

Money and Banking
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Lecture - 36

Yesterday, I started this topic banking institutions, and I told you the various kind of banks that exists not the non banks, banks. And I told you about the functions of a bank, and modern day also activities of banks. Then I gave a brief description of scheduled non scheduled banks that definition exists. Then I went into very specific functions, which are general across commercial banks in India, this is with respect to India of course, again special type of activities extra activities; one of them was the lead bank scheme, I told you about that it is still running, it was initiated in the year 1969, the famous year 1969 year when banks were nationalized in India. Mrs. Gandhi came to power after the India - Pakistan war, our prime minister expired. So, within about 3 years or so this came, 69 was the beginning of the fourth plan also.

So, there were massive nationalization programs going on in India. One of them was this bank commercial bank nationalized. The lead bank scheme basic idea is there will be a leader bank who will give the leader ship to the local requirements of an area. Specifically with respect to a district, what the requirements are. So, they have to prepare a district credit plan, and all institutions concerned institutions non banks, banks whoever they are in that district functioning already, will be have will have a coordinated effort, which is called consortium banking, in terms of helping out the local needs. Essentially, there are credit gaps you need money nobody is giving it to you, called credit gaps are there gap between supply and demand. So, the idea is to fill up the supply and demand gap, which is excess demand situation.

The reason is of course, banks are profit making organizations, and they just do not want to give money to anybody. They would like to check out that if they give money to somebody there is some return a profit, but this is social banking; in social banking you cannot make profit. So, somebody got to help you out. So, often what has been the case NABARD would gave money to the banks to help out the needy ones. So, the banks do not have to take money from their pocket, sometimes it has happened.

So, I talked about that then there were two more programs of RBI that were initiated around that time or later with respect to banks. These are not directly always connected with the lead bank scheme, but they have relevance for the lead bank scheme. The first one, which was initiated in 1985, 1985 is which year 1985 is coming to the end of sixth plan Rajiv Gandhi is already there. So, 1985 around that time the plans were initiated, these are called banking related actions these are called action plans.

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So, action plans were initiated action plans what are action plans? This were initiated 1985 the basic idea here is not social banking like lead bank scheme. The basic idea here is to improve the performance of banks. Banks have been very poorly performing in India. One of the reason they were nationalized was that the banks, which started out as private banks they were performing miserably. So, government had to nationalize them to save them because they are not only they are employing whole lot of people, they are dealing with public money.

So, if they go broke tomorrow completely your money and my money, which we deposited in bank will be gone and imagine the suffering of the people. So, they were all nationalized, but later they were this efficiency of banks did not really improve even after nationalization. Some of the banks probably performance became weaker, which is

the case with our public sector undertakings because they were not profit oriented, not performance oriented, not efficiency oriented.

Now, action plans were introduced to improve essentially the idea, idea is to improve the performance of banks. And the quality of banking services not only the performance in terms of how much profit they will make, but also in terms of quality of services. So, these are action plans, focused on individual issues in an institution, which is true of any entity a company may be producing something else. Look at things they focused on the organizational structure that means, what? Whether there will be a bank manager in each branch where there will be a supporting manager also, sometimes called personal bank manager. Some of the banks we have today.

Who would be above the bank managers in a district or in a state, all right? Within a bank will there will be I remember when I used to go to bank very early there is to be something called somebody use to called head cashier. Not who are manning the cash tellers there is a head cashier alright, like head master in a school. So, organizational structures they will look at because it is are very important how the things are managed.

Customer service you understand how you attend customers? How you look after them. If you are not looking after them properly they will go away to other banks, who look after them properly better, so what you need to do. Deposit mobilization is a very important thing banks run their business on the basis of your and my money. So, if you are and my money are not going to the banks how can banks make money? How can banks lend, so it is a very important issue. Credit management my goodness, whom to give money credit management? How to recover the money? What will be the interest rate? Some times in India those days interest rates were highly regulated.

So, you have no say on that if you are giving money to somebody for a small scale industry. This is the interest rate you fixed, for medium scale industry, this is the interest rate for housing loans, for educational loans. I remember for educational loans early 1980s I paid an interest rate of about 18 percent, or something like that huge amount of interest rate massive. Then the productivity aspect how much work you get done, and which are also connected with efficiency etcetera, which you know very well.

