilize deposits it has to look after the weaker sections, it has to look after bank as a as a important organization in framing and ensuring development of a particular district etcetera etcetera alright. Now, I have a very old data is that, which said that the lead bank scheme approaches the problem through a bank given the leadership loan in developing a district. So, what they do, they prepare something called a district credit plan, what they do is something called a district credit plan.

So, a district credit plan is something which is to be created for a number of years, but of course they have to be revised as things change. So, what they do the lead bank is they prepare a district credit plan with the help of all other funding organizations around. Now, I in in a book a few years back about about 10 year 9, 8, 9 years back I found that the district credit plan at least for all districts in India have been formulated. The question is whether they are getting implemented or not and you you have nearly 600 districts or something in India today with the formation of states more states more districts have come alright.

So, this is what the lead bank scheme is and you if you want to read up on lead bank scheme its reviews like how is it functioning, who is doing better in the leadership role enormous amount of literature available, enormous amount even online its available. RBI has regularly annual report [FL] RBI, there is a chapter on lead bank scheme in every RBI 's annual report alright.

Let me stop it here, I have to go over to there are some follow up schemes that have developed after the lead bank scheme came in 1969. And the two follow up schemes that I will take up tomorrow one is called action plans, one is called service area approach. The two follow up schemes or lead bank scheme alright that have come to strengthen the lead bank scheme, I need to take that up I know it is descriptive, but you should know as a student of Indian economics here, this is very much Indian the social banking concept or lead bank scheme alright.

Do not think social economic activities are uncommon in other countries USA for instance if you go there are something called welfare payments, unemployment insurance we do not have that much here. But we have social activities through these

kind of thing alright social banking like lead bank scheme etcetera. So, we need to take that up. So, I will do that tomorrow and I will also talk about the regional rural banks, after that I have some very important thing to talk about it is a details of the commercial banks first that I need to do. And, then with cooperative banks I will close this topic, so is this alright, I close it now.