You walk into any office whether it is functioning efficiently or not you do know that immediately. Of course, all of the them together will determine your profitability final

result end product. If you are productive you are looking after customers deposits are mobilized, the organizational structure is they all finally, result in one thing that is profitability definitely. So, how would you manage this. So, the RBI has been continuously trying to improve these functional aspects of commercial banks. Either through short term courses, training programs, surprise visits, checks, all sorts of things they do.

And of course, within an institution you have to have internal supervision like you are studying here it cannot be MHRD sending people, now and then to find out whether classes are being held. Whether exams are to being held, whether students are admitted properly or not, whether the living conditions are good or not MHRD cannot be ministry cannot be sending people to do all this it has to be organized internally. So, internally we need to function better, so how you make a institution, which is not functioning well internally will, now function well internally amazing amount of work.

And this is usually the story of the downfall the reason for the downfall of public sector units they internally got mismanaged. So, nobody externally threatened them internally, they damage themselves. So, internal supervision training, cost control, modernization, technological up gradation like computers, now have definitely improved efficiency. But it requires a cost you know to bring in computers enormous amount of costs are required, but once the computers are there the system definitely functions better. An annual review of credit limits, various things health coding of accounts very interesting.

Health coding of accounts very interesting, health coding of accounts. So, the accounts of two types of accounts are there; one are the borrowers accounts. Where the health coding is primarily done, if they are borrowing money how frequently are they borrowing money against a loan. The loan is not immediately given the whole amount to you in case of consumer loan that happens, but other loan proper loans money is not given to you right away. They open an account in your name and then they slowly release the funds into that account.

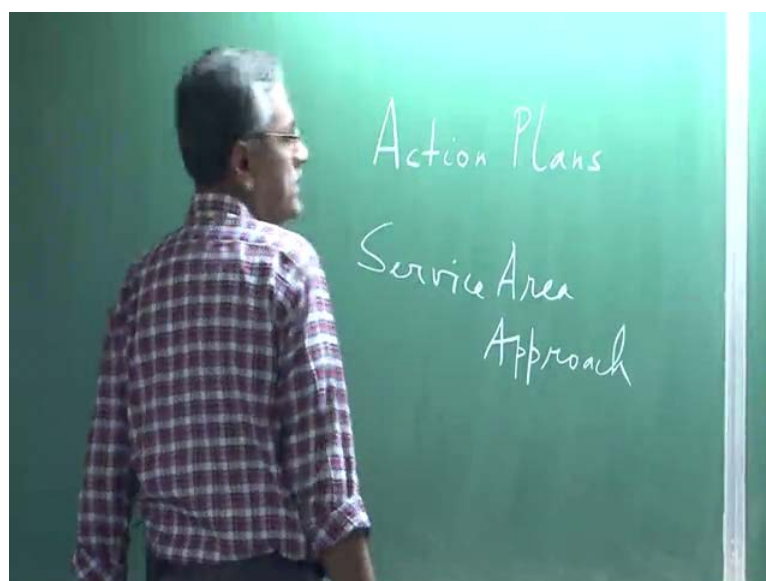
And here also I am going to talk about that soon and here also allowed certain amount of borrowing every month or every week or whatever, and here also supposed to return money. So, the accounts health coding means, how much the monies have been returned etcetera. And from the point of view of depositors accounts there are also annual reviews

are required because you know sometimes, these accounts sometimes go dry, the minimum balances are not properly maintained.

Then account holders disappear very interesting accounts are lying in a bank who deposited some money, but never to be seen again. Enormous amount of cleaning up duty is there in a bank all the time. Then to find out whether an institution, which is very important is performing well, but you are ignoring it, but are you reaching a red line where you might be declared a sick unit. You know sick industrial units can be declared sick units that means, it is terribly bad shape. Essentially from the point of view of financial performance. So, an industry can be declared a bank can also be declared as a sick unit.

So, are you really approaching a point where, your performance has been poor for such a long time that, now you will be declared a sick unit my goodness [FL] a company [FL]. If you are declare a sick unit, but if bank declares if a bank is declared a sick unit its terrible news bank is holding all your money. Of course, we have safeguards CRR, RBI etcetera. But there is a strain on them to bail you out like when a child falls sick in a family it is an extra work that parents have to do, it is not a normal situation. So, a sick unit and in India it's very common. So, these are various things that came under the purview of action plans. Last thing about this kind of a thing special banking programs that I would mention, which is connected with that with the lead bank scheme this is called the service area approach.

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Service area approach, service area approach this is very much connected with the lead bank scheme. The service area approach came 4 years later in 1989 and what they did was essentially this. What happened? If you look at the history, banks were nationalized in 69 lead bank schemes with extra duties on banks at the same time. And one of the things in lead bank of course, you understand is to expand because if there is credit gap you have to open a branch, which would cover about 4 to 10 villages.

Then you have to do the local study ground work at the ground level, what is the credit gap? What is the nature of the gap? Who wants credit? Who are the types of preoccupation you have professions there etcetera. So, over time with government of India help and RBI of course, banks suddenly started expanding quite a bit in India. Suddenly branches started coming out like on a dry land you start watering them and plants shoots come out, and they grow into trees and the various branches are there. So, banks started expanding quite a bit then they realized banks are not performing well with government support they are performing well.

Then came the action plans when the action plans came essentially, they were looking into how to improve the banks performance. Now, they have reached a stage where they have, now expanded or grown. So, they in the service area approach the precursor to the service area approach was now, that the banks have increased in term of branches etcetera and volume of credit.

Let us do a survey on selected areas, we do like a random sampling or something of selected areas districts to find out, how much this bank expansion lead bank scheme etcetera, have impacted rural development because one of the objectives there have not been the urban economy lead bank scheme. The primary objective of lead bank scheme was to supplement. The already existing institutions like, co-operative banks etcetera and other banks in terms of required credit gaps in rural areas primarily. Some urban area districts do not include only rural areas. So, when you are leader of a district urban areas also come into the picture, but the focus has been in the lead bank scheme, on the rural area.

So, now they are saying let us see, which is 69, 1985 [FL]. So, its nearly completing 20 years and they are trying to do a survey of the that how is the new kind of credit system lead bank scheme etcetera, and branch expansion has impacted rural development. And

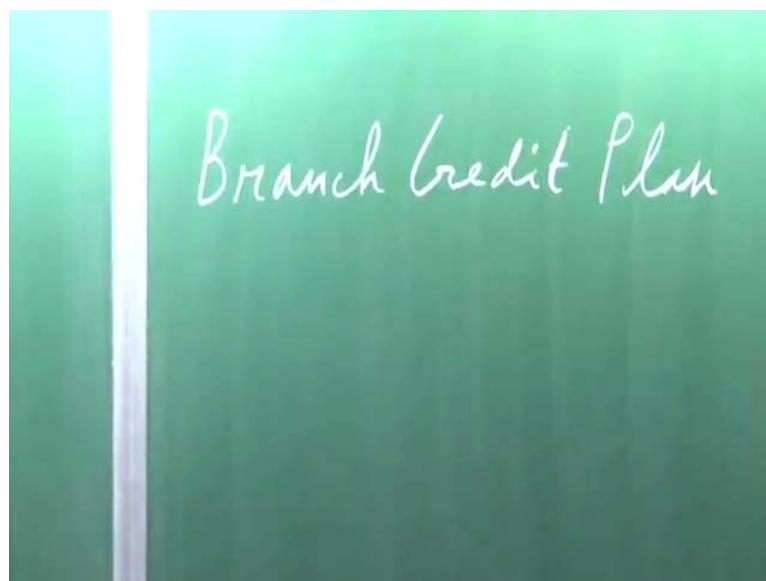
following the findings the RBI announced a new strategy of rural lending under the lead bank scheme on first April 1989. So, you can imagine exactly 20 years later RBI announced a new strategy to lend under the lead bank scheme.

So, there is the leader and all that structure exists, what is the strategy? What is the objective? The objective of this, so called service area approach, which is this strategy. Is improve the quality of rural credit and semi urban area, and credit in semi urban areas through commercial banks and regional rural banks. So, that rural income increases just not the credit gap, you have to give money in a way they are utilized productively. And you have to find out the areas where you should like, there are all kind of soils, but you do not water soil were no plants can be grown. You look for soil where plants can be grown the top soil has some quality left, so you try to nurture them. So, now the objective is becoming just not a desperate need for rural credit. Now, the objective after 20 years of the lead bank scheme is how can we do a credit lending to rural and semi urban areas. So, that the income generation improves.

So, these branches of these banks, what they did was every bank has a branch. I am the leader bank, so I take stock of how many banks are there in my area in my district Kanpur, and non banks are also there NABARD etcetera. Now, I ask these my partners or members in my group to take up a specific area called a service area that you are going to service [FL]. So, I am asking I am bank of Baroda. I am the lead bank of Kanpur district I ask state bank, I take stock of state bank branches how many are there.

Then I ask state bank this district is, now going to be divided into various areas in terms of Talukas, Panchayats or whatever. And you is my partner in this you take up a service area, or I give you a service area consisting of about roughly 15 to 20 villages, roughly 15 to 20 villages that is going to be your service area. You service that area, you go out there do the ground work, ground level survey and all this surveys you prepare some plans for your branch. Say state bank a branch of state bank is going to service 15 to 20 villages. You prepare something called a branch credit plan for your branch consisting or covering 15 to 20 villages.

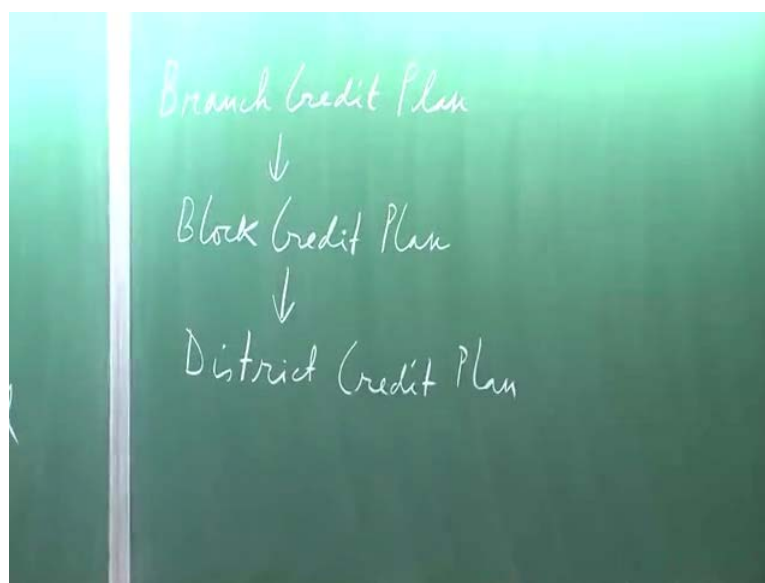
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So, prepare something called a branch credit plan. You prepare a branch credit plan. This branch credit plan, which you prepare a document you then forward it to your lead bank. So, if you come to my office I am the bank of Baroda. You guys prepare the branch credit, you are State bank branch, you are a Canara bank branch, you are some other branch, covering some villages.

So, I distribute this work the total district work. This branch credit plan will then be aggregated into block credit plan. So, a block under a district consist of various villages. So, the branch credit plan branch credit plan of your branch credit plan of his bank branch together then I will create the block credit plan. Very decentralized planning this is called decentralized planning. You start at the ground level not our 5 year plan, which you start at the top and propose a project.

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So, branch credit plan will give rise to block credit plan [FL]. Now, the blocks, blocks, blocks, blocks, which are there under a district. And district, district, district make up a state and state, state, state make up the country you know how it is going. So, block, block, block, and block will, now create the DCP. DCP is district credit plan. They have, now prepared the district credit plan for mostly all districts of the country, they are ready and getting implemented, but it taking years do the district credit plan.

And they require revisions from time to time enormous amount of work I mean, honestly if you have to develop country's enormous amount of work. If you go to a western world, one thing you will see they live well of course, they have this sky scrapers, lovely highways, excellent eating places and, so much of money, but basically one thing they do seven days a week they keep on working. Enormous amount of work and household work here you can have a servant quarter [FL] servant quarter [FL] butler [FL] housekeeping [FL] or you have to live in a hotel, where they would do the housekeeping, and will cook in the restaurant you go and eat there at home you also do that.

So, essentially what they do if you go to a western country, which lives well one thing you make sure you are ready for it. You keep on working seven days a week and with computer, now you can work from home, which is easier, but you keep on working basically. So, district credit plan, you do not develop a country you cannot develop a country, and say what a wonderful country and there is other side of it, what an amount of work [FL]. No, I am not joking look at the amount of work required. You prepare a

district credit plan over a year they will start implementing them within 5 years you have to revise it then its change again [FL]. So, this is how they approach the service area, it is very important this kind of decentralized planning it is called at the ground level you do.

So, they are DCP is and there is a place of monitoring system continuously to monitor the implementation of service area approach. Of course, you have to monitor how it is going on top of that. On top of that this this leaders some of them can be very weak. So, somebody is again required to monitor the leaders. So, RBIs work never ends it has not really decentralized all that work it has, but is not free because RBI will after all it saves plan, this strategy.

So, RBI have to go back again and again and find out whether the leaders are performing well or not, and the units under the leaders are performing well or not. Good company versus bad company, good company [FL]. Now, you have to do whole lot of work for them, so this is there. Now, having said that, now let me come to these three schemes, I mentioned lead bank scheme very important, action plans 1989. This is 1989 service area approach. Now, let me talk about the regional rural banks how they came into existence regional rural banks.

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The RRBs are our commercial banks that means, they have all these functions of a commercial banks accept deposits, arrange for remittances, give loans etcetera, etcetera saving accounts, fixed deposit account and all that, but they do not have these specialized

activities like RRBs do not get into investment banking, or you know this what you call underwriting business (()) or mutual funds, which commercial banks other the big commercial banks do. Gramin banks do not do that they do not have the expertise also, they do not have the expertise. And they do not do that Gramin banks and, but they do other normal banking activities.

So, idea is a commercial bank can open a branch and expand we have done that, but now let us create, which they have done a set of commercial banks, which will come up without branches without branches in these rural areas and start functioning. Regional rural banks this is most probably without branches, these regional rural bank, but they have a name also the general name is Gramin bank. Now, how they came these fellows came in the 70s about 6 years later, 6 years after nationalization. Regional rural bank probably one of the reason why they where conceptualized is to carry out the lead bank scheme. They implement the lead bank scheme.

So, I am the leader. I have some other my fellow bank. Say, I am bank of Baroda there is a state bank in my district, there is a Punjab national bank there is something else, but I cannot force them to open the branches. So, they will do some work, but there is still some work left. So, regional rural bank were created to fill up the void. So, now you guys are created you do this work I ask you, implement the lead bank scheme. They came into existence in 1975 as is interesting how there were created they were sponsored banks.

Commercial banks to develop the rural economy the paid up capital was only 25 lakhs. Can you believe in 1975 prices were so low 25 lakhs paid up capital [FL]. 25 lakhs I paid up capital, and how it was contributed. This a ratio very interesting 50 percent will be contributed by central government, 15 percent by the state government [FL]. And the remaining 35 percent will be come from the sponsoring commercial bank. So, who is the sponsoring commercial bank usually that was the lead bank, who is sponsoring the regional rural bank in his district usually, but sometimes some other commercial bank can be sponsoring too. The sponsoring means, giving money of course, buying the paid up capital buying the shares.

So, the company can be set up called a bank a regional rural bank is set up through the central government giving 50 percent of the paid up capital. State government giving 15

percent and the remaining coming from the sponsoring bank, but the responsibility of the lead bank or the sponsoring bank does not end there. Sponsoring bank may be the lead bank may not be the lead bank alright, usually the lead bank. Now, who would be coming what kind of a job they will have I will tell you.

The sponsoring bank becomes the best friend, friend philosopher guide the advisor of the regional rural bank [FL]. It trains also their staff, who would work in the bank. RBI used to have training program under action plan for commercial banks to perform well. Now, when a lead bank is sponsoring or somebody sponsoring for regional rural bank RBI is not directly coming into the picture. This sponsoring bank will take the responsibility to have the personnel properly trained money to [FL].

Sometimes the regional rural banks will also get a financial help from the NABARD because it is for the rural area. NABARD is essentially agriculture credit and rural development. So, sometimes extra funds have also come from NABARD. And regional rural banks these are commercial bank, so remember they have to maintain CRR no choice and SLR, CRR cash has to be kept. And the way they were set up they were scheduled banks from the right from the beginning because government is setting them up in some sense. They provide credit to essentially rural credit to small and margin farmer, which is the big problem in India. Small farmer [FL] loan [FL] loan [FL] household consumption [FL] may be 50 percent remains then he invests in his field.

So, the money can never return is never returned often, and then there is a natural calamity a flood or a drought or something [FL]. So, this is a perennial problem of Indian rural economy perennial problem. That is why bank where not interested that is why government had to do, so much. So, farmers artisans [FL] potter [FL] other handicrafts products. And usually, these regional rural banks remember one thing. This people do not understand often the regional rural banks jurisdictions do not get confined to a district, which is a lead banks jurisdiction is within a district.

When regional rural bank are created they often start operating across districts just like a bank, a bank is not confined to a state or a couple of districts. I can have a branch in Karnataka. I may be UP bank, I can have branch in Karnataka, I can have a branch in West Bengal, I can have a branch in Rajasthan, in Madhya Pradesh where ever I want. The regional ruler bank since, they are commercial banks lead bank is a very specific

object, very specific scheme. They may be connected with regional rural banks development initially, were connected with the lead banks objectives, but their operations were not confined to a district, they can go to now district.

So, I guess they can have branches also, which I do not understand may be they have branches also go to Unnao they can have depositors. Suppose a regional rural bank is located at the border of Kanpur and Unnao. So, they can have depositors and borrowers from both the districts, they are not confined to like a lead bank to only Kanpur district, my responsibility ends there. The Unnao lead bank will look after Unnao it is not that case here.

Since, regional rural banks are really at the ground layer at the village level and you have this traditional. I have not spoken about them traditional cooperative banks, which have been funding rural lending because there were no commercial bank to help them. So, people develop this co-operative banks on their own with whatever little subscription they could have towards the share capital, but later RBI came up with schemes etcetera to support them, but co-operative banks are [FL]. Now, these regional rural banks are supposed to provide support to the co-operative banks because there at a ground level, and co-operative banks are also doing the same helping out the rural economy the rural borrowers.

So, the lending rates etcetera were always at par with the cooperative banks lending rates etcetera, not maybe the bank of Baroda, what it charges to the industrialists or the agriculturists or whatever or in urban areas [FL]. Local co-operative banks [FL] interest rate, where are important for regional rural bank also because they are like, now they belong to same fraternity, they belong to the same group trying to help out. They are not trying to really compete or out compete each other, they are trying to help each other out in some ways. So, the objective went like this.

Now, in 2006 there were 133 regional rural bank, now it is some 89 or something regional rural banks I saw you saw the data. Now, what I have done is I have given you the broad contours of commercial bank sector, but now I am going to take you inside a commercial bank like inside RBI. I took you I talked about the money market, but then I took you inside RBI and told you about the connections with the money market and the rest of the monetary system. So, now my next task is to take you inside a commercial

bank for that I will open their balance sheet because the balance sheet lists all that they do, not the profit and loss account. The balance sheet has the assets side and the liabilities side.

So, I will take you into a conceptual framework of commercial banks assets and liabilities. Some of that you already know, but this will be my next task to take you inside then I will show you aggregate data. Scheduled commercial banks aggregate data, assets liabilities various head. This is how I have been trying to teach you this course right from the beginning you saw that.

So, next few minutes what you can do is just pay attention to slide. I would not lecture I will take it up may be Thursday I will call it off. So, I will teach on Friday. Thursday I have morning class afternoon presentation and all that if you do not mind Thursday I will take off. I will declare a leave and Friday I will teach. So, what I will teach is something, which is you are now going to have a look. Next 5 minutes is no big deal I am not going to strain your mind or asking you to go in hurry.

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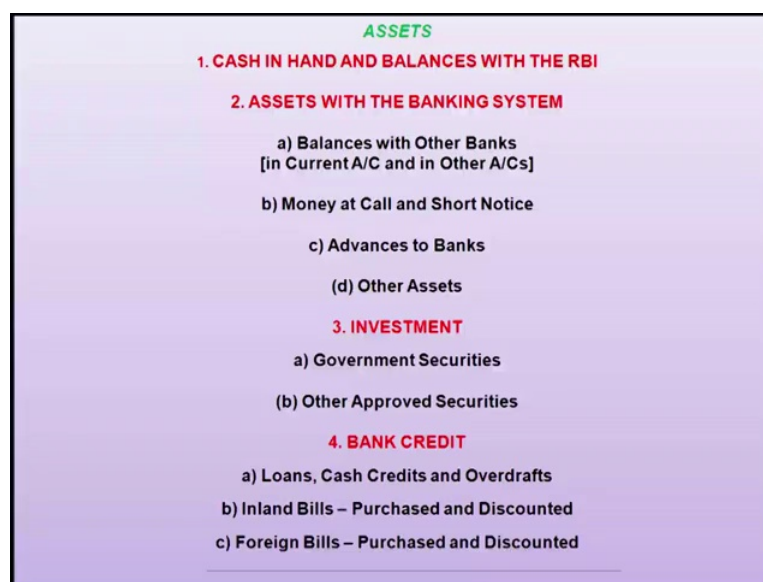
Table V.1 Balance Sheet Scheduled Commercial Banks	
LIABILITIES	
1. LIABILITIES TO THE BANKING SYSTEM	
(a) Demand and Time Liabilities from Banks	
(b) Borrowings from Banks	
(c) Other Demand and Time Liabilities from Banks	
2. LIABILITIES TO OTHERS	
(a) Aggregate Deposits [Demand Deposits and Time Deposits]	
(b) Borrowings from Others	
(c) Other Demand and Time Liabilities	
3. BORROWINGS FROM THE RBI	
a) Against Usance Bills/ Promissory Notes	
b) Others	

Look at the liabilities of scheduled commercial banks in India. This is what I am going to make you go through and many of the stuff you know, but I am, now formally organizing them. I am coming to the end of the course called money and banking. So, you end the course with some banking knowledge, some knowledge about banks. They have three kinds of liabilities there is liabilities to the banking system a bank can have a

liability to the banking system. Then the bank has liabilities to others to non bank whoever they are. Then you have the borrowings from RBI the third group.

Every group has sub headings and you can read the sub headings, these are the liabilities of a bank of our commercial banks, scheduled commercial banks. So, I need to go through this some of this you know, but still I need to explain them. This is the first thing I will do on Friday then I will go to assets how do commercial banks accumulate assets. So, I am coming to end of the course I want to give you some more banks, now it is the title of course, is money and banking. So, I have done of lot of money discussion monetary economics.

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[FL] assets [FL] These are the typical assets structure of commercial banks. Cash in hand and balances with the RBI, four items are there assets with the banking system, investment and then finally, bank credit. Now, I am formal very formal, now I am looking at the balance sheet of commercial banks in India, and I am using their language. And In fact I will Supply data also on this heads. Directly from RBI site, I got the data. So, four kinds of assets cash in hand and balance with RBI, assets with the banking system, various items are there I need to explain them. Some of them is self evident. Investment two types government securities and other approved securities. Bank credit three items loans cash credits overdrafts, one inland bills purchased and discounted, which you have seen commercial bills.

And foreign bills, purchased and discounted, which you have already seen. Many of the stuff you have already seen, but I am, now putting together course is, now getting complete. And the last thing I will do is co-operative banks. I will have a day or two on co-operative banks fascinating stuff co-operative banks. Started in 1907 [FL], but they became very big organizations they are formally part of a system.

Now, RBI has declared some of them scheduled banks also co-operative banks scheduled bank status doing very well, but there is a lot of interaction with RBI extra I need to explain that to you. So, this is what I plan to do on Friday. This and co-operative banks and looks like by next week end Friday, course lecturing maybe coming to an end. I need to show you some data that's it, but I am showing this to you beforehand what is coming. So, probably Thursday [FL] Friday [FL